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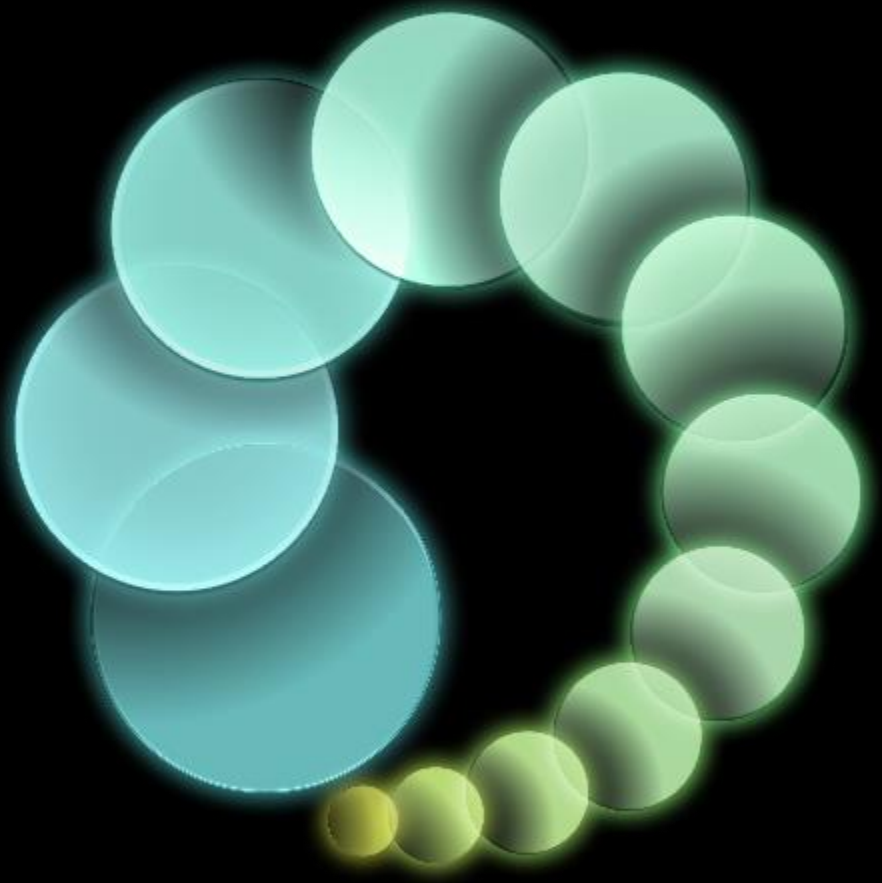


Deloitte Finance Club
Winter Technical Update 2018

13 November 2018

Deloitte Finance Club

Winter Technical Update

Agenda

• Opening remarks	Tom Murray
• Year-end hotspots	Peter Westaway
• Corporate governance	Corinne Sheriff
• Narrative reporting developments	Amanda Swaffield
• Remuneration	David Cullington
• IFRS 16	Lucy Newman
• UK GAAP	Amanda Swaffield
• Closing remarks	Tom Murray

Opening remarks

Tom Murray

Year-end hotspots

Peter Westaway

Newly effective IFRSs for December 2018 year-ends

- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers (including subsequent clarifications)
- IFRIC 22 Foreign Currency Transactions and Advance Consideration
- IFRS 2 Amendments – Classification and Measurement of Share-based Payment Transactions
- IFRS 4 Amendments – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts
- IAS 40 Amendments – Transfers of Investment Property
- 2014-16 Annual Improvements – IFRS 1 and IAS 28 Amendments

Disclosure of the adoption of IFRS 9 Financial Instruments

New accounting policies

- Description new policies applied on adoption
- Avoid boiler-plate
- Where relevant/material explain clearly:
    - ECL models (even application of provision matrix)
    - C&M models (e.g. business model assessment)
    - Relevant policy choices that have been applied
    - Use of practical expedients such as the low credit risk exemption.

Quantification of impact on transition

- Changes in the classification/measurement:
    - Tabular format (narrative may have been used for interims)
    - Explain assessments/rules that result in reclassifications
- Changes in loss allowances:
    - Reconcile closing IAS 39 to opening IFRS 9
    - Qualitative discussion/clear explanation of underlying credit risk management practices.

Key judgements and estimates

- Judgements may include classification assessments (e.g. extent of sales); and definition of default/SICR criteria
- Estimation uncertainties may include assumptions in various different economic scenarios.

