Right to the end.
Surveying financial statements in annual reports
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1. Executive summary

"Who's like us?" is a popular question in many walks of life. It is a particularly appropriate question in financial reporting as decisions on policies and presentations cannot be taken in a vacuum. They are influenced by rules, recommendations, regulators and the reality of what is happening in practice.

Over the years, Deloitte has published its survey of narrative reporting, namely what is covered in the front half of the annual report. Its 2008 survey “Write from the start” was published in October 2008. In 2007 Deloitte made public for the first time, merely as a powerpoint presentation, the results of its survey of the back half, namely the audited financial statements of UK listed companies. The report generated considerable interest and, as a consequence, in 2008 the analysis is published in this report.

“Right to the end” picks up where “Write from the start” finishes. The financial statements of the same group of companies, split into two categories, being investment trusts and other companies, have been analysed.

The main fashions or findings in this 2008 survey are that for companies other than investment trusts:

- 5% of listed companies surveyed had a modified audit opinion. There were six emphases of matter paragraphs within these five audit opinions, five related to going concern and one on uncertainty around certain liabilities. Only one company had a qualified opinion arising from a disagreement about a particular accounting treatment;

- 14% of companies did not identify any key sources of estimation uncertainty or areas of critical judgements in their financial statements. For the others, the most common issues were around goodwill, pensions, tax and provisions. However, the disclosures tended to be generic in nature and thus not terribly informative; and

- 88% of companies had share option schemes while 61% had continuing exposure to defined benefit retirement obligations.

UK GAAP continues to be a feature of listed companies’ financial reporting. 49% of companies, other than investment trusts, continue to use UK GAAP for their parent company only financial statements. This ranged from 39% of the smallest 350 companies to 59% of the top 350 companies by market capitalisation. For investment trusts, 27% were group companies and therefore required to use IFRS in their consolidated financial statements. For the remaining 73% which were single companies, this split between 60% continuing to use UK GAAP and 13% choosing to use IFRS.

This report cannot answer all questions on current reporting practices. But it is hoped that it has achieved its aim of identifying the main fashions in the last reporting season and thus will inform those making choices on policies and presentation for the next round of annual reports.
2. Survey objectives

The main objectives of the survey were to discover:

- the level of variety in presentation of the primary statements in listed companies’ financial statements;
- which critical judgements and key estimations directors consider to be the most significant when preparing their financial statements;
- how compliance with disclosure requirements and the accounting policy choices made under IFRSs varied; and
- how many companies chose to adopt IFRSs for the parent only financial statements, and how audit opinions varied.

The annual reports of 130 UK listed companies were surveyed to determine current practice. This sample of companies is the same as that used for Deloitte’s recent publication “Write from the start” which surveyed narrative reporting. The companies were split into two groups being 30 investment trusts and 100 other companies. Investment trusts are those companies classified by the Stock Exchange as being in the industries of non-equity or equity investment instruments (this excludes real estate investment trusts). They have been treated as a separate population due to their specialised nature and the particular needs of their investors. The sample was selected evenly and at random from three categories being those within the top 350 companies by market capitalisation at 29 April 2008, those in the smallest 350 by market capitalisation, and those that fall in between those categories (the ‘middle’ group).

The annual reports used were those most recently available and published in the period from 1 August 2007 to 31 July 2008.

Deloitte conducted a similar survey in 2007. Where possible and as appropriate, the results from the 2007 survey have been included so that the analysis is comparable year on year.

As noted above, the findings for investment trusts are analysed separately within this publication. Sections 3 to 15 that follow summarise the results for the 100 companies excluding investment trusts and section 16 reviews the 30 investment trusts.

This publication is structured in a similar way to that of most financial statements, starting with analysis of the primary statements, followed by the accounting policies and then the notes.
3. Overview of the financial statements*

- Annual reports are 34% longer in 2008 than in 2005.
- Financial statements range from 13 to 175 pages in length.
- One company has a qualified audit opinion, and a total of five companies have an emphasis of matter paragraph.

With the complexity of financial reporting ever on the increase, it is no surprise that the average length of annual reports continues to rise year on year. As discussed in “Write from the start”, it has become increasingly challenging for companies to meet the regulatory requirements for more disclosure, while still providing shareholders with clear, concise and relevant information about their business.

Figure 1 below sets out the results in total and by category of company for the four most recent survey periods.

Annual reports ranged from 31 to 473 pages with the financial statements covering from 13 to 175 pages. As a percentage of the annual report as a whole, the financial statements fluctuated from 25% to 75%. The largest companies tended to dedicate more pages to narrative reporting, with an average of only 43% of the report being financial statements, compared to the average of 46% across the sample. This was driven not only by the extensive narrative reporting requirements, but also by the opportunity to include financial disclosure requirements within the front half of the report (such as discussion of the critical accounting policies and judgements adopted by management). In comparison, the smallest companies surveyed had an average of 53% of the annual report taken up by the financial statements.

*This section analyses the findings for all companies other than investment trusts.
Surveying financial statements in annual reports

Speed of reporting

As noted in “Write from the start”, the trend in speed of reporting has improved on previous years. 61% of companies approved their financial statements within 75 days of their year-end compared to 57% in the 2007 survey. This is likely to be a response to a new deadline introduced by the Disclosure and Transparency Rules (DTR) requiring listed companies to publish their annual report within four months of the year-end.

In 2008, 14% of companies reported between 76 to 90 days and 25% approved their accounts after 90 days. Four companies in the survey reported after 120 days. Another four approved their financial statements between 115 and 120 days after their year-end. These eight companies in particular need to consider their ability to comply with the new four month deadline introduced by the DTR.

The top 350 companies were the quickest to report their results, with 91% (2007: 82%) reporting within 75 days. The smallest 350 companies were the slowest with 58% (2007: 47%) reporting after 90 days. Both the middle group and smallest 350 companies were slower in reporting in 2008 than 2007, with 18% (2007: 17%) of the middle group approving their financial statements after 90 days.

Reporting frameworks and auditors’ reports

Of the sample of companies chosen, one newly listed company was adopting IFRS for the first time, whilst the remaining 99 had already transitioned to IFRS in previous periods.

All but one company had an audit opinion under accounting policies which are in accordance with IFRSs as adopted by the European Union (EU). The exception was a Guernsey company which reported under IFRSs as issued by the International Accounting Standards Board (IASB).

19 companies had further audit opinions under IFRSs as issued by the IASB in addition to those adopted by the EU. This is an increase on 2007 where only 13 companies within the sample had such audit opinions. This indicates that the benefits derived from the inclusion of such audit opinions (likely to be ease of reporting to fellow companies in the USA) are being more widely realised. One FTSE100 company also had a third audit opinion provided under US GAAP.
95% of audit opinions given were not modified. Of the remaining five, four had an emphasis of matter paragraph in relation to going concern; one of these companies had an additional emphasis of matter paragraph in relation to uncertainty around loss adjustment liabilities. The fifth company had both a qualified opinion arising from a disagreement about accounting treatment and also an emphasis of matter paragraph in relation to going concern uncertainties due to reliance on continued support from related parties. Discussion of the issues around going concern in the narrative reporting of these five companies was minimal. Three companies provided generic statements on going concern rather than addressing the specific issues, whereas the remaining two companies provided some indication of the particular issues. Only two companies cross-referred from the narrative reporting to the financial statements, of which one is shown in the example below.

49% of companies reported results from their parent company under IFRSs. A further 49% reported under UK GAAP. The two remaining companies were exempt from producing consolidated accounts (either through being a single listed entity with no subsidiaries, or by having only dormant subsidiaries) and thus no separate parent financial statements were applicable. This indicates that opinions are split as to the benefits gained from moving to IFRSs for parent companies. Such benefits include an ease in reporting different entities under the same frameworks and thus consistent accounting policies, as well as providing more comparability between group and parent reporting. The benefits of remaining under UK GAAP for parent companies include the exemption available from having to publish cash flow statements, the avoidance of dividend blocks caused by pre-acquisition reserves under IFRS and not having to invest in new reporting tools.

The majority of entities provided one auditors’ report which covered all opinions given, whether applicable to the consolidated accounts or the parent company accounts. 39% of companies provided 2 auditors’ reports, being a separate one for consolidated and company accounts. British Telecommunications plc provided three separate auditors’ reports, being one for consolidated accounts covering both IFRS opinions (EU endorsed IFRSs and as issued by the IASB), one for consolidated accounts under US GAAP and one for the parent accounts.

Figure 6. What opinion was given in the audit report(s)?

- Unqualified: 95%
- Emphasis of matter: 4%
- Emphasis of matter & qualified: 1%

Goshawk Insurance Holdings plc, “Annual Report and Accounts 2007”
(Extract from Directors’ Report)

Goshawk Insurance Holdings plc, “Annual Report and Accounts 2007”
(Extract from Notes to the Financial Statements)
4. Income statement – results from operating activities*

- Presentation of the income statement varies widely across the sample.
- 98% of companies comply with minimum disclosure requirements on the face of the income statement.
- 52% of companies present additional non-GAAP performance measures on the face of the income statement.

One of the IASB’s important, long-running and challenging projects is that on financial statements presentation. A discussion paper was issued on 16 October 2008 by both the IASB and the US standard-setter, the Financial Accounting Standards Board (FASB). In the meantime, there continues to be considerable variety in practice in income statement presentation. Indeed, among the listed companies sampled, it would be difficult to find two which were the same.

Such variety allows companies to adopt a presentation which is most appropriate to their business, but hinders the reader’s ability to compare results with those of other entities.

Nearly all complied with the presentational requirements of IAS 1 Presentation of Financial Statements**, with only two companies apparently not meeting the requirements. Non-compliance was due to:

- not showing results from joint ventures as a separate line. These were included within operating profit and disclosed separately in the joint venture note to the accounts; and
- not disclosing discontinued operations separately on the face of the income statement. A separate note to the accounts was used to disclose relevant information relating to the discontinued operation, including an analysis of the result from the operation in both the current and prior years.

The length of income statement, measured in number of lines from the top to profit after tax, ranged from 7 to 30 lines. Figure 7 below illustrates how this varies according to size of company.

IAS 1 requires, as a minimum, separate disclosure on the face of the income statement of revenue, finance costs, tax expense and profit or loss. There is no specific requirement regarding the classification of operating expenditure on the face of the income statement. IAS 1 recognises that both methods of showing expenses by function and by nature have merit for different types of entities. This freedom is utilised in practice as illustrated in figure 8, opposite.

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* This section analyses the findings for all companies other than investment trusts.

** For the purposes of the survey, all references to IAS 1 relate to the revised version dating from 2003; the new revised IAS 1 (September 2007) is effective only for periods beginning on or after 1 January 2009.
The most common presentation (52%) was to classify expenses by function, for example, as part of cost of sales or administrative activities. At a minimum, this method requires an entity to disclose its cost of sales separately from other expenses.

Out of the 23 companies which did not classify their expenses by function or nature on the face of the income statement, all of them provided further detail in the notes.

A further requirement of IAS 1 is that when an entity chooses to present expenses by function (or, indeed, not classified at all) additional information on the nature of expenses shall be disclosed. Of the 75 companies which presented expenses on the face of the income statement by function or which did not classify expenditure at all, 68 complied with the requirement to provide further detail by nature (e.g. staff costs, depreciation etc.) in the notes.

Additional non-GAAP measures

As noted above, 98% of the companies sampled complied with the presentation and disclosure requirements of IAS 1 for the face of the income statement. What is perhaps more interesting is that 51% of companies went beyond the IAS requirements to present additional non-GAAP performance measures on the face of the income statement.

