



Governance *in brief* FRC publishes 2015 Corporate Reporting Review and areas of focus for the coming reporting season

Headlines

- Findings from the review:
 - The quality of UK corporate reporting, especially from large public companies, continues to be good.
 - There is concern regarding the assessment of materiality by boards, both for accounting and disclosure: The FRC expects boards to consider what investors would believe to be material.
 - There has been a positive response from most FTSE 350 retailers and their suppliers to the FRC's Press Notice calling for enhanced disclosures around complex supplier arrangements, although there remains scope for more transparency in this area.
- The FRC is keen to see more companies performing a "Clear and Concise" review of their public reporting and adopting changes to make their annual reports easier to read and more transparent to users.
- It is clear that the CRR's reviews are becoming increasingly sophisticated and are drawing on many sources of information when they consider the disclosures made in the annual report. This re-emphasises the need for boards to consider carefully the story being told and whether it is consistent throughout the annual report and with other announcements made and information presented, for example, on the company website.

Quality of corporate reporting

The FRC's Corporate Reporting Review (CRR) annual report, published on 22 October 2015, covers activities for the year ended 31 March 2015. It is written for those with board-level responsibility for preparing the annual report. The CRR team reviewed 252 annual reports and wrote to 76 companies (30% of those reviewed) seeking additional explanation or information. This level of additional enquiry is 7% lower than in 2014. Over 90% of cases were closed in the reporting year.

Six companies made a Committee Reference in the annual report where they made a change following the CRR's communications, providing as required, public evidence of the Conduct Committee's engagement with a company. Just three company-specific Press Notices were issued as a result of restatements.

One generic FRC press notice was issued during the year, relating to complex supplier arrangements and the level of transparency of the relevant accounting judgements in the financial statements. A review conducted of FTSE 350 retailers and their suppliers during the year determined that most companies had responded positively and there was a general improvement in disclosures.

The quality of reporting by smaller listed and AIM quoted companies continues to be more variable and the FRC issued a consultation paper earlier in the year to highlight the issues these companies face in improving their reporting. Concerns centre around judgemental areas, including complex transactions and management estimates, and a lack of transparent disclosure – some companies "fail to explain their story".

Common findings from the review

There were ten areas of corporate reporting raised frequently with companies during the year, on substantially similar themes to the areas raised most frequently in 2014. For all of these, but especially where boards and audit committees conclude on accounting errors or omitted disclosures, the FRC calls for detailed and appropriate consideration of materiality and transparent reporting by boards, with particular focus on items that could be qualitatively material for investors or other users of financial statements.

- **Strategic reports** should be fair, balanced and comprehensive, with suitable prominence given to IFRS measures alongside alternative performance measures. Boards are encouraged to focus on disclosures that are relevant to investors and not include extraneous material in their reports. Disclosures should be consistent with and reflect the company's business model and any unusual or non-recurring items should be explained.

- Completeness of **accounting policies**, which should include policies for all material transactions, including unusual or company-specific transactions, avoid the use of jargon and provide clear disclosures on development cost capitalisation, where relevant. Again, consistency with the business model was raised. For example, if the business model includes distinct and significant revenue streams, the FRC would expect to see accounting policies relevant to each revenue stream.
- **Critical judgements** made by the board in applying accounting policies should be explained clearly and judgements areas should be identified separately from accounting estimates. The quality of narrative disclosure in the accounts should be as high a standard as the quality of discussion around significant issues in the Audit Committee report.
- Cutting clutter is a serious area of focus for the FRC and companies should not include irrelevant information in the accounts. Many companies would benefit from a specific “**Clear and Concise**” review. When considering clear and concise reporting, boards should consider the investor and stakeholder perspective.
- The purpose of **business combinations** should drive the identification of separate intangible assets. Boards need the right level of resource and expertise to identify and measure intangible assets arising from business combinations and the FRC recommends that companies should consider using external advisors for support.
- **Exceptional and similar items** are still a common finding – as before, this year the CRR also identified inconsistent presentation of non-recurring expense and income, the absence of accounting policies for exceptional items and the same “non-recurring” items arising in consecutive years.
- **Revenue** is a key area of focus for investors and some companies continue to have boilerplate accounting policy disclosures that do not address all material revenue streams described in their business model descriptions. A common finding is inadequate explanation of how companies estimate the stage of completion of long-term contracts.
- On **pension accounting**, policies have been found unclear and areas of focus included the disclosure of the accounting judgements made when assessing trustees’ rights and disclosure of sensitivity analysis.
- On tax, disclosures around the reconciliation between a company’s notional and effective tax rate need to be enhanced as well as **tax accounting** on share-based payments.
- The Cash Flow Statement receives continued focus, including the classification of **cash flows** as operating, financing or investing and inappropriate netting of cash flows.