Other relevant disclosures

- IFRS 7 amendments e.g. credit risk management practices; analysis of periodic change in loss allowances; hedge accounting disclosures.

IFRS 9 Financial Instruments
FRC Thematic Review Highlights

Significant judgements

Hedging disclosures

Impairment of intercompany debtors

Boilerplate accounting policies

Explanation of IFRS 9 vs IAS 39

IFRS 15 Revenue from Contracts with Customers

Disclosures on transition

Consider APM impact

Two approaches to transition: full retrospective or modified retrospective

Only need to present comparative line item information of transitional impact [IAS 8:28(f)] when IFRS 15 is applied fully retrospectively [IFRS 15:C4]

Under the full retrospective approach:
Comparative line item disclosures. There is a number of practical expedients. For any practical expedients applied IFRS 15:C6 requires disclosure of:

- The expedients used
- To the extent possible, qualitative assessment of estimated effect of applying each of the expedients

Under modified retrospective approach:
Cumulative effect of initial application adjusts opening retained earnings in the year of application (i.e. 2018). There are also some practical expedients.
If applied with a cumulative adjustment IFRS 15:C8 requires disclosure of:

- The amount by which each financial statement line item is affected in the current period
- An explanation of the reasons for significant changes

IFRS 15 Revenue from Contracts with Customers
FRC Thematic Review Highlights

Significant judgements and policies

Cost accounting

Identification of performance obligations

Effect on balance sheet accounts

Transition adjustments

IFRS 15 – Common pitfalls

Areas that tend to be difficult or underestimated

Agent / principal Focus should be on primary responsibility, and also inventory risk, not on credit risk
Applying the ‘distinct’ concept
Allocating transaction price between POs, especially variable consideration – this is a very rules based area
Constraining variable consideration to zero when zero is not a plausible outcome
Applying the over time criteria (IFRS 15:35) Failing to use a single measure of progress for each over time PO Failing to spot that over time criteria in IFRS 15:35(c) are met Failing to spot significant financing component

IFRS 16 Leases

FRC expectations in 2018 accounts

- Provide meaningful information about the application of the standard with a focus on entity specific facts and circumstances
- Disclose qualitative and quantitative information, identifying any lease portfolios that are significantly impacted by the new requirements
- Explain the specific judgements and policy changes prompted by the new model and provided detail about the structure of their implementation projects
- Identify the exemptions that entities intend to apply

Issues raised by FRC

‘Top 10’ topics for substantive points

- Judgements and estimates
- Alternative performance measures
- Strategic report
- Income tax
- Cash flow statement
- Business combinations
- Impairment
- Employee benefits
- Revenue
- Provisions and contingencies

Significant judgements and estimates

What are they?

Significant judgements	• Judgements in applying accounting policies, **apart from those involving estimations**, that have the **most significant effect** on amounts recognised (IAS 1.122)
Significant sources of estimation uncertainty	• Assumptions and other sources of estimation uncertainty where there is a **significant risk** of resulting in **material adjustment** to the carrying amounts of assets or liabilities **within the next year** (IAS 1.125)

If in 'estimates', not in 'judgements'

Judgements and estimates

Recurring issues

- **Not distinguishing** between key judgements in applying accounting policies and sources of estimation uncertainty
- **Loss of clarity** by including matters not falling within scope of IAS 1 disclosures
- **Not quantifying** or not disclosing sensitivities or ranges of outcomes for key estimates, e.g. tax

What FRC wants to see (based on IAS 1):

- Separate disclosure of significant judgements and estimates
- Entity specific and concise, looking for connectivity with other sections
- Explaining what the significant judgement was and why
- For key sources of estimation uncertainty disclose quantitative information about assumptions made (sensitivity or range of possible outcomes)

Alternative performance measures (APMs)

Continuing challenges

ESMA Guidelines on Alternative Performance Measures

- Label and define
- Clear purpose
- Prominence v GAAP measures
- Comparatives
- Reconciliations
- Consistency

APMs presented with more prominence or given greater authority than IFRS measures

Not explaining exclusion of items from adjusted profit measures or why items are 'non-recurring' or similar

Not reconciling all APMs to IFRS figures, e.g. ROCE, organic/constant currency growth

Mislabelling, e.g. referring to APMs as "reported" or being clear measure is an APM

Not defining all APMs, e.g. free cash flow, ROIC

Not explaining why APMs are presented or why information is considered helpful or relevant to users