In the similar survey conducted by Deloitte in 2007, 45% of companies presented non-GAAP performance measures.

This use of additional measures is permitted under IAS 1 which encourages such items to be presented when this is relevant to an understanding of the entity’s financial performance.

The most common performance measures excluded costs relating to fundamental reorganisation or restructuring (20% of all non-GAAP measures) and the disposal of fixed assets (13% of all non-GAAP measures). Nearly three quarters of the companies with these disposals disclosed that they related to large items, usually property or land, but very few provided further explanation as to why these items had been singled out. Also common were the effects of sales or terminations of operations (other than discontinued operations) and items relating to IAS 39 Financial Instruments: Recognition and Measurement.
Within “Other” in figure 10 above, eight companies excluded amortisation of intangibles (most commonly acquired intangibles but in one case this included existing intangibles). Seven companies excluded costs relating to legal action and tax-related items. The following costs were each excluded by six companies: costs or provision releases relating to terminated contracts, credits or costs relating to pensions and costs relating to business combinations (such as integration costs).

Over half of the companies (54%) giving additional measures referred to the excluded items as “exceptional”, a term not used in IFRS but obviously a hangover from UK reporting in which FRS 3 Reporting Financial Performance requires identification of such items. Less common was “underlying”, a term used by only 14% of those companies with such measures, whilst 6% of companies used the term “non-recurring”.

The methods by which these additional performance measures were shown on the face of the income statement varied. 35% of relevant companies adopted a columnar approach so that the following were presented: a complete income statement from revenue to profit after tax which excluded the “exceptional items”; at least one middle column with those items; and then a column showing the full results including the “exceptional items”.

Other approaches, adopted by 13 (25%) and 15 (29%) companies respectively, were the use of an additional line and the inclusion of a removable box. With the former, the exceptional item was excluded from the main body of expenses and often a sub-total used (such as “operating profit before exceptional items”). In this case, the non-GAAP measures are an integral part of the income statement. This is demonstrated in the Annual Report for Chloride Group Plc, below.
In comparison to this, a removable box is used to provide the reader with extra information in addition to the results reported. A common use of the box is to split out operating profit into underlying profits and the exceptional items. This is demonstrated in the Annual Report and Financial Statements 2008 of J Sainsbury Plc, below.

### Consistency of presentational style adopted in 2007

Five companies that were included within the sample in both the 2007 and 2008 surveys presented non-GAAP measures in either columnar form or as additional line items in 2007 but presented no such measures in 2008.

Similarly, a further seven companies included within both surveys changed from presenting non-GAAP measures as either additional line items or removable boxes in 2007 to using a columnar approach in 2008.

These changes year on year highlight the variability of presentation amongst all companies and that there is significant flexibility available to Directors to present their results in a way in which they consider most appropriate to their circumstances.

### Two companies took an approach which was classified as “Other”.

In both cases an additional table was presented below the income statement reconciling operating loss to a separate measure (referred to in one as “EBITDA” and “trading profit” in the other).
5. Income statement – other items*

- 30% of companies have discontinued operations with all but one presenting the results from the operations separately on the face of the income statement.
- 25% of companies with additional non-GAAP performance measures provide an adjusted earnings per share figure.

**Discontinued operations**

The overall objective of the presentation and disclosure requirements within IFRS 5 Non-current Assets Held for Sale and Discontinued Operations is to enable users to evaluate the financial effects of discontinued operations and disposals of non-current assets or disposal groups. To this end, the standard distinguishes discontinued operations from other operations and presents them separately.

The other company did not disclose any discontinued operations on the face of its income statement, although there was detail of the revenue, costs and tax charges relating to a disposal group in the current period in a separate note to the financial statements. Perhaps this disposal group did not meet the IFRS 5 definition of a discontinued operation.

**Presentation of other line items**

An operating profit line is commonly given by UK companies, although this is not a requirement under IAS 1. The standard does not define “operating profit” and there is some variety in the level at which the item is shown or whether it is omitted entirely. If shown, IAS 1 states that it would be misleading to exclude items of an operating nature such as inventory write-downs, restructuring and relocation expenses. It must be presented consistently year on year and the group should have stated a policy making it clear what this line item includes and excludes.

94% of the sample included an operating profit line, with 24% of these companies choosing to use an alternative name. Popular names were profit from operations, profit before financing income/costs and names specific to the company such as operating profit before/after share-based payments.

IAS 1 also requires the share of the profit or loss of associates and joint ventures accounted for using the equity method to be presented separately as a single line item on the face of the income statement. Of the 38 companies with associates and joint ventures, 35 (92%) complied with this requirement. Of the remaining three, one did not disclose any income on the face of the income statement (presumably due to the immaterial nature of the investment in the joint venture) and one was exempt from the requirement through choosing to account for the entities through the proportional method. The third presented the pre-tax profits, tax charge and the net figure within a removable box on the face of the income statement.

30% of companies had discontinued operations in either the current or the prior years. Of these, 93% presented the results from the discontinued operations as a single amount on the face of the income statement. This is in line with the minimum requirement under IAS 1 which requires the post-tax profit or loss of discontinued operations to be presented as a single amount.

Of the two companies that did not adopt this presentation, one used a columnar approach, with one column representing continued operations, one representing discontinued operations and the third being the total. Curiously, the statement “the results above relate to continuing operations” was also included below the income statement.

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*This section analyses the findings for all companies other than investment trusts.
Of the 35 companies who presented the share of the profit or loss of associates and joint ventures as a single line, 42% presented this in operating profit, 55% reported this below operating profit and this question was not applicable for one bank as it did not have an operating profit line on its income statement.

The position of other line items on the face of the income statement also varied.

- 32% of companies presented costs of fundamental reorganisation on the face of the income statement. Of these companies only one presented this below the operating profit line. This presentation is inconsistent with IAS 1.BC13 which considers exclusion of such items from operating activities to be misleading, although this was usual practice under UK GAAP.
- 66% of companies clearly disclosed the profit or loss on the disposal of fixed assets (whether on the face of the income statement or in the notes). All companies presented the results above operating profit.
- Four companies disclosed the disposal of investments on the face of the income statement. All companies presented this above the operating profit line.

There was a variety of presentations of defined benefit pension scheme costs in the income statement. IAS 19 Employee Benefits discusses the various costs that may need to be recognised in the income statement (such as current service cost, interest cost, expected return on plan assets, actuarial gains and losses to the extent recognised and the effect of curtailments or settlements). However, neither IAS 19 nor IAS 1 clearly directs how the charge/credit to the income statement should be presented.

![Figure 13. Of the companies presenting results of associates/joint ventures, are they presented in or below operating profit on the face of the income statement?](image)

![Figure 14. Are the following presented in or below operating profit on the face of the income statement?](image)

![Figure 15. Where are defined benefit pension scheme costs included in the income statement?](image)
61% of the companies surveyed operated defined benefit pension schemes. 31% of these companies allocated pension costs solely to staff costs; 33% attributed costs to staff costs and finance costs. 20% of companies specifically disclosed the costs as staff costs, finance costs and expected return. The remaining 16% of companies presented pension costs in other combinations, including:
- expected return on plan assets less finance charge (i.e. no service cost in the current year); and
- staff costs, finance costs and an exceptional pension credit.

**Earnings per share (EPS)**

A compulsory performance measure to be shown by all listed companies is EPS. The objective of the basic EPS information is to provide a measure of the interests of each ordinary share of a parent entity in the performance of the entity over the reporting period. 22% of the companies surveyed presented additional performance measures, other than EPS for discontinued operations, on the face of the income statement. 13 of these companies (59%) presented both adjusted basic and diluted EPS to take into account the additional performance measures. Two companies (9%) produced only an adjusted basic EPS and did not adjust the diluted EPS. These additional performance measures were often an adjusted profit figure, such as profit before exceptional items.

Of the remaining seven companies (32%) which presented additional performance measures but did not present an adjusted diluted or basic EPS, six companies presented dividend per share as a measure and one company presented weighted average shares outstanding as a performance measure. Disclosure of the amount of dividends and the amount per share must be disclosed either on the face of the income statement or the statement of changes in equity (SOCE), or in the notes.

Some companies chose to present further performance measures in the notes, such as Wm Morrison Supermarkets PLC which presented EPS based on underlying earnings in note 1 to the financial statements (including adjusted diluted EPS).

Of the 30 companies with discontinued operations in the year, 19 presented EPS for total operations and EPS for continuing operations (the difference being the result for discontinued operations) and nine showed both EPS for continuing operations and discontinued operations, often along with a total. The remaining two companies presented EPS for total operations only on the face of the income statement.

**Income statement for parent companies**

The exemption under the Companies Act 1985 which allows companies not to publish a separate income statement for the parent financial statements was popular, with 90% of companies taking advantage of the exemption. Of the remaining ten, six produced a separate statement for the parent company, for two the exemption was not applicable as there was no separate parent company and the last two companies were subject to Guernsey law rather than UK law.
6. Reporting changes in equity*

IAS 1 requires that the financial statements should include a primary statement showing either all changes in equity, or changes in equity other than those arising from capital transactions with owners and distributions to owners (i.e. transactions with equity holders acting in their capacity as equity holders).

The second approach, usually titled Statement Of Recognised Income and Expense (SORIE), has proven more popular with companies. Further detail of other changes in equity is then disclosed within the notes to the financial statements.

**Presentation**

In contrast, of the smallest 350 companies only 48% of them presented a SORIE. 40% produced a SOCIE, whilst two companies (6%) produced both as primary statements. Including both the SORIE and SOCIE as primary statements has the potential to be confusing for readers as the SORIE is itself a statement of changes in equity. The remaining two companies did not produce either a SOCIE or a SORIE as a primary statement, explaining on the face of the income statement that there was no other income or expense incurred during the period. A reconciliation of equity was provided in the notes to the financial statements in both cases.

**Individual line items**

**Cash flow hedges**

43 companies indicated in their accounting policies that they entered hedging contracts to hedge against cash flow risk. 33 of these companies (77%) included movements in cash flow hedges within the SORIE or SOCIE. Of the remaining ten companies, most of them implied that they had not entered into such contracts in either the current or prior periods. The others did not clearly state why movements in hedges had not been recognised in equity.

**Dividends**

IAS 1 requires entities to disclose, either on the face of the income statement or the SOCIE, or in the notes, the amount of dividends recognised as distributions to equity holders during the period. 79% of companies paid out dividends on ordinary shares in the current period. 20% of these companies presented a SOCIE as a primary statement and 3% presented both a SOCIE and SORIE; all of these companies included dividends within the SOCIE rather than the SORIE.

Of the remaining 77% of companies who paid out a dividend in the year, all but one produced a SORIE as a primary statement. None of these companies included dividends within the SORIE, instead accurately presenting the movement within the notes to the financial statements where the movement in equity was disclosed. The one remaining company which produced neither a SOCIE nor a SORIE as a primary statement also included dividends within the notes to the financial statements.

A clear majority of companies chose to present a SORIE instead of a SOCIE as a primary statement. Nearly all of the companies within the top FTSE 350 produced a SORIE, with only two financial institutions choosing to present a SOCIE. Similarly, 70% of the middle-tier companies presented a SORIE.

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*This section analyses the findings for all companies other than investment trusts.*
Share-based payment charge

IFRS 2 requires an entity to disclose information that enables users of the financial statements to understand the effect of share-based payment transactions on its profit or loss for the period and on its financial position.