This year the CRR has prepared a more detailed technical presentation on issues arising from the year’s reviews which is available on the FRC’s website.

Areas of future focus

The corporate reporting environment is mature, with few new standards being introduced and boards are largely familiar with IFRS requirements and application. The 2016 reporting season areas of focus will be driven by macro-economic factors, including:

- Volatility in commodity prices and in equity and bond markets which may affect **asset valuations**, including appropriate disclosures of measurement sensitivity and impact on goodwill impairments in certain industries.
- Global and national focus on taxation could increase **tax uncertainties**, leading to an increasing focus on disclosure of accounting policies, tax risks and tax estimates.

There will also be focus on evaluating significant accounting judgements that are specific to each company and are important to investors. Boards are also encouraged to consider both the quantitative and qualitative aspects of materiality and whether issues are relevant to investors even if they do not meet a quantitative threshold.

Good practices when receiving a CRR letter

The CRR have suggested some good practices which assist CRR companies and the CRR team in addressing the matters raised promptly and effectively:

- Acknowledge receipt of the letter and tell the Conduct Committee when a substantive response will be sent – ideally this should be within 28 days of receiving the letter. This year the average time to respond to the initial letter was 36 days.

- Volunteer all information that is directly relevant to an issue early in the correspondence – for instance, providing a relevant Board paper with an initial submission may reduce the duration of the enquiry.
- Involve the auditor and bring audit firm representatives along with company representatives to meetings with the Conduct Committee – this can be helpful in facilitating the discussion and ensuring the auditors are in agreement with any proposed changes to future reporting.
- Take responsibility for all information in the annual report and accounts, even where an external service provider has acted as expert or prepared disclosures.
- Where companies are based overseas, the UK-registered office should have a process to ensure correspondence from regulators is shared promptly.

For further information

The Corporate Reporting Review annual report is available on the FRC’s website: <https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf>

A report on the Technical Findings of the Conduct Committee’s Financial Reporting Review Panel is available here: <https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Technical-Findings-of-the-Conduct-Committee-s-Fina.pdf>

FAQs – “My company has received a corporate reporting review letter” is available at: <https://www.frc.org.uk/Our-Work/Conduct/Corporate-Reporting-Review/FAQs/FAQs-My-company-has-received-a-corporate-reporting.aspx#Review5>

Deloitte View

- The CRR report is the usual helpful reminder as we approach the year end reporting season.
- Remember, that although not singled out in this report, the disclosures around risk management and longer term viability will be new this reporting season and will also attract FRC focus in the coming year.

Join us at the Deloitte Academy to debate emerging issues live

Located in Stonecutter Court (EC4A 4TR), the Deloitte Academy has been designed to provide support and guidance to boards, committees and individual directors through a series of briefings and bespoke training. The briefings and training workshops help directors both to stay up to date with the changing regulatory environment and to meet their everyday business challenges. They also provide directors with the opportunity to discuss and debate matters with their peers.

Membership of the Deloitte Academy is principally for board directors of the FTSE 350.

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

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