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The Deloitte Academy
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Governance in brief

FRC issues advice on annual reports for 2019/20 reporting season

Headlines

- The FRC has issued its Annual Review of Corporate Reporting and annual open letter to Audit Committee Chairs and Finance Directors covering its perspectives on key developments and areas of focus for 2019/20 annual reports. The report was referred to as setting out the FRC's "expectations for corporate reporting to improve trust in business", emphasising the annual report being a vehicle of trust and stewardship.
- Key areas for this year's annual reports include:
  - the new Section 172 report;
  - environmental disclosures, including reporting on climate risk;
  - disclosure of critical judgements and estimates;
  - responding to heightened levels of risk as a result of continuing uncertainty;
  - planning for the transition to reforms of interest rate benchmarks;
  - presenting a compliant cash flow statement;
  - transparency of supplier financing arrangements;
  - application of the ESMA Guidelines for reporting Alternative Performance Measures;
  - impairment of non-financial assets; and
  - implementation of new accounting standards (IFRS 15, IFRS 9 and IFRS 16).
- More comment to follow later this year on expectations for reporting on the 2018 UK Corporate Governance Code.

Strategic report

The first area covered by the FRC in its letter, separated from other financial statement disclosure matters, is a reminder to preparers that the strategic report provides an opportunity to provide users with a holistic narrative explaining and supplementing key information in their financial statements.

Non-financial information statement

The statement should be separately identifiable but can cross-refer to where the required disclosures are provided within the strategic report. These include clear description of the company's policies, any due diligence processes implemented in pursuance of those policies and their outcomes in respect of environmental, social, anti-corruption and anti-bribery matters, employees and respect for human rights.

Section 172 report

For periods commencing after 1 January 2019, boards are required to include a further statement within their strategic report, describing how they have had regard to a number of factors when working to promote the success of their business. Broadly, these include the likely consequences of any decision in the longer term, the interests of stakeholders such as employees, suppliers and customers, the impact of the company's activities on the community and the environment, the desirability of high standards of business conduct and the need to act fairly as between members of the company.

Boards are encouraged to disclose:

- the issues, factors and stakeholders that they consider relevant in complying with s172(1) and the basis on which they came to that view;
- the main methods they have used to engage with stakeholders and to understand the issues to which they must have regard; and
- information about the effect of that regard on the company's decisions and strategies during the financial year.

The FRC has drawn out a specific example of reporting on how payment to suppliers is in line with the BEIS response to their call for evidence 'Creating a Responsible Payment Culture'.

Environmental disclosures, including reporting on climate change

In July, the Government published its Green Finance Strategy which sets the direction for climate change regulation and action: large asset owners and listed companies are expected to report in accordance with the requirements of the Task Force on Climate-Related Financial Disclosures ("TCFD") by 2022.

While there are many reporting requirements that may require companies to address climate-related issues, including the 2018 UK Corporate Governance Code, currently in the UK there is no specific requirement to report on the potential impact of climate change on their operations.

The FRC's Financial Reporting Lab ("the Lab") published a report on climate change in October 2019, which aims to reflect the views of investors on existing reporting by companies and to help companies move towards more effective and comprehensive reporting. Rather than creating a separate framework, the Lab report is structured around the TCFD framework and thus covers the following areas:

- The organisation's governance around climate-related risks and opportunities;
- The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning. Note that the FRC expects companies to disclose risks that extend beyond the period covered in their viability statement;
- The processes used by the organisation for identifying, assessing and managing climate-related risks and how they are integrated into the organisation's overall risk management; and
- The metrics and targets used to assess and manage climate-related risks and opportunities in line with its strategy and risk management process.

Other topical areas of reporting for attention

Area of focus	Description
Critical judgements and estimates	• More companies this year made a clear distinction between judgements and estimates. However the following points should be considered: – sufficient disclosure where a particular judgement has significant impact on the reporting, for example, whether a specific investment should be consolidated; – clear disclosure of the sensitivity of carrying amounts to the assumptions and estimates underlying a measurement calculation, or, if more meaningful, disclosure of the range of reasonably possible outcomes within the next year in respect of the carrying amounts of the relevant assets and liabilities; and – voluntary, additional disclosures to be provided in respect of estimation uncertainty, for example, where the impact of any possible material change in estimate is not anticipated to have effect until a period outside the twelve-month window required by the standard.
2019 year-end reporting environment	• Companies are expected to consider carefully the details provided in those areas of the reports which are exposed to heightened levels of risk; for example, going concern considerations, the impact of Brexit and all other areas of material estimation uncertainty.
Reforms of interest rate benchmarks	• The recent amendments to IFRS 9 Financial Instruments and IAS 39 Financial Instruments: Recognition and Measurement impact this season's year-end reporting and reflect global reforms of interest rate benchmarks, such as LIBOR. The future of a number of these benchmarks beyond 2021 is not clear: – boards must reach their own judgement as to whether the level of this uncertainty is so high that the conditions for hedge accounting are not met; and – companies which are a party to contracts referencing LIBOR, or any other rate subject to the reforms, should start planning now for the transition to new rates, including early consideration of the need to re-negotiate relevant contracts and agreements.
Cash Flow Statements	• In order to improve the reliability of cash flow reporting companies should: – follow the detailed requirements of IAS 7 Statement of Cash Flows and ensure robust pre-issuance review in order to avoid basic errors, in particular, misclassification of cash flows which is evident from the face of the financial statements; and – disclose and explain where a genuine material judgement has been made regarding cash flow presentation.
Supplier financing arrangements	• There remain concerns about the level of disclosure around supplier financing arrangements. Companies should disclose whether and, if so, the extent to which, they enter into this type of arrangement. This point was also raised in the FRC Financial Reporting Lab report on 'Disclosures on the sources and uses of cash'; • Companies are encouraged to disclose explicitly that they don't use such arrangements in industries where their usage is more common.
Alternative performance measures ("APMs")	• All companies that report APMs should apply the Guidelines produced by ESMA. In particular: – explanation and meaningful definition of APMs; and – reconcilation to the closest equivalent IFRS line item.
Impairment of non-financial assets	• In relation to the impairment of non-financial assets, the following expectations have been set: – clearly identify and quantify the key assumptions used in the cash flow projections, not just the discount and long-term growth rates; – explain the process by which the board determined those key assumptions; – describe the changes in key assumptions that management thinks reasonably possible and the impact of these changes if they would reduce headroom to nil or give rise to potential material adjustment to its carrying value; and – perform an impairment review where a parent company's investment in subsidiaries exceeds the market capitalisation of the group.