88% of companies had share-based payment or share option schemes. Of these, 92% recognised a movement for the period within either the SOCIE as a primary statement (18%) or within the notes to the accounts where the movement in equity is disclosed (74%). In nearly all cases this movement could be clearly identified as the corresponding credit to equity for the IFRS 2 charge incurred for the period. Where other movements were identified, these were due to the exercise, lapsing or vesting of share options.

More often than not these movements could be reconciled to the disclosure of the charge to income statement within the share-based payment note to the accounts. In five particular instances it was not easy to reconcile the movement shown in the SOCIE or equivalent note to any detail provided in the share-based payment note.

The remaining 8% of companies with share-based payment or share option schemes did not recognise any movement within the SOCIE or equivalent note. 5% only had schemes which had granted options or awards prior to 7 November 2002 which are exempt from IFRS 2. 1% did not recognise any expense because it was not anticipated that the relevant performance conditions would be met, and the remaining 2% of relevant companies did not provide a clear reason as to why no movement in equity was recognised in the year.

Minority interest

IAS 1 also requires disclosure, on the face of the SOCIE, of total income and expenses for the period (including amounts recognised directly in equity), showing separately the amounts attributable to equity holders of the parent and to minority interests.

A third of companies (34%) had minority interests. Seven of these companies (21%) presented a SOCIE as a primary statement and included the movement in minority interests within the SOCIE. Of the remaining 27 companies which had minority interests but presented a SORIE as a primary statement, 15 of these companies (56%) included the movement in minority interests within the SOCIE note or the equivalent reserves note. The remaining twelve adopted the following presentation:

- six reconciled the minority interest in a separate note;
- four had clearly immaterial movements and therefore did not include a reconciliation; and
- two companies did not clearly state what the movement in minority interest related to (other than the relative profit or loss for the period).

In summary, the findings above confirm a high level of compliance with IAS 1 and other appropriate standards with regards to reporting changes in equity.
7. Cash flow statement*

- Both interest paid and interest received are classified as operating, investing and financing activities across the sample.
- All companies with dividends payable comply with reporting standards and classify them as either operating or financing cash flows.
- Only 7 out of 30 companies with discontinued operations present cash flows from discontinued operations on the face of the cash flow statement.

IAS 7. Statement of cash flows requires that a cash flow statement must be presented reporting inflows and outflows of cash and cash equivalents during the period. Those cash flows must be analysed across three main headings (operating, investing and financing activities), compared to UK GAAP which requires up to nine main headings.

All companies within the sample complied with the requirement to present a cash flow statement as a primary statement. Despite detailed guidance provided in IAS 7, presentation of cash flow items varied considerably across the companies sampled.

Two methods of presenting cash flows from operating activities are allowable under IAS 7, namely the direct method and the indirect method. 97% of companies chose to present cash flows using the indirect method. Only 2% adopted the direct method, indicating that the former is easier to calculate accurately and efficiently. One company failed to disclose any calculation, reconciliation or explanation as to how the “cash flows generated from operations” figure shown on the face of the cash flow statement had been determined.

Interest received and paid are usually classified under operating activities in financial institutions. For other companies, IAS 7 notes that interest received may be classified as operating or investing cash flows.

93% of companies recognised a cash flow from interest received. Most companies (51%) classified cash flows from interest received as investing, with 42% classifying them as operating. One company chose to split interest received into both categories. The remaining six companies considered interest receivable to relate to financing activities. These were predominantly in the chemicals or real estate industries.

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*This section analyses the findings for all companies other than investment trusts.
In accordance with IAS 1, interest paid should be classified as either an operating or a financing cash flow. Figure 19 below shows which option companies chose.

96% of companies recognised a cash flow for interest paid. Two thirds of relevant companies presented interest payable as relating to operations, with nearly all other companies classifying it as financing. Only two companies classified some or all of their interest payable as investing. Whilst one of these companies had classified all of their interest payable as investing, the other had classified bank loan and overdraft interest as financing and an additional amount that had been capitalised during the period as investing.

**Dividends**

Only 32% of companies received dividends during the period. Of these, 69% classified the cash inflows as investing, 25% classified them as operating whilst the remaining 6% classified them as financing.

IAS 7 is prescriptive in classifying dividends payable as either operating or financing. 79 companies within the sample paid dividends on ordinary shares in the current year. All of these companies had followed the guidance in IAS 7, with 97% classifying them as financing and the remaining 3% classifying them as operating. One company paid out dividends on preference shares and also classified this cash flow as operating.

**Discontinued operations**

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations requires the net cash flows attributable to the activities of discontinued operations (operating, investing and financing) to be presented either in the notes or on the face of the financial statements. Where an entity chooses to present these disclosures on the face of the cash flow statement, care must be taken to ensure that the requirements of IAS 7 are met. In particular, where an entity reports cash flows from operating activities using the indirect method in accordance with IAS 7 (b) profit or loss is adjusted for a number of items. Profit or loss in this context includes both continuing and discontinued operations. If the direct method is used, the gross cash flows are from both continuing and discontinued operations.

As demonstrated in the findings below, companies have adopted a variety of presentations to comply with the multiple requirements.
8. Balance sheet, tax and reserves*

- 92% of companies comply with minimum disclosure requirements on the face of the balance sheet.
- The length of balance sheets varies from 23 to 53 lines.
- Only 13% disclose a description of the nature and purpose of each equity reserve.

Balance sheet presentation

The minimum requirements in IAS 1 allow companies some freedom in presentation of the balance sheet. Despite this, the variety in presentation of balance sheets was less than that of the income statement, discussed in section 4. 92% of companies complied with the minimum line requirements as per IAS 1. Non-compliance was due to:

- not presenting all the relevant tax balances separately. In most cases of non-compliance, the current tax creditor was included within payables;
- the provisions not being separately disclosed on the face. Instead this was included within the trade payables balance and split out separately within the notes to the financial statements; and
- not including assets held for sale separately on the balance sheet. These were included within "other assets" and disclosed within the notes.

IAS 1 allows entities to present their balance sheet in order of ageing of items (i.e. current/non-current) or in order of liquidity. 87% of companies presented their year-end position in order of ageing of items. Only 10% presented their balance sheets in order of liquidity. The remaining 3% were two banks and one insurance company which appeared to combine elements of both ageing and liquidity.

Presentation of assets held for sale

IFRS 5 requires the following line items to be presented separately on the face of the balance sheet:

- total assets classified as held for sale and assets included in disposal groups classified as held for sale, and
- liabilities included in disposal groups classified as held for sale.

23% of companies presented assets held for sale on the face of the balance sheet. Over half (57%) of these companies separated out the assets and associated liabilities into two lines, as required by both IAS 1 and IFRS 5. The other 43% of companies which showed assets held for sale did not have any liabilities to disclose because the assets were tangible fixed assets rather than disposal groups.

*This section analyses the findings for all companies other than investment trusts.
Reserves

The number of reserves other than share capital varied hugely, as demonstrated by figure 23, below. The average across all companies was five. Two companies in the top 350 companies by market capitalisation had nine reserves, while one company in the middle tier had ten reserves. In general, the larger the company the more reserves it had, with the average number of reserves in the top, middle and bottom tiers being six, five and four respectively.

IAS 1 requires a description of the nature and purpose of each reserve within equity. Only 13% of companies fulfilled this requirement for every reserve. A large number of companies complied with the requirement for reserves whose function was not necessarily explicit in their name (such as “other reserve”). Interestingly, many companies described all reserves other than retained earnings, indicating that a description of that reserve would be superfluous to the readers’ needs.

7% of companies had share capital or a component of it included within liabilities. In most cases this represented preference shares.

Taxation

91% of companies were compliant with IAS 1 in disclosing tax separately on the face of the balance sheet. For half of the remaining companies, this requirement did not apply as they did not have any tax payable or deferred tax recognised at the year-end. The remaining companies appeared not to meet this disclosure requirement.

All but two companies produced tax reconciliations, a requirement under IAS 12 Income Taxes. One of the two companies disclosed that no liability to corporation tax arose during either the current or prior periods. The other company was domiciled in Guernsey where it had been deemed exempt from Guernsey taxation.

A handful of companies chose not to disclose their tax reconciliation using absolute numbers, instead preferring to present a reconciliation of effective rates in percentage terms which is also acceptable under IAS 12.

Nearly a third of companies clearly disclosed the amount of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax had been recognised on the balance sheet. In comparison to this, 25% of companies clearly disclosed temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures for which deferred tax liabilities had not been recognised. Both of these disclosures are required under IAS 12. It is difficult to tell whether all companies in our sample complied with these requirements as some companies may not have had any such temporary differences or had in fact recognised deferred tax liabilities on these differences.

Only two companies made clear reference to ‘interesting’ tax schemes or tax returns that had not been settled for a number of years.

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Surveying financial statements in annual reports

IAS 21 The Effects of Changes in Foreign Exchange Rates requires disclosure of the amount of exchange differences included in the net profit or loss for the period (excluding those arising on financial instruments measured at fair value through profit or loss). Similarly, IAS 21 requires that the net exchange differences classified as a separate component of equity be disclosed, with a reconciliation of such exchange differences at the start and end of the period.

38% of companies disclosed both the amount of foreign exchange gains and losses charged or credited to the income statement and the net exchange differences classified in a separate component of equity.

24% of companies disclosed no foreign exchange gains or losses at all, implying that their cash inflows and outflows were generated within the same exchange currency.

Leases

Only 3% of companies did not have any evidence of leasing transactions in their financial statements. Two of these companies had financial-based activities whilst the third was a software company. The forthcoming discussion paper on lessee accounting from the IASB is therefore likely to be of widespread interest to UK companies.
9. Accounting policies*

- Accounting policies are on average 5 pages long and make up 12% of the financial statements.
- 93% of companies disclose standards and interpretations in issue but not yet effective, with 90% of these clearly stating their impact.
- 75% of companies clearly disclose critical judgements, with the average number of judgements being 4.
- 82% of companies disclose key sources of estimation uncertainty.
- 52% of revenue recognition policies are between 100 and 250 words long.

A summary of significant accounting policies and other explanatory notes are a required component of a complete set of IFRS financial statements. The financial statements must include an explicit and unreserved statement in the notes that they comply with IFRSs.

The Financial Reporting Review Panel (FRRP) has looked closely at accounting policies over the recent years. In its recent publication, “Review Findings and Recommendations – 2008”, the FRRP confirmed that it asked fewer questions in this area in 2008 compared to earlier years and that “inappropriate retention of UK GAAP descriptive material had diminished”. The FRRP also noted that it encouraged deletion of redundant information being included within the summaries of accounting policies. But what is clear from this survey is that a significant proportion of financial statements was taken up by accounting policies.

The length of accounting policies notes ranged from 1.5 to 16.5 pages with an average of 5 pages. As shown in figure 25, the length of the note as a percentage of the financial statements ranged across the sample from 5% to 21% with an average of 12%.

Interestingly, the average length of accounting policies as a proportion of financial statements decreases as the size of company increases. This suggests that the ever-increasing disclosure requirements impacts the smaller companies more than the larger ones.

The results above do become skewed, however, when taking into account the fact that some companies choose to disclose information which is not strictly an accounting policy (such as critical judgements, key sources of estimation uncertainty, reporting standards in issue but not yet effective, basis of preparation and so on) in a separate note. For example 44% of companies disclosed critical judgements within the accounting policies section, as discussed below.

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*This section analyses the findings for all companies other than investment trusts.
Reporting standards

Despite only one company reporting under IFRSs for the first time, 25% of companies continued to make reference to choices they made under IFRSs on transition. The most common references were to goodwill and foreign exchange reserves.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors requires disclosure of a listing of standards and interpretations in issue but not yet effective, coupled with the anticipated impact on the financial statements of each of these. 93% of companies complied with the requirement to provide a listing, but only 90% of these companies clearly stated the impact (including where the directors considered there to be no impact).