Strategic Report

Risks and policies

'Brexit'	• Distinction between the specific and direct challenges to their business model and operations from the broader economic uncertainties. • Particular threats (e.g. to supply chain) clearly identified together with potential management actions • Sensitivity of cash flows in (for example) impairment testing or viability statement • Updated to date of approval of annual report
Distributions	• Policy on payment of dividends in the context of wider capital allocation decisions. • Any associated risks and constraints. • Practice under that policy, including a clear explanation of capital allocation decisions. • "The Government will legislate to require companies to disclose and explain their capital allocation decisions if investor pressure and new section 172 reporting requirements do not deliver sufficient progress." [BEIS Consultation – Insolvency and Corporate Governance]
Climate Change	A clear articulation of how your organisation is addressing climate change and whether this is a principal risk for your business, and if it is, how that risk is being managed.

Transparency of supplier financing

What is Reverse Factoring / Supply Chain Finance?

Reverse factoring is led by the **buyer** (creditor) rather than the **seller/supplier** (debtor).

Benefit for the Buyer?

Early (or at least prompt) payment to suppliers

Enhanced supplier relationship

Ability to pay Bank later than could have paid Supplier (obtain finance)

Benefit to the Supplier?

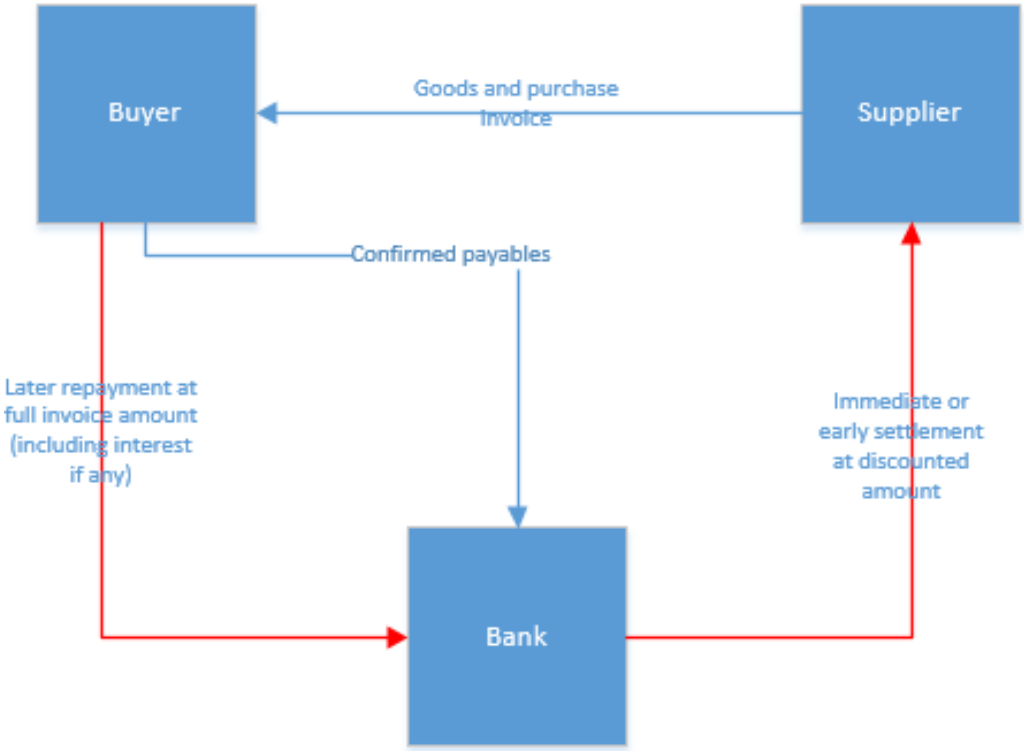
Flexibility for early payment (accepting a discount)

Benefit for the Bank?

Fees from Buyer

Interest earned from Buyer should they choose to obtain finance

Margin from 'lending' to Supplier at an amount less than they get paid from Buyer



Transparency of supplier financing

Financial reporting issues

Balance sheet presentation

Is the amount owed to a Bank in substance still a 'trade payable', an 'other payable' or 'bank borrowing'?

IAS 1 requires separate presentation of trade and other payables from other liabilities

Some key questions:

- Is the Buyer paying the Bank later than it would pay its Supplier?
- Does Supplier having recourse to the Buyer if Bank fails to make a payment?
- Has the Buyer's obligation to Supplier been legally extinguished before the Bank is repaid by the Buyer?
- Is the Bank's seniority of claim against Buyer different to that of a Supplier?