Area of focus	Description
IFRS 15 Revenue from Contracts with Customers	• All companies should seek to benchmark the quality of disclosures and focus on greater clarity and transparency by addressing the following expectations: – the accounting policy should identify the specific nature of performance obligations and explain the point at which they are satisfied; – the accounting policy should clearly set out when revenue is recognised in respect of all material revenue streams; – specific judgements which have a significant impact on the amount or timing of revenue recognition should be disclosed; – estimation uncertainties relating to revenue should be quantified, and provide sensitivities or ranges of outcomes; and – significant movements in contract assets and liabilities should be explained.
IFRS 9 Financial Instruments	• Banks are expected to: – adequately explain the triggers for any significant increase in credit risk and default; and – when considering forward looking information, quantify the most significant economic assumptions. • Non-banking companies are expected to: – ensure that the description of the business model adequately explains and supports the hold to collect model; – remove all old IAS 39 Financial Instruments: Recognition and Measurement terminology from the disclosures; – ensure that accounts reflect the fact that the scope of the impairment requirements includes, for example, IFRS 15 contract assets, lease receivables and also applies to loans to subsidiaries and other undertakings in the individual parent company accounts; and – if relevant, explain why the impact of IFRS 9 Financial Instruments is not material, particularly where significant financial instruments are recognised in the accounts.
IFRS 16 Leases	• As IFRS 16 is effective for periods beginning on or after 1 January 2019, companies are required to provide: – clear explanation of the key judgements made in response to the new reporting requirements; – effective communication of the impact on profit and loss, addressing any lack of comparability with the prior year; – clear identification of practical expedients used on transition and accounting policy choices; and – well explained reconciliation, where necessary, of operating lease commitments under the previous leasing standard and lease liabilities under IFRS 16.

For further information:
The CRR Annual Report, the FRC's letter and press release are available at: https://www.frc.org.uk/news/october-2019/frc-sets-out-expectations-for-corporate-reporting

FRC Thematic Review – Impairment of non-financial assets: https://www.frc.org.uk/getattachment/4daee650-59fe-43b0-904c-ba9abfb12245/CRR-Thematic-Review-Impairment-of-Non-financial-Assets-final.pdf

FRC Financial Reporting Lab – Performance metrics – Principles and Practice: https://www.frc.org.uk/getattachment/e94631d1-69c1-4349-8ce5-780d4eca455f/LAB_Reporting-of-performance-metrics_June-2018.PDF

FRC Financial Reporting Lab – Climate-related corporate reporting: https://www.frc.org.uk/getattachment/85121f9f-15ab-4606-98a0-7d0d3e3df282/FRC-Lab-Climate-Change-Final.pdf

ESMA guidelines on alternative performance measures are available at: https://www.iasplus.com/en/news/2015/06/esma-apm

Deloitte's Annual Reporting Insights 2019: www.deloitte.co.uk/annualreportinsights

Deloitte view

- We welcome publication of this advice for Audit Committee Chairs and Finance Directors, as there is much to consider this year, including the new section 172 statement.
- This advice provides a timely reminder for audit committee agendas for the period ahead which continues to hold much uncertainty. The document is much more detailed than in prior periods – this and the tone leave no doubt over the messaging.
- Whilst disclosure expectations have been increasing over recent years, and continue to increase, audit committees should take note of the FRC's message around the provision of adequate and transparent disclosure, particularly in relation to key judgements and areas of estimation uncertainty.
- Reporting on the impact of climate change continues to increase in importance and there is now a clear expectation that companies make steps towards adoption of the TCFD framework.

The Deloitte Academy

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For further details about the Deloitte Academy, including membership, please email enquiries@deloitteacademy.co.uk.

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