Some companies chose to adopt early the following standards:

- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions which was adopted by 17 companies. The effective date of the interpretation meant that for twelve of these companies this was compulsory. The remaining five companies chose to adopt early;
- IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction was adopted early by five companies with financial year-ends between December 2007 and April 2008. Technically, IFRIC 14 has not been endorsed for use in the EU. Presumably companies believed its requirements were consistent with existing IFRSs; and
- IFRS 8 Operating Segments was adopted early by three companies. One of these companies concluded that the segments previously disclosed were still appropriate under the new standard and therefore no change to prior years was necessary. The second company had to change its business segments to comply with the new requirements, whilst the third company changed its organisation structure and therefore early adoption of the new standard was convenient.

No company chose to adopt early IFRIC 12 Service Concession Arrangements. IFRIC 12 has not yet been endorsed by the EU and this is unlikely to happen by the end of 2008. In Europe the interpretation will be effective for periods beginning after the date of endorsement.

Critical judgements

IAS 1 requires disclosure of the critical judgements made by management in the process of applying the group’s accounting policies. These are described as those judgements that have the most significant effect on the amounts recognised in the financial statements. 75% of companies clearly complied with this requirement.

59% of all compliant companies disclosed the critical judgements within the accounting policies section, with 38% disclosing them separately in a note to the financial statements. The remaining 3% disclosed them primarily in the narrative report, with a clear cross-reference to the financial statements as appropriate.
The number of judgements varied from one to ten, with an average of four across the compliant companies. As shown in figure 27 above, the most common judgements were around goodwill (including both valuation and impairment), pensions (commonly the actuarial assumptions and the liability for defined benefit schemes), tax-related items, provisions (including stock provisions) and PPE (including determining useful economic lives and impairment).

The results indicate that many companies face the same issues when making judgements that affect the financial statements. Consideration of impairment, whether it be in relation to goodwill, intangible assets or other assets held on the balance sheet, was clearly an issue for the majority of companies.

On the other hand, these results also indicate that management are not necessarily considering the judgements that uniquely affect their company, but instead stating generic judgements to satisfy another disclosure requirement. This is in line with the FRRP’s findings in its publication noted above, which also stated its concern that too often the disclosures tend to be boiler-plate without referring to specific issues faced by individual companies.

The “Other” category shown in figure 27 comprised a variety of judgements, most commonly associated with presentation or classification (such as exceptional items).
One company stood out of the sample with five critical judgements that were unique to itself within the sample. This was Rio Tinto plc, which determined the following items to be critical judgements:

- merger accounting in 1995;
- determination of ore reserve estimates;
- deferral of stripping costs;
- capitalisation of exploration & evaluation costs; and
- identification of functional currencies.

It also disclosed three other critical judgements which were common to other companies.

Key sources of estimation uncertainty

Along with critical judgements, IAS 1 requires disclosure of key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

A total of 82 companies disclosed key sources of estimation uncertainty, with only 30 (38% of relevant companies) using the terminology “key sources of estimation uncertainty”. In line with the critical judgements, the number of estimates varied from one to ten, with an average of four.

Of the compliant companies, 58 (71%) presented them in combination with critical judgements while only 13 (16%) split them out as separate considerations. The remaining 11 companies (13%) disclosing key sources of estimation uncertainty did not disclose any critical judgements. 55 companies provided key sources of estimation uncertainty which were the same as the critical judgements identified. This highlights the confusion around the distinction between critical judgements and key sources of estimation uncertainty.

Four companies chose to disclose only critical judgements, whereas ten companies chose to disclose only key sources of estimation uncertainty. Disappointingly none of these companies disclosed either judgements or key estimations that were particularly specific or unique, instead choosing to plump for the standard judgements as discussed above.

As stated by the FRRe, “directors will need to pay particular attention to disclosure of key assumptions and key sources of estimation uncertainties during the forthcoming reporting season given recent developments and continuing difficulties within the financial markets”.

Prior year restatements

35 companies had restatements of prior year balances. A total of 45 restatements were made across these relevant companies.

As shown in figure 29, the most common reason to restate was due to reclassifying balances either on the income statement or on the balance sheet (27% of all restatements). 20% of restatements were due to reclassifying results from discontinued operations. 20% of restatements were due to a specific change in accounting policy.

Two companies restated the comparatives to reflect a change in accounting estimate, although such a retrospective change is not permitted under IFRS. It was not clear from the disclosures of these restatements whether the change in accounting estimate was due to a material error being identified.
One company changed its presentation due to a change of its accounting system which allowed different analysis to be extracted.

Ten companies disclosed a change in accounting treatment, but not in policy, thus not requiring comparative information to be restated.

Revenue recognition

Revenue recognition has continued to be a ‘hot topic’ covered by the FRRP. Questions tend to be focussed on “the sufficiency of the stated policy to enable users to understand the bases on which management recognised its significant sources of revenue”.

The detail given about revenue recognition varied across the sample. The majority of companies (52%) had revenue recognition policies of 100 to 250 words. There were nine companies with policies less than 50 words long. These were from across the sample (including three of the top 350 companies and two of the middle group) and from a variety of industries. In comparison, of the 15 companies with policies longer than 250 words, ten of these came from the FTSE 100 and included all of the banks within the sample.

Three companies showed evidence that the revenue recognition policy had been changed or expanded from the prior year. This was due to separate disclosure for operations classified as discontinued in the current period or a reclassification of cash inflows from other income to revenue.

The shortest revenue recognition policy was only 13 words, being “Revenue is measured at the fair value of the consideration received or receivable”. This company did have another section called “sale of goods” which was seventy words long.
Fair values

All companies with derivatives or which applied hedge accounting valued these instruments at fair value, in line with IAS 39. For only one company the accounting policy note was not considered to be sufficiently explicit to determine whether fair value accounting had been applied to its net investment hedges.

Out of the 96 companies with property, plant & equipment on their balance sheet two measured these assets at fair value. This was applied only to the buildings included within PPE.

Under IAS 40 Investment Property entities may choose whether to apply the fair value model or the cost model. Twelve companies in the sample held investment property on their balance sheet, of which half of them chose to apply the fair value model to these assets.

The other half accounted for the assets at cost (commonly the fair value at date of transition to IFRS) less accumulated depreciation. In one instance the accounting policy implied that the assets were held for the purpose of rental income, rather than trading the properties as part of the company’s operations. In this case it is not unreasonable for the properties to be treated in the same way as for the other non-current tangible assets. The remaining five companies choosing not to apply fair value to their investment properties were silent on the rationale supporting their choice. Five of these six companies complied with the IAS 40 requirement to disclose the fair value of the property at the balance sheet date.
10. Segmental analysis*

- 74% of companies identify business segments as their primary reporting format.
- 10% of companies do not identify any primary reporting format.
- Only 5% of companies do not provide a reconciliation between segmental figures and their primary statements.
- Three companies adopt IFRS 8 early, which has little impact on the length of segmental reporting disclosures.

Impact of IFRS 8 Adoption

As noted in section 7, three companies had chosen to adopt early IFRS 8 Reporting Segments. IFRS 8 is effective for accounting periods beginning on or after 1 January 2009.

The new standard requires segmental analysis on a basis that more closely reflects what management use for internal reporting purposes. This may encourage the inclusion of more non-GAAP measures. For the three early adopters, the change to the new standard made minimal difference to the length of the disclosures previously provided under IAS 14 Segment Reporting.

Under IFRS 8, when an entity has only one reportable segment it needs to provide information about each product and service or groups of products and services. This will impact those companies which did not provide segmental analysis for their primary reporting format on the basis that they only had one class of business.

Analyses of revenues and certain non-current assets by geographical area are also required under IFRS 8, with an expanded requirement to disclose revenues/assets by individual foreign country (if material), irrespective of the identification of operating segments. Disclosure of transactions with major customers is also required.

IAS 14 reporters

There was a variety of approaches to, and interpretations of, IAS 14 among companies. A company is required to determine whether its primary segment reporting format is business segments or geographical segments, based on the dominant source and nature of the company’s risks and returns. As illustrated in figure 32, 10% of companies did not identify a primary reporting format, 74% of companies identified business segments as their primary reporting format and 16% used geographical segments.

Of those companies that identified a primary reporting format, two stated that whilst their primary reporting format was business segments, they had only one class of business and thus provided no analysis or disclosure for segmental reporting purposes. Another four companies had identified only one business segment as their primary reporting format, and did meet the disclosure requirements for their secondary reporting format, being geographical segments.

Three companies determined that although more than one segment could be identified that generated revenue, all assets and liabilities of the group related to one overall segment and therefore no analysis was provided for other income statement items or balance sheet items.

As illustrated in figure 33, the number of segments identified under the primary reporting format (excluding unallocated or general corporate segments), ranged from one to ten, with an average of three segments across the sample. Of those companies that identified a primary reporting format, 93% identified two or more segments to report.

One company did not produce any segmental analysis, on the basis that its operations were in one geographical location and in one class of business. Unexpectedly, in the segmental reporting note an analysis of revenue and cost of sales was provided by market sectors in which the company operated, suggesting that different segments could be identified. Within this additional analysis non-GAAP measures were presented.

*This section analyses the findings for all companies other than investment trusts.
55% of companies providing a segmental analysis produced more information than was required, by including non-GAAP measures for each segment. Such measures typically included operating profit before exceptional items, EBITA or EBITDA. IAS 14 requires a reconciliation between the information disclosed for reportable segments and the aggregated information in the consolidated or individual financial statements. Most companies with a segmental analysis provided this reconciliation. Only 5% did not.

IAS 14 states income tax expense is not included in segment expense, income tax assets are not included in segment assets and income tax liabilities are not included in segment liabilities. As shown by figure 34 above, of those companies preparing reconciliations to the group’s overall balance sheet, 46% of companies made it clear that they had allocated tax expense, assets and liabilities to segments. It was unclear for 35% of companies whether or not these balances had been excluded from the segments. 19% of companies had not included tax balances in segment expense, assets or liabilities.
11. Goodwill and intangibles*

- Only 68% of companies with goodwill disclose an allocation by cash generating unit.
- 90% of companies with goodwill calculate its recoverable amount as its value in use.
- 47% of companies with goodwill do not disclose the growth rate used for future cash flows when assessing value in use.
- 79% of companies have intangibles other than goodwill.

IFRS 3 Business Combinations includes a general objective to disclose information that enables users of the financial statements to evaluate changes in the carrying amount of goodwill during the period. Further information about the recoverable amount and impairment of goodwill must also be disclosed in accordance with IAS 36.

The FRRP released a Press Notice in October 2008 detailing its review of goodwill impairment disclosures made in the financial statements of 32 listed companies in 2007. Its conclusions included the observation that most companies disclosed more generic than specific information in this area, thus limiting the understanding and insight that could have been conveyed to the users.

The results from the survey indicated that a significant proportion of companies were not meeting the basic requirements of disclosure under IAS 36 Impairment of assets, as discussed below.

**Goodwill – allocation**

81% of the companies surveyed had goodwill on their balance sheets. Of these, only 54 companies (67%) disclosed all of the cash generating units (“CGUs”) to which the goodwill had been allocated. Two companies disclosed several CGUs but this did not account for all of the goodwill balance. One company disclosed two CGUs, one of which was named “other”, while a further company provided information on the number of CGUs to which goodwill had been allocated but did not disclose what the CGUs actually were. The remaining 24 companies did not disclose any detail regarding the CGUs.