Cash flow statement presentation

CFS classification follows Balance sheet classification

Trade and other payables = operating

Bank borrowing = financing

If bank borrowing then its recognition is a non-cash transaction. Consider presenting as an accounting policy:

- Payment to Bank as financing outflow, or
- Payment from Bank to Supplier as an operating outflow along with a financing inflow, then later payment to Bank as a financing outflow

Disclosure of accounting policies and extent of reverse factoring is critical

Income taxes

Adequacy of disclosures

- Explaining significant items in tax reconciliation
- Recognising deferred tax assets relating to losses with recent history of lossmaking trading
- Granularity of information about temporary differences

IFRIC 23 Uncertainty over income tax treatments (effective 1 Jan 2019)

- Clarifies how to recognise and measure income tax when uncertainty over tax treatment
- Items should be considered separately or together depending on which best predicts the resolution
- If probable tax authority will accept an uncertain tax treatment, then determine tax consistently with treatment used or planned to be used in filings;
- If not probable tax authority will accept uncertain tax treatment, the uncertainty is reflected by using either of the following methods, depending on which better predicts resolution of the uncertainty:
  - the single most likely amount in a range of possible outcomes, or
  - the expected value (i.e. probability-weighted)

Cash flow statements

Classification of cash flows

Investing

- Purchasing PPE or intangible assets
- Acquiring a subsidiary, JV or associate
- Making loans to others
- Proceeds from disposal of businesses or assets

Only cash outflows resulting in a recognised asset can be investing

It depends…

- Derivatives in effective hedges follow the hedged cash flows

Operating

- Employee remuneration
  - Caution: earn-outs or similar on acquisitions – remuneration if linked to future service
- Expenses relating to acquisition or reorganisation

Financing

- Issue or purchase of own shares, including by employee share trust
- Purchase of non-controlling interests
- Paying dividends
- Taking out or repaying loans

Cash flow statements

Common pitfalls and hot topics

- Cash flows included in wrong category, e.g. shown as 'investing' when should be 'operating'
- Non-cash movements included in cash flow statement
- Netting off when not permitted under IAS 7
- Items classified incorrectly as cash equivalents

- Disclosure of liabilities arising from financing activities:
  - Consistency with how cash flows are classified
  - Not 'net debt' but IAS 7 reconciliation may be a component of a net debt reconciliation
  - Need comparatives in second year of application

Overall concern over control environment covering preparation of financial statements

Annual report insights 2018

- Survey of 100 UK listed companies, examining trends in **narrative reporting**, **corporate governance** and **financial statements**
- Available at www.deloitte.co.uk/annualreportinsights
- Includes examples of good practice disclosure and a regulatory overview

Other IFRS news

IASB pronouncements during the past year

Title	Effective date
Annual Improvements 2015-17 Cycle	1 Jan 2019
Amendments to IAS 19: Plan Amendment, Curtailment or Settlement	1 Jan 2019
Amendments to References to the Conceptual Framework in IFRS Standards	1 Jan 2020
Amendment to IFRS 3: Definition of Business	1 Jan 2020
Amendments to IAS 1 and IAS 8: Definition of Material	1 Jan 2020

Newsletters available at www.ukaccountingplus.co.uk

Corporate governance

Corinne Sheriff

Reporting changes for 2018 year ends – a reminder

Nothing new this year

Prospects and viability

A reminder of the Code provision

STAGE ONE

C.2.2. Taking account of the company's current position and principal risks, **the directors should explain in the annual report how they have assessed the prospects of the company**, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have **a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment**, drawing attention to any qualifications or assumptions as necessary.

STAGE TWO

Prospects and viability

Degree of confidence lessens as time period extends

Longer term prospects
About the sustainability of the business model – consistent with other longer term statements made by the company and explaining how they relate to the assessment of prospects

Viability statement
Significantly longer than 12 months – taking account of:
- the board's stewardship responsibilities
- the nature of the business, stage of development
- investment and planning cycles

Going concern assessment 1 year

Generally 3-5 years
Period set by the directors

Longer time horizon
Set by the directors to align with other statements and with business model

Changing corporate governance codes

Changes to AIM Rule 26

Must report against a recognised corporate governance code

Each AIM company must from admission maintain a website on which the following information should be available:

- