Top of mind topics for board members
2017 Annual Reports
Deloitte Financial Reporting plus
Now that 2017 is drawing to a close, for companies with a calendar year end, astute board member thoughts may be turning to supporting management’s efforts in preparing a top class annual report that delivers the organisation’s key messages clearly and effectively. It is clear that disclosure expectations are increasing and directors should challenge bland and generic disclosures which are unchanged from the prior year, out of date, or irrelevant. Disclosures need to be company specific and year specific.

In this short “Top of Mind” briefing Deloitte identifies some potential key areas of focus for 2017 including:

Brexit
It remains difficult for most reporters to be very specific regarding the probable impact of Brexit on their business. Nonetheless it is important that the board challenges management to keep these disclosures current.

Assessment of the risks and ongoing uncertainties regarding the effects of the EU referendum, making appropriate disclosures to reflect the latest analysis and how this has developed over the year will be key activities once again this year in the preparation of annual reports.

Viability statements
The Investment Association encourages companies to separate prospects from viability and differentiate the time horizons used for those assessments: “It is helpful if the disclosures around prospects address the long-term strategic plans and look longer than the period over which viability is assessed... Investors want companies to give them an insight into their plans for the future which may be separate from the plans that support the viability statement. To facilitate this directors may wish to consider separating their assessment of prospects from their assessment of viability. The former then gives them the opportunity to demonstrate that they have considered the future of the business over the long-term.”

Reporting on longer term prospects and viability in two stages was envisaged in the original guidance however describing prospects over the business and investment cycle is a challenge, but presents the opportunity to comment on positioning against industry trends and draw out other, longer-term, company-specific matters, such as technology disruption, pension funding and the like. Careful thought will be needed to navigate between inadvertent assurances about the future but also to avoid generic, bland disclosures.

Practical guidance from the FRC's Financial Reporting Lab is expected shortly with examples of how the two stage process can be sensibly applied in annual reports.

**Alternative Performance Measures**

Investors focus on these measures for insight into how management are running the business and our surveys show that they do like them. Compliance with the ESMA guidelines on APM is a tick box exercise for management, however will your annual report get the balance right between IFRS measures and APMs? IFRSs have been carefully developed over many years and are well accepted as the orthodox measure of business performance and condition. Could your APMs be sending out the wrong message? Should the annual report provide clearer and more concise explanation to justify any APMs provided – highlighting in particular how management use the APMs to measure performance against strategy?

**Linkage**

Investors report that they are very often frustrated by annual reports not having clear messaging and not being able to find the information they require.

In terms of messaging investors want to see clear linking in the front half of the report between the business model, the strategy that drives that model, the key risks and uncertainties to achieving that strategy; the KPI measures used to quantify the achievement of strategy and performance against risks and how remuneration and achievement of strategy and KPIs are linked.

**New non-financial statement**

For accounting periods commencing on or after 1 August 2017² certain listed companies with more than 500 employees are required to include a “non-financial statement” in the directors’ report or as a separate statement, if certain conditions are met.

Note that these requirements apply to 2017 annual reports of UK companies with calendar year ends. This statement is to include, by force of law, (as opposed to Corporate Governance Code):

- a brief description of the applicable company’s business model;
- an analysis of non-financial key performance indicators;

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² The EU's non-financial reporting directive was transposed into Irish law by the European Union (Disclosure of Non-Financial and Diversity Information by certain large undertakings and groups) Regulations 2017 (S.I. 360 of 2017)
information, to the extent necessary for an understanding of the development, performance, position and impact of its activity relating to, at least, the following matters:

i. environmental matters;
ii. social and employee matters;
iii. respect for human rights;
iv. bribery and corruption,

this information to include:

• Description of policies
• Due diligence processes
• Outcomes of those policies

Principal risks linked to the applicable company’s operations including, where relevant and proportionate—

i. its business relationships, products or services which are likely to cause adverse impacts in those areas, and
ii. how those risks are managed.

If a company does not have a policy in relation to the matters above a clear and reasoned explanation is required.

While the law includes a “seriously prejudicial” exemption in relation to the above information, the fact that such information has been omitted and the reason for such omission are required disclosures.