The variety in number of disclosed CGUs is shown in figure 35. The maximum was eleven and the average, excluding those with none, was three.

In addition to disclosure about the allocation of goodwill, 15 companies also provided information on the total number of CGUs.

Of the 81 companies recognising goodwill on their consolidated balance sheet, 48 (59%) disclosed the allocation of goodwill among segments, five (6%) did not present any segmental analysis (see discussion of segmental analysis in section 10) and the remaining 28 (35%) did not disclose any allocation of goodwill to segments.

The number of segments to which goodwill had been allocated varied. The maximum number was six and the average was two.

*This section analyses the findings for all companies other than investment trusts.
Goodwill – impairment review

Disclosure of the basis used to measure recoverable amounts of cash-generating units containing goodwill is a requirement of IAS 36. The recoverable amount for an asset or a CGU is the higher of its fair value less costs to sell and its value in use. Entities are required to disclose which calculation has determined the recoverable amount.

The most common basis on which the CGU’s recoverable amount had been determined was value in use, with 90% of all companies with goodwill following this approach (see figure 37). Five companies referred to both value in use and fair value less costs to sell calculations, but no companies used the latter on its own. Three companies failed to disclose clearly the basis on which the CGU’s recoverable amount had been determined.

Figure 36. How many segments has goodwill been allocated to?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>0</th>
<th>5</th>
<th>10</th>
<th>15</th>
<th>20</th>
<th>25</th>
<th>30</th>
<th>35</th>
</tr>
</thead>
<tbody>
<tr>
<td>No segmental analysis</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

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Figure 37. How has the unit’s recoverable amount been calculated?

- Value in use: 90%
- Both fair value and value in use: 4%
- No evidence: 6%

Only 81% of companies with goodwill described the key assumptions on which management based its cash flow projections. Fewer still disclosed the period over which the cash flows were projected. 35 companies (43%) of those with goodwill indicated that this period was not greater than five years. Of the remaining 46 companies, twelve (15%) confirmed that the period was greater than five years and provided an explanation for that. 17 (21%) confirmed that the period was greater than five years but provided no explanation and there was no evidence in the remaining 17 companies (21%) of the length of period over which the cash flows were projected.

Figure 38. Have the key assumptions on which management bases its cash flow projections been described?

- Yes: 81%
- No: 19%
The FRRP has clearly identified in its October 2008 press notice that disclosure surrounding impairment of goodwill is of great importance, even more so in the current economic environment.

The goodwill note to the group financial statements from the Annual Report and Accounts 2007 of LSL Property Services plc serves as a good example of providing clear detail of management’s judgement on goodwill impairment.

Figure 39. Is the period over which the cash flows are projected more than five years?

Only 53% of companies with goodwill disclosed the growth rate used for any part of their value in use calculations. 32% of these companies indicated that the growth rate did not exceed the relevant long term average growth rate. 4% of these companies indicated that the growth rate exceeded the relevant long term average growth rate but failed to justify this. There was no evidence at all in the remaining 64% of relevant companies as to whether or not the growth rate exceeded the relevant long term average growth rate.

Figure 40. Is the growth rate disclosed?

IAS 36 contains further sensitivity disclosure requirements that apply where a reasonably possible change of key assumptions would cause the unit’s carrying amount to exceed its recoverable amount. Of the 81 companies with goodwill, twelve (15%) included such additional sensitivity disclosures.
Intangibles

79% of all companies recognised intangible assets other than goodwill on their balance sheet. The number of classes of intangibles ranged from one to seven, with an average of three across these companies.

For each class of intangible asset, IAS 38 Intangible Assets requires disclosure of whether the useful lives are indefinite or finite, the amortisation rates used where the useful lives are finite and the reasons supporting the assessment of the indefinite life of any asset.

Of the companies with intangibles other than goodwill, eight companies (10%) had assessed some or all of the intangibles as having an indefinite life. Six out of these eight companies went on to disclose the reasons supporting the assessment of the indefinite life.

The FRRP’s comments on the importance of clear disclosure relating to goodwill impairment can be considered equally relevant to impairment of other intangibles. While the FRRP expects to see an increase in impairment of goodwill, it is not unreasonable to expect also more discussion around the recoverable amounts and useful lives of intangible assets and possibly changes in accounting estimates in this area.

Research and development

38% of all companies disclosed the aggregate amount of research and development (“R&D”) charged as an expense in the year. Of the remaining companies with no such disclosure, 7% had an accounting policy for R&D, suggesting perhaps that there may have been R&D expenditure during the year, whilst 55% were silent on the matter.
12. Financial instruments*

- 80% of companies adopt or early adopt IFRS 7.
- 67% of companies present their IFRS 7 disclosures solely in the notes to the financial statements.
- 5% of companies provide no financial instruments notes, whilst 5% have over 10 pages.
- 56% of companies disclose both the impairment loss for the year and provision in place in respect of trade receivables.

IFRS 7 Financial Instruments: Disclosures became effective for accounting periods beginning on or after 1 January 2007 and thus the 2007/8 reporting season was the first time this new standard was operable. 80% of the companies sampled were caught by this standard, although early adoption was also permitted. This, together with extended related disclosures in IAS 1, introduced significant additional disclosures compared to the previous regime.

One of the trickier elements of these IFRS 7 financial instruments disclosures is that it is not mandated that they all appear in one place in the annual report. This comment is particularly applicable for disclosure of the nature and extent of risks arising from financial instruments. Disclosure of risks is discussed in the legal requirements for an enhanced business review (EBR) and in the Reporting Statement ‘Operating and financial review’ (RS). Thus companies may choose to give such disclosures in the front half of their annual reports and to include a cross-reference in the notes to the financial statements to the earlier discussion. Only 5% of companies sampled chose this approach but a further 15% included discussion in both the front and back half of the annual report, as figure 42 shows below.

Of the 21 companies giving disclosure in the front half, clear cross-referencing between front & back halves was seen in 10 companies.

The number of pages in the notes devoted to financial instruments was surveyed. Figure 43 below shows that it ranged from 5% of companies providing no specific notes on financial instruments to 5% of companies (all of which were financial institutions) giving over 10 pages of such notes. There was also a clear correlation between the length of such disclosures and the size of the company, with an average of nine, three and two pages across the top, middle and smallest companies respectively.

Prior to FRS 29 (IFRS7) Financial Instruments: Disclosures, UK GAAP never called directly for companies to disclose their bad debts provisions against trade receivables. For IFRS-reporters this came in from 2005 but it has not been entirely clear whether the required disclosure was merely the bad debt provision set off against trade receivables in the balance sheet or whether the income statement movement for the period was also necessary. Paragraph 16 of IFRS 7 now calls for a reconciliation of changes in allowance accounts by class of financial asset, thus ensuring that all movements are disclosed. The results from the companies surveyed showed that 56% clearly give both balance sheet and income statement amounts, while 18% apparently failed to give either, as illustrated by figure 44.

*This section analyses the findings for all companies other than investment trusts.
Surveying financial statements in annual reports

IFRS 7 requires companies to provide information to enable users to evaluate the nature and extent of risks arising from financial instruments. It refers to these risks typically being credit, liquidity and market risks.

For liquidity risks, paragraph 39 of IFRS 7 calls for:

- a maturity analysis for financial liabilities that shows the remaining contractual maturities; and
- a description of how liquidity risk therein is managed.

68% of companies disclosed information that clearly met this requirement. A good example of maturity analysis disclosure is taken from the 2007 Annual Report and Accounts of Abbey National Plc.

Market risk is “the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk”. As reported in “Write from the start” foreign currency risk is widely discussed in annual reports and is the most commonly disclosed risk in the EBR’s principal risks and uncertainties section. This survey also reviewed the extent to which companies discussed their exposure to interest rate risks and found that 68% of companies did so.

As the 2007/8 reporting season has been the first period for reporting in accordance with IFRS 7, it is expected that disclosures on financial instruments will improve as companies become more familiar with the new standard and how it is being applied in practice.


<table>
<thead>
<tr>
<th>Maturities of financial liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>The table below analyses the maturities of the undiscounted cashflows relating to financial liabilities of the Group based on the remaining period to the contractual maturity date at the balance sheet date. Deposits by customers are largely made up of retail deposits. In particular the ‘Demand’ grouping includes current accounts and other variable rate savings products. The ‘Up to 3 months’ grouping largely constitutes wholesale funding of wholesale assets of a similar maturity. This table is not intended to show the liquidity of the Group.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Group</th>
<th>At 31 December 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Demand</td>
</tr>
<tr>
<td></td>
<td>£m</td>
</tr>
<tr>
<td>Deposits by banks</td>
<td>416</td>
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<tr>
<td>Deposits by customers</td>
<td>55,766</td>
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<tr>
<td>Derivative financial instruments</td>
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<tr>
<td>Trading liabilities</td>
<td>21,009</td>
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<tr>
<td>Financial liabilities designated at fair value</td>
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<tr>
<td>Debt securities in issue</td>
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<tr>
<td>Other borrowed funds</td>
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<tr>
<td>Subordinated liabilities</td>
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</tr>
<tr>
<td>Total financial liabilities</td>
<td>77,354</td>
</tr>
</tbody>
</table>

13. Provisions*

- 66% of companies recognise provisions.
- 92% of companies with provisions give a description of the obligation.
- 80% of companies provide details around the expected timing of outflows.

Two-thirds of the companies surveyed recognised provisions in their financial statements. IAS 37 Provisions, Contingent Liabilities and Contingent Assets is very prescriptive in terms of the items that must be disclosed for each class of provision, most of which are straightforward. It was surprising to see some companies failing to meet the disclosure requirements on a number of occasions. It may be that in some of those cases the disclosures had not been provided due to the immaterial nature or value of the provision.

In the current economic climate transparency of a company's financial position and of its outstanding liabilities at any given point is fundamental in providing the reader of the financial statements with an understanding of the company’s position. The survey findings indicated that companies were failing to provide all the necessary information in this respect.

Companies can be exempt from providing all of the detail required for provisions in extremely rare cases if disclosure is considered to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision. No such cases were found in the companies surveyed.

Of the 66 companies which recognised provisions, the vast majority (92%) provided a description of the obligation, as shown in figure 45. Of the five companies which failed to describe the nature of each obligation for which a provision had been made, four had provisions which were relatively self-explanatory from the names of the provisions provided (such as onerous lease provision, or professional fees provision). However, the fifth company provided explanations for two of its provisions, being deferred consideration and leases, but failed to provide a description of the “other” provision.

As illustrated by figure 46, 80% of relevant companies met the IAS 37 requirement to provide details of the expected timing of any resulting outflows for provisions. No explanation was given by the other 20% of companies, although in many cases the classification of provisions as either current, non-current or both provides some indication of the expected timing of the outflows of economic benefit. Only 38% of those companies with provisions disclosed particular uncertainties around the timing of the associated outflows.

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*This section analyses the findings for all companies other than investment trusts.*
Over three quarters of relevant companies did not disclose the major assumptions concerning future events relating to provisions held at the year-end, as shown by figure 47 below. This disclosure is required by IAS 37 only where it is “necessary to provide adequate information”. This most likely explains the low proportion of companies providing such a disclosure.

27% of relevant companies disclosed the unwinding of any discounts on provisions, as shown by figure 48 below. Discounting is required where its effect is material. It is likely that the low level of disclosures in this area is because few companies had discounted their provisions (particularly if they are expected to be utilised within a year).

Overall, only three companies clearly complied with all the requirements of IAS 37 that were examined in this survey. Three other companies complied with all the requirements other than disclosing the possible unwinding of any discounts.
14. Share based payments, retirement benefits and related parties*

- 88% of companies have share option schemes.
- All companies granting share options provide information on how fair value is calculated.
- 88% of companies with defined benefit pension schemes recognise actuarial gains and losses in the SORIE.
- 50% of companies fail to define key management personnel.

Share based payments

88% of companies included in the survey had share option schemes in place at the year-end. 12 companies did not, eight of which were within the smallest 350 companies, three within the middle group and only one company from the top 350 companies.

IFRS 2 Share-based payment has an extensive list of disclosure requirements to enable users to understand the nature and extent of share-based payment arrangements. The FRRP 2007 activity report commented on three areas where disclosure on these arrangements could be improved. These have been reviewed in more detail below and overall there was a reasonably high level of compliance for these across the sample.

As shown in figure 49, share options had been exercised during the period in 71 of the 88 companies with schemes. 64 of these companies (90%) disclosed the weighted average share price at the date of exercise. Seven companies (10%) did not provide this disclosure. The mid group performed best in this area with all except one relevant company (97%) disclosing the weighted average share price at the date of exercise, compared to 94% of the top 350 companies and 84% of the smallest 350 companies.

Figure 50 below shows that the level of disclosure of the range of exercise prices for share options outstanding at the end of the period was slightly lower. 84% of companies with schemes did provide this disclosure. From the middle group six relevant companies (20%) omitted this information, as did five of the smallest 350 companies (20%) and two of the top 350 companies (6%) with share-based payment schemes.

*This section analyses the findings for all companies other than investment trusts.
It is not surprising that most companies (93%) recognised these gains and losses in the SORIE as this is the most similar treatment to the one which would have been applied historically under UK GAAP. Two of the banks and one retailer used the corridor approach for recognising actuarial gains and losses and only one company recognised actuarial gains and losses immediately in the income statement.

Figure 52 below shows which policy the companies in the survey adopted for recognising actuarial gains and losses.

It is not surprising that most companies (93%) recognised these gains and losses in the SORIE as this is the most similar treatment to the one which would have been applied historically under UK GAAP. Two of the banks and one retailer used the corridor approach for recognising actuarial gains and losses and only one company recognised actuarial gains and losses immediately in the income statement.

Figure 53 below shows which companies used a corridor approach for determining the overall expected rate of return on plan assets.

Not all of the companies which provided information on the range of exercise prices also disclosed the weighted average remaining contractual life for share options outstanding at the end of the period. However, almost three quarters of companies (72%) with share option schemes did, as shown by figure 51 above. All the outstanding share options of one company were exercised within seven days of the year-end and for this reason the company did not provide information on remaining contractual life.

Share options were granted during the period in 89% of companies with schemes. There was a high level of compliance with the disclosure requirements of IFRS 2 in this area, as all of these companies provided information on how the fair value was measured.

Retirement benefit schemes

61 companies in the survey had defined benefit retirement schemes. The 39 which did not were split fairly evenly between the middle group (18) and smallest 350 companies (19). There were only two companies in the top 350 companies which did not have a defined benefit pension scheme.

IAS 19 Employee Benefits allows a number of options for the recognition of actuarial gains and losses. At a minimum, to the extent that the unrecognised gains and losses exceed a corridor of 10% of the defined benefit obligation, then that excess is recognised in the income statement over a specified time span. This is known as the ‘corridor’ approach and is the most significant difference between IAS 19 and its UK GAAP equivalent, FRS 17 Retirement Benefits. FRS 17 requires actuarial gains and losses to be recognised immediately in the statement of total recognised gains and losses (STRGL). IAS 19 also permits systematic methods of faster recognition of actuarial gains and losses provided that the basis is consistent, including immediate recognition in the income statement or immediate recognition outside the income statement and in the SORIE.
As shown in figure 55, only 39% of companies defined the terminology “key management personnel”. This includes direct reference to lists of directors and other management in the annual report. 13% of companies produced generic statements such as “key management personnel are considered to be operational management”, without defining operational management either in the financial statements or elsewhere in the annual report. The remaining 48% of companies surveyed had not defined key management personnel. While IAS 24 does not require disclosure of a definition of key management personnel, it is good practice to do so.

Companies with defined benefit pension schemes must describe in their financial statements the basis used to determine the overall expected rate of return on plan assets. All relevant companies in the survey provided some information on the expected rate of return on plan assets. However, as shown in figure 53, only 72% of companies with defined benefit pension schemes also provided a narrative description of the basis used to determine this measure. Companies in the top 350 performed best in this area with 81% of relevant companies disclosing the information. The middle group performed worst with only 47% compliance, while 79% of the relevant smallest 350 companies included a narrative description of the basis for the rate of return on plan assets.

The actual return on plan assets disclosed?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Total</th>
<th>Top 350 companies by market capitalisation</th>
<th>Middle</th>
<th>Smallest 350 companies by market capitalisation</th>
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As shown in figure 55, only 39% of companies defined the terminology “key management personnel”. This includes direct reference to lists of directors and other management in the annual report. 13% of companies produced generic statements such as “key management personnel are considered to be operational management”, without defining operational management either in the financial statements or elsewhere in the annual report. However it is generally accepted that the financial statements will contain a related parties note. 10 companies in the survey (10%) were noted not have a separate related parties note.

Related parties

IAS 24 Related Party Disclosures requires disclosure of related party relationships and transactions between related parties during the period. Certain disclosure requirements of IAS 24 are often positioned within other parts of the financial statements (such as the key management personnel compensation which is commonly disclosed either in a staff costs note or in the remuneration report). However it is generally accepted that the financial statements will contain a related parties note. 10 companies in the survey (10%) were noted not have a separate related parties note.

IAS 19 also requires disclosure of the actual return on plan assets. Compliance in this area was slightly better, with 80% of companies disclosing the actual return. However, four companies in each of the groupings failed to provide this disclosure.

One of the other principal actuarial assumptions that must be disclosed is the discount rate. One company disclosed that there had been a change in the discount rate assumption to reflect changes in long term corporate bond yields. All other companies listed the principal actuarial assumptions used at the end of the reporting period but provided little further narrative or explanation.

As discussed in section 9, IAS 1 requires companies to disclose information about the assumptions it makes about the future and other major sources of estimation uncertainty, at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. 43 companies referred to their pension obligations in such disclosures.
Figure 56 shows whether the term “key management personnel” had been defined within the related parties note. In one case, as there was no separate related parties note, key management had been defined within the staff costs note. Of the remaining 50% of companies who defined the term, either with a specific or generic statement, 41% did so within the related parties note. The remaining 9% did so elsewhere.

An example of where terminology was clearly defined and a sufficient level of disclosure was provided is in the related party transactions note to the financial statements of MJ Gleeson Group Plc, below.
15. Subsidiaries, joint ventures and business combinations*

- 48% of acquisitions have the accounting determined provisionally.
- 27% of prior period acquisitions have fair value adjustments in the current period.
- 2% of groups disclose non-consolidation entities.
- 79% of joint ventures are accounted for using the equity method.

**Subsidiaries**

IAS 27 Consolidated and Separate Financial Statements requires disclosure in the consolidated financial statements of the nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly, through subsidiaries, more than half of the voting power. As indicated in figure 57 below, this disclosure was not applicable for the majority of companies in the survey. Only one company, which had consolidated an entity where there was 20% indirect ownership, failed to disclose the nature of the relationship.

With the exception of the special purpose entities (SPEs) held by one bank, and discussed in more detail below, no instances were noted whereby ownership of more than half of the voting power or potential voting power did not constitute control.

In contrast, ten companies disclosed detail of entities consolidated as if they were a subsidiary but where the parent did not own more than half of the voting power.

**Figure 57.** Where the parent does not own more than half of the voting power, has the nature of the relationship between the parent and subsidiary been disclosed?

- 10% Yes
- 95% No
- 5% Not applicable

**On the horizon**

The IASB currently has a consolidation project on its agenda. The project objective is to publish a single IFRS on consolidation replacing IAS 27 and the interpretation SIC-12 Consolidation – Special Purpose Entities. The project addresses the following aspects:

- a revision of the control definition to apply the same control criteria to all entities. This will focus on the consolidation of structured entities; and
- enhanced disclosures about consolidated and non-consolidated entities.

The IASB expects to publish an exposure draft by the end of 2008.

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*This section analyses the findings for all companies other than investment trusts.
Joint ventures

A third of companies in the survey had interests in joint ventures at the period end. As shown in figure 58 below, more than three quarters of these companies (79%) accounted for their interests in joint ventures using equity accounting.

On the horizon

In September 2007 the IASB published ED 9 Joint Arrangements which proposed a replacement to the current standard, IAS 31 Interests in Joint Ventures. The most significant changes proposed were:

- to shift the focus in accounting for joint arrangements away from the legal form of the arrangements and on to the contractual rights and obligations agreed by the parties; and
- to remove the choice currently available for accounting for jointly controlled entities (equity method or proportionate consolidation) by requiring parties to recognise both the individual assets to which they have rights and the liabilities for which they are responsible, even if the joint arrangement operates in a separate legal entity. If the parties only have a right to a share of the outcome of the activities, their net interest in the arrangement would be recognised using the equity method.

The IASB is currently considering the comment letters received on the exposure draft, in particular as many respondents disagreed with the removal of the proportionate consolidation method. The publication of a new standard is currently expected in the second quarter of 2009.

Business combinations

48% of companies in the survey disclosed that business combinations had occurred in the reporting period. This comprised 82% of top 350 companies, 48% of the middle group and 18% of the smallest 350 companies.

Where at the end of an acquirer’s first accounting period following the combination the fair value of the acquiree’s net assets can only be determined on a provisional basis, IFRS 3 Business Combinations requires that:

- the acquirer accounts for the business combination using provisional fair values;
- the fact that provisional values have been used is disclosed; and
- an explanation of why this is the case is given.

As indicated in figure 59 below, half of the companies with business combinations stated explicitly that the initial accounting had been determined provisionally. There was only one company where it was not clear whether or not the initial accounting was provisional.

Companies were less successful at explaining why the initial accounting for the business combination had been determined provisionally, with only 42% of relevant companies providing an explanation. Compliance was best amongst the smallest 350 companies with 67% of relevant companies providing this disclosure and the middle group performed least well with only 13% giving an explanation.
Adjustments to provisional values may be made within twelve months of the acquisition date and accounted for as if they were made at the acquisition date. 45% of companies had reported a business combination in the prior year. The survey considered whether any retrospective adjustments had been made to previously reported provisional fair values. Only 27% of relevant companies reported that they had made adjustments of this nature.

IFRS 3 requires a description of the factors that contributed to the recognition of goodwill and of each intangible asset that was not recognised separately from goodwill, together with an explanation of why the intangible assets’ fair value could not be measured reliably. Only ten companies (21% of companies with business combinations during the period) clearly provided information that was specific to the transaction. Other companies made very brief generic statements, such as goodwill represented ‘operating synergies’ or ‘anticipated profit from the distribution of products to new markets’.  

Companies performed better at disclosing the revenue and profit or loss of the combined entity for the period as if the acquisition date for all business combinations during the period had been the beginning of the period. 79% of relevant companies provided this information. Of those ten companies that did not, one disclosed that this was because the impact was immaterial.
On the horizon

In January 2008 the IASB issued a revised IFRS 3 Business Combinations and a revised IAS 27 Consolidated and Separate Financial Statements which will, subject to EU endorsement, be effective for business combinations occurring in periods beginning on or after 1 July 2009. In so doing, the IASB achieved substantial convergence between IFRSs and US GAAP on these topics. Five headline changes will be brought about by the 2008 standards, as summarised below.