The law also requires that the Corporate Governance Statement includes a diversity report giving:

A. a description of the diversity policy applied in relation to the company’s board of directors with regard to aspects such as age, gender or educational and professional backgrounds,
B. the objective of that diversity policy,
C. how that diversity policy has been implemented by the company, and
D. the results of that policy in the financial year.

Better reporters could integrate the non-financial statement disclosures within the business model disclosures and consider making them in their 2017 annual report. Given the emphasis on diversity and respect in the workplace in the wider media in recent times, management could be well advised to consider making these disclosures in the 2017 annual report.

The likely impact of new IFRS accounting standards

Implementation of IFRS 9 “Financial Instruments” and IFRS 15 “Revenue from contracts with customers” should be well advanced and IFRS 16 “Leases” permits early adoption alongside IFRS 15 from 1 January 2018. All three standards have been endorsed for use in the EU.

Investors and Accounting Regulators will be looking for clear disclosure in the 2017 annual report with reference to the company’s existing accounting policies, including detailed quantitative disclosures supported by good explanations of the company’s analysis, particularly for IFRS 15 and IFRS 9. While
somewhat generalised descriptions may have been accepted in the past, investors and regulators have an expectation that the 2017 annual report disclosures will be specific to the company’s circumstances and transactions and describe key judgements management will need to make in transitioning to and implementing the standards on an ongoing basis.

**Anticipated developments in guidance**

We anticipate that the FRC will publish updated Guidance on the Strategic Report for UK companies in the first half of 2018 with a view to encouraging companies to include information that is material to the long-term success of the company, even where this goes beyond the legal requirements.

Best in class reporters may wish to ensure the narrative in the front of their annual report have clearly addressed the areas for enhanced disclosures we anticipate the FRC to highlight, including:

- providing better information on how boards have fulfilled their duty when taking decisions to promote the long-term success of the company;
- how they engage with key stakeholders;
- how the allocation of resources will support the achievement of their strategy; and
- disclosing sources of value or intangible assets and how those sources of value are managed, sustained and developed, whether or not they are recognised under traditional accounting requirements.
**Financial statement disclosure matters**

Areas that involve considerable thought and judgement are worthy of scrutiny by directors and include:

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<th>Area of focus</th>
<th>Description</th>
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<td>Statement of cash flows</td>
<td>Amendments to IAS 7 Statement of Cash Flows were effective 1 January 2017 – requiring an explanation of changes in a company’s financing obligations over the period (e.g. a net debt reconciliation).</td>
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<td>Investors are seeking clearer reporting on the use of financing facilities such as invoice discounting arrangements. There is concern that lack of disclosure may hide a company’s reliance on this type of facility, especially where customer receivables are derecognised.</td>
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<td>Dividends</td>
<td>Further reporting on the capacity to pay dividends is encouraged, including any restrictions on profit distributions by subsidiary companies.</td>
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<td>The FRC’s Financial Reporting Lab issued a recent report on dividend disclosures and noted some improvement in FTSE 100 reports.</td>
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<td>Critical judgements and estimates</td>
<td>Critical to explain key judgements in management’s accounting policy decisions and the extent to which assets and liabilities may change in the following year.</td>
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<td>Company-specific disclosures should be provided, with granular information about a smaller set of judgements and estimates that had a significant impact on results.</td>
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<td>This year, more companies heeded the FRC’s call to clearly distinguish critical accounting judgements from key sources of estimation uncertainty, which have often mistakenly been merged together, despite IAS 1 requiring separate and different disclosure for each.</td>
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<td>FRIC 23 makes clear that uncertain tax positions may fall within these IAS 1 required disclosures. Disclosures in IAS 1 on estimation uncertainties are triggered only where there is a significant risk of a material adjustment to the carrying amount of assets and liabilities within the next financial year.</td>
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<td>Accounting policies</td>
<td>Accounting policies should be properly tailored to a company’s circumstances, for instance, revenue policies covering each significant business stream.</td>
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<td>Business combinations</td>
<td>Focus on impact of contingent and deferred consideration arrangements, in particular clarity of disclosure around estimation and assumptions.</td>
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<td>Concern over sufficiency of disclosure where few or no intangible assets, other than goodwill, were recognised in acquisition accounting.</td>
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<td>Pensions</td>
<td>The current low interest rate environment continues to require transparency on pension arrangements and valuations.</td>
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<td>This includes a need for informative explanations of deficit funding arrangements, risk management strategies and scheme assets.</td>
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