Acquisition costs
All acquisition costs are to be recognised as period expenses and generally written off rather than added to the cost of acquisition. Costs incurred to issue debt or equity securities will continue to be recognised in accordance with the standards on financial instruments.

Contingent consideration
Consideration for an acquisition, including any contingent consideration, is recognised and measured at fair value at the acquisition date. Subsequent changes in those fair values can affect the measurement of goodwill only where they occur during the ‘measurement period’ and are as a result of additional information becoming available about facts and circumstances that existed at the acquisition date. All other changes are dealt with in accordance with relevant IFRSs. This will usually mean that changes in the fair value of contingent consideration are recognised in profit or loss.

Partial acquisitions
A partial acquisition refers to the acquisition of a controlling interest, but with a proportion of the acquiree’s equity interests held by other investors referred to as ‘non controlling interests’ (formerly minority interests). A choice is available, on an acquisition by acquisition basis, to measure such non-controlling interests either at their proportionate interest in the net identifiable assets of the acquiree (current IFRS 3 requirement) or at fair value (a new option and mandatory under US GAAP).

Step acquisitions
A step acquisition refers to obtaining a controlling interest through two or more separate transactions. A business combination occurs, and acquisition accounting is applied, only at the date that control is achieved. Consequently, goodwill is identified and net assets measured at fair value only for the transaction that achieved control and not in any earlier or subsequent acquisitions of equity interests.

In measuring goodwill, any previously-held interests in the acquiree are first remeasured to fair value, with any gain or loss recognised in the income statement. Similarly, on disposal of a controlling interest, any residual interest is remeasured to fair value and the gain or loss is reflected in any profit or loss on disposal.

Transactions with non-controlling interests
Once control has been achieved and acquisition accounting applied, any subsequent transactions in subsidiary equity interests between the parent and non-controlling interests are accounted for as equity transactions. Consequently, additional goodwill does not arise on any increase in the parent interest, there is no remeasurement of net assets to fair value and no gain or loss is recognised on any decrease in the parent’s interest.
16. Investment trusts

This section analyses the findings for the 30 investment trusts included in the survey, being those companies classified by the Stock Exchange as being in the industries of non-equity or equity investment instruments (this excludes real estate investment trusts). As with the other companies surveyed, investment trusts have been split into three categories being those within the top 350 companies by market capitalisation at 29 April 2008, those in the smallest 350 by market capitalisation, and those that fall in between those categories (the ‘middle’ group). Three of these companies are registered in Guernsey and one in Jersey, and therefore are not subject to UK Company Law. Where these have affected the results of the survey, this has been discussed in more detail below.

Overview

As described in the Deloitte publication “Write from the start”:

- the average length of annual reports for investment trusts was 48 pages. The investment trusts in the top 350 companies had annual reports with an average length of 57 pages;
- financial statements on average made up 37% of the annual report and narrative reporting the remaining 63%;
- the average time taken for investment trusts to approve their accounts was 86 days for those in the smallest 350 companies, 74 days for the middle group and 59 days for those in the top 350 companies; and
- all trusts approved their accounts within the four month limit now coming into force under the DTR for periods beginning on or after 20 January 2007.

Primary statements

Reporting framework

As illustrated in figure 63, 27% of trusts surveyed were parent companies within a group and in preparing consolidated accounts as a listed entity were required to adopt IFRS. Another 13% of the trusts were single entities who chose to adopt IFRS, of which 10% were registered in Guernsey and 3% were incorporated in the UK. The remaining 60% were stand-alone trusts who continued to report under UK GAAP.

The Association of Investment Companies (AIC) issued a Statement of Recommended Practice (SORP) in December 2005, setting out best practice for investment trust companies across a range of accounting issues. The vast majority (87%) of trusts surveyed had prepared accounts in accordance with the SORP in so far as it was practicable. In some instances the SORP and IFRS have contradictory requirements, for example, the SORP requires a reconciliation of movements in shareholders’ funds (RMSF) and a STRGL, whereas IFRS requires a SOCIE. In such cases, companies applied IFRS instead. Further information around the statements disclosing movements in equity is given below.

One venture capital trust applied the SORP despite not being an investment company as defined by the Companies Act 1985. The absence of this status did not preclude it from applying the SORP though and, because of the sector in which the trust was operating, the directors considered it appropriate to present financial statements in this manner. In July this year the AIC issued an exposure draft of a SORP for both investment trusts and venture capital trusts. This revised SORP may also change the requirements around disclosing realised profits and distributable reserves.

Income statement

IFRSs require an “income statement” to be presented as a primary statement, and for those trusts reporting under UK GAAP the SORP also recommends this title. Only two trusts still had a “profit and loss account” instead of an “income statement”. This was however appropriate given that the they were venture capital trusts preparing accounts under UK GAAP and were not applying the AIC’s SORP.
The companies stating that they had applied the SORP presented a revenue, capital and total column on the face as required. 97% of companies presented the return per share at the foot of their income statement and only one company applying the SORP failed to meet the additional requirement to analyse return per share between capital and revenue. Interestingly, 30% of companies referred to this as “earnings per share”.

Unlike the other companies surveyed, none of the investment trusts in the survey stripped out any exceptional items or presented non-GAAP measures on the face of their income statement. The consistency in the presentation of the income statement by the investment trusts population of the survey undoubtedly aided their comparability. The comparability is driven by investment trusts all carrying on business of a similar nature. In addition, the existence of industry-specific guidance in the form of a SORP certainly promotes consistency and best practices for entities. This in turn improves comparability for users of financial statements.

Balance sheet
Aside from two trusts registered in Guernsey, all the trusts presented their balance sheet with current and non-current assets and liabilities categories. The two Guernsey companies simply presented an ‘assets’ category and a ‘liabilities’ category, without distinguishing between current and non-current items or putting them in order of liquidity.

Current and deferred tax balances were rarely disclosed on the face of the balance sheet as required by IAS 1. In a number of cases the balances were immaterial, as franked dividend income received by the trusts from other UK companies has already been taxed at its source and the recipient is not subjected to corporation tax. Capital gains recognised by an investment trust are also not subject to UK corporation tax.

All trusts disclosed their net asset value per share at the foot of their balance sheet, thus fulfilling a requirement of the SORP. Only one company then failed to provide a note to the accounts detailing how the number had been calculated.

Cash flow statement
The cash flow statements presented were relatively consistent across the companies sampled. As expected, all companies showed dividends and interest received as cash flows from operating activities. Where interest was paid, 70% of the trusts disclosed it under the category “Servicing finance” or “Financing” (the relevant headings under UK GAAP and IFRSs respectively) and 30% showed it under operating activities. Where dividends were paid, those trusts reporting under UK GAAP disclosed them as a separate item in accordance with FRS 1 Cash Flow Statements, whilst those reporting under IFRSs classified them under financing activities as permitted by IAS 7.

Other primary statements
As mentioned previously, the SORP states that all companies should present as primary statements a STRGL and a RMSF. Over half the trusts (57%) presented only a RMSF, stating that a STRGL was not required since all gains and losses were already included in their income statement. All the companies preparing accounts under IFRSs had accordingly presented a SOCIE. One company surveyed which reported under UK GAAP failed to disclose a RMSF or a STRGL.

Accounting policies
For the trusts applying IFRSs, 58% met the requirement of IAS 8 to disclose standards and IFRICs in issue but not yet effective. In these cases, all those companies went on to describe whether these new rules and areas of guidance would have an impact on their financial statements. No instances of early adoption of standards, IFRICs or UITFs (for trusts under UK GAAP) were noted.

The description around revenue recognition varied in length and as expected, the largest companies tended to provide the most information. Surprisingly, smaller companies were seen to be providing more detail than medium size companies as illustrated in figure 64 below. 70% of the medium-sized companies were seen to provide less than 50 words on the subject, whereas none of the top 350 or bottom 350 by market capitalisation provided less than 50 words.

Financial instruments
The length of disclosures around financial instruments varied considerably, ranging from one to eight pages in the annual reports surveyed. Given the nature of investment trusts, a reasonable amount of information was expected to be provided in this area. The average length was just under three pages.
90% of companies surveyed provided information around their exposure to interest rate risks in respect of their assets and liabilities. 97% of companies also provided details around their liquidity risk, its management and a maturity profile of their liabilities where borrowings existed. This information was typically well presented in a tabular format, with some companies fulfilling the FRS 29 requirement of including a sensitivity analysis. A good example was Foreign & Colonial Investment Trust PLC as shown below.

There was no evidence that the credit crunch had prompted new disclosures in the notes to the financial statements. 73% of companies had however provided information in the front half of their annual reports regarding the credit crunch and its impact. Some of those companies who did not comment were investing in markets where the credit crunch had not had such a notable impact at that time e.g. Japan. A small number of trusts however did not refer to the credit crunch despite operating in markets that had been impacted.

Only one company surveyed, having followed relevant industry guidance, carried their unlisted investments at cost, although this was subject to impairment. All other companies were recording the investments at fair value, typically considering factors such as the price of similar investments, any recent arms-length transactions, net asset values and earnings multiples.

Other notes to the financial statements
Two of the annual reports included a segmental analysis of the business, both on a geographical basis. In all other instances, such a disclosure was not deemed necessary by the directors, with similar information being provided in the investment analysis typically provided in the front half of the annual report.

Where companies had in place any provisions a description was always given in the notes to the financial statements.

Of those trusts with a summary page towards the start of their annual report, 93% had included a mixture of GAAP measures taken from the primary statements as well as other performance indicators. Typical headline figures included net asset value, revenue and capital returns plus dividends declared. Of those companies who had disclosed GAAP measures, only 35% had adjusted any of those figures, often adjusting borrowings to their fair value instead of their carrying par values. A balance needs to be struck in terms of providing both relevant and transparent information to the users of financial statements and it was interesting to note that the majority of companies appeared content not to adjust their GAAP figures.

Disclosures under the SORP
The SORP sets out a number of disclosures that should be made by investment trusts. As detailed below, adherence to these requirements was particularly strong in some areas but weak in others.
Costs

The allocation of finance costs, investment management fees and any performance-related fees were all examined as part of the survey. The results are as shown in figure 65 below.

Finance costs showed the greatest variation, with 38% allocating the costs solely to the revenue account, whilst 62% allocated it between revenue and capital. Most companies (69%) split investment management fees between the two accounts and in all instances companies detailed their basis for allocation as required by the SORP. 78% of companies allocated any performance fees in their entirety to the capital account, with the remainder splitting it between capital and revenue.

The SORP also states that transaction costs incurred both in acquiring and disposing of investments should be disclosed. Only 57% of trusts included this information in the notes to their accounts.

Reserves

The majority of trusts failed to disclose clearly which of their reserves were distributable and their movements in the year. Only four companies clearly presented this information, another three quoted a total distributable figure at the year-end and the remaining majority did not disclose any information about the total distributable reserves. Whilst clear disclosure of this information is a recommendation of the SORP, it may well be that the trusts presume their readers already know which reserves are distributable. The few trusts that did clearly present this, did so in an efficient manner, providing clarification under their reserves note (which already lists movements in the year) as to which were distributable. All but one of the trusts applying the SORP had as recommended analysed their capital reserves between realised and unrealised, 72% showing this on the face of the balance sheet and the other 28% in the notes to the financial statements.

Investment portfolio

Trusted are required to disclose a broad geographical and industrial analysis of their portfolio under the SORP, specifically listing all investments representing 5% or more of their portfolio and as a minimum their ten largest investments.

Where investing in more than one location and one industry, the SORP’s requirement for a broad geographical and industrial analysis was met in 93% of cases. This included some trusts that were not applying the SORP, but which still believed such information to be useful. All but one of the trusts providing this information disclosed it in the front half of their annual report.

53% of companies disclosed their entire investment portfolio and the remaining 47% all disclosed at least their top ten investments by size. The number of investments disclosed in these cases varied from ten to just over 50 and in most cases still covered the majority of their portfolio. Two companies explained that a full list was too long for inclusion in their annual report, although this information could be found on their website.
Appendix 1 – Top ten audit committee questions on financial statements

Under the Combined Code on Corporate Governance the audit committee has a number of duties, one of which is responsibility for monitoring the integrity of the financial statements of the company. Audit committee members may wish to consider the following questions on financial statements to satisfy this duty.

Compliance
1. Are you aware of the standards and interpretations applicable to your company now and in the foreseeable future?

As discussed in chapter 3, financial reporting requirements continue to grow in number and complexity. The period of stability which the IASB introduced following the transition to IFRS in 2005 is now over and there are a number of significant changes to standards on the horizon. It is important to understand which standards currently apply to your company and the impact of those in issue but not yet effective.

Length of financial statements
2. Are you presenting the required information in a succinct and informative way?

It may be tempting for companies to meet increasing disclosure requirements by including standardised ‘boiler plate’ wording. However, this does not facilitate a user’s understanding of the performance and position of the business. The FRRP encourages the deletion of redundant information. The numbers in the financial statements should be presented in a format that is easy to understand. The accompanying narrative should be specific and relevant to the individual company. The information provided should be comprehensive but concise.

Primary statements
3. Does the presentation of the primary statements provide readers with readily understandable and comparable information? Are any non-GAAP measures clearly identified, justified and defined?

Many companies consider measures, such as operating profit before exceptional items, relevant to understanding their business. Additional non-GAAP measures on the face of the income statement should be presented clearly and the reason why such a presentation is relevant to an understanding of the entity’s financial performance should be given. Non-GAAP measures should be presented consistently year on year so that the company’s results are comparable in all periods presented. Regardless of which additional non-GAAP measures are presented, companies should ensure that the minimum requirements of IAS 1 are met.

Accounting policies
4. Are the accounting policies disclosed relevant and tailored to your company?

As discussed above, it is important that disclosures are not ‘boiler-plate’ and refer to the specific issues faced by the individual company. In its 2008 activity report the FRRP has commented that “directors will need to pay particular attention to disclosure of key assumptions and key sources of estimation uncertainty used in preparing your financial statements been adequately considered and disclosed?”

5. Have the critical judgements and key sources of estimation uncertainty used in preparing your financial statements been adequately considered and disclosed?

The description of the revenue recognition policy should be sufficient to ensure that users understand the bases of recognition for each significant revenue stream. There should be consistency between a company’s business model, as discussed in the narrative sections, and the range of goods and/or services for which revenue recognition policies are disclosed in the notes to the financial statements. This is of particular importance in the current economic environment. For example, the FRRP has highlighted that “uncertainties about changes in market and other conditions will require some companies to consider whether revenue should be deferred due to an unacceptable level of uncertainty about the reliability of measurement”.

6. Does your revenue recognition policy clearly explain how revenue is recognised in your business?

Many companies in the survey failed to comply clearly with straightforward disclosure requirements, in particular, providing descriptions of provisions and reserves. It is important that all material balances are described in sufficient detail to enable users to understand the impact of particular transactions, other events or conditions on the entity’s financial position or performance.

Notes to the financial statements
7. Are all material balances in your financial statements clearly described?

As discussed above, it is important that disclosures are not ‘boiler-plate’ and refer to the specific issues faced by the individual company. In its 2008 activity report the FRRP has commented that “directors will need to pay particular attention to disclosure of key assumptions and key sources of estimation uncertainty used in preparing your financial statements been adequately considered and disclosed?”
8. Is there adequate disclosure of the risks that arise from financial instruments and how they have been managed?

IFRS 7 requires disclosure of information around the nature and extent of risks arising from financial instruments to which the company is exposed at the reporting date. These risks typically include credit risk, liquidity risk and market risk. In the current economic climate it is even more important that disclosure is sufficient to understand the risks attached to financial instruments.

True and fair view

9. Do the financial statements give a true and fair view?

Directors should satisfy themselves that, from an overall review of the financial statements, no material information is missing and the financial statements they approve are appropriate. The continued relevance of the ‘true and fair’ concept to the preparation and audit of financial statements was confirmed by a legal opinion in May this year. The conclusion that the financial statements show a true and fair view should not solely be based on compliance with applicable accounting standards but should also consider their overall integrity.

Auditors’ report

10. Are you receiving a modified audit opinion and if so do you understand why? Can the area of non-compliance be addressed for future financial statements?

In June 2008 the FRRP announced its interest in company accounts which are qualified by their auditors for breach of accounting requirements, on the basis that the financial statements may not be properly prepared in accordance with the law nor give a true and fair view. Directors who presently prepare accounts that do not comply with the law are encouraged to address the non-compliance so that neither the audit qualification nor an FRRP enquiry is necessary in future. Where a listed company has chosen to produce a preliminary announcement, this must include details of any likely modification to the audit opinion in the annual report.
Appendix 2 – Glossary of terms and abbreviations

**AIC** Association of Investment Companies
The Association of Investment Companies is the trade organisation for the closed-ended investment company industry. Amongst other initiatives, it provides technical support and guidance to members and their advisers in areas such as accounting, tax, company law and regulation.

**ASB** Accounting Standards Board
The role of the Accounting Standards Board is to issue UK accounting standards. The ASB also collaborates with accounting standard-setters from other countries and the International Accounting Standards Board (IASB) both to influence the development of international standards and to ensure that its standards are developed with due regard to international developments.

**CGU** Cash generating unit

**DTR** Disclosure and Transparency Rules
These rules, which include requirements for periodic financial reporting, replace some of the Listing Rules and have been inserted into the Disclosure Rules handbook of the Financial Services Authority (FSA). The periodic financial reporting rules of DTR 4.1 apply to companies with shares and/or debt admitted to trading on a regulated market for periods commencing on or after 20 January 2007. The corporate governance requirements of DTR 7 apply to the same companies for periods commencing on or after 29 June 2008.

**EBITA** Earnings before interest, tax and amortisation
**EBITDA** Earnings before interest, tax, depreciation and amortisation

**EBR** Enhanced Business Review
It is a requirement of the Companies Acts 1985 and 2006 that directors’ reports include an Enhanced Business Review. This includes a fair review of the business and a description of the principal risks and uncertainties facing the company.

**EPS** Earnings per share
Basic earnings per share shows the profits attributable to ordinary equity holders of the parent during the period. Diluted earnings per share adjusts this measure by assuming all dilutive potential ordinary shares were converted to ordinary shares.

**EU** European Union

**FASB** Financial Accounting Standards Board
The body responsible for establishing financial accounting and reporting standards in the USA.

**FRRP** Financial Reporting Review Panel
The body in the UK responsible for monitoring public and large private companies’ compliance with accounting standards.

**FSA** Financial Services Authority
The Financial Services Authority is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. The FSA regulates the financial services industry in the UK and acts as the competent authority for setting and enforcing the rules applicable to listed companies and those admitted to trading on a regulated market.

**FTSE** Financial Times Stock Exchange top 100/350 companies (share index)

**GAAP** Generally accepted accounting practice

**IAS** International accounting standard

**IASB** International Accounting Standards Board
The International Accounting Standards Board is an independent body that issues International Financial Reporting Standards.

**IFRIC** International Financial Reporting Interpretations Committee
The International Financial Reporting Interpretations Committee develops interpretations of IFRSs and IASs and provide timely guidance on financial reporting issues not specifically addressed by existing standards.

**IFRS** International Financial Reporting Standard

**Listed company**
A company, any class of whose securities is listed (i.e. admitted to the Official List of the UK Listing Authority).

**Market capitalisation**
A measure of company size calculated as share price multiplied by the number of shares in issue at a certain point in time.

**PPE** Property, plant and equipment

**Regulated market**
Regulated market is defined in the Markets in Financial Instruments Directive. The European Commission website also includes a list of regulated markets at:
http://ec.europa.eu/internal_market/securities/isd/index_en.htm

**RMSF** Reconciliation of movements in shareholders’ funds
How can we help?

Deloitte would be pleased to advise on specific application of the principles set out in this publication. Professional advice should be obtained as this general advice cannot be relied upon to cover specific situations; application will depend on the particular circumstances involved. If you would like further, more detailed information or advice, or would like to meet with us to discuss your financial reporting issues, please contact your local Deloitte partner or:

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RS The Reporting statement: Operating and Financial Review
A statement of best practice on OFRs published by the ASB in January 2006.

SOCIE Statement of changes in equity

SORIE Statement of recognised income and expense

SORP Statement of Recommended Practice
A statement setting out recommendations, intended to represent current best practice, on the form and contents of financial statements.

Stock Exchange London Stock Exchange

STRGL Statement of total recognised gains and losses

UITF Urgent Issues Task Force
The UK equivalent of IFRIC which assists the ASB in interpreting existing standards under UK GAAP

UKLA UK Listing Authority
The FSA acting in its capacity as the competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000.
Partners who can assist in dealing with these issues are set out below:

<table>
<thead>
<tr>
<th>Category</th>
<th>Partner</th>
<th>Telephone number</th>
</tr>
</thead>
<tbody>
<tr>
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Alternatively, please contact your local office.

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<tr>
<th>Location</th>
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Please also refer to our website www.deloitte.co.uk
Other Deloitte publications

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Write from the start – Surveying narrative reporting in annual reports
This publication looks at what listed companies are reporting in the narrative sections in their annual reports. The 2008 survey builds on those performed between 1996 and 2007 and includes an overview of current regulatory requirements and latest developments, as well as “best practice” examples. This year there has been an increase in both the size of the sample (with separate consideration of investment trusts) and the scope of the survey, which now includes a review of corporate governance statements.

First ImpressionS – The first year’s interim management statements
This publication considers how UK listed companies have implemented the new requirements for a twice-yearly interim management statement (IMS) in the first year of compliance with the Disclosure and Transparency Rules (DTR). In particular, it surveys interim management statements of UK listed companies (including separate consideration of investment trusts), reviews compliance with the new rules and compares the findings to the 2007 Deloitte publications “Early Learning” and “Early Learning II”. It also contains an illustrative IMS, an IMS disclosure checklist containing all the requirements and three example IMSs.

Half a story – Surveying the first half-yearly financial reports under the new rules
This publication considers the new Disclosure and Transparency Rules (DTR) and their impact on half-yearly reporting by UK listed companies. The publication surveys the half-yearly financial reporting practices by UK listed companies, reviewing compliance with the new rules and IAS 34, including comparisons to the 2007 Deloitte publication “Clear all year”. It also contains an illustrative half-yearly financial report and a half-yearly financial report disclosure checklist containing all the requirements.

CompAct – Q&As on the 2006 Companies Act
This publication sets out the key areas of change in the new Act and provides answers to almost fifty questions on the detail contained within it. In particular the publication covers the new rules in the following areas:
- Directors’ duties
- Shareholder rights
- Electronic communications
- Derivative claims
- The Business Review
- Voting of institutional shareholders
- Private company deregulation
- Directors’ liability provisions

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Right to the end
Surveying financial statements in annual reports

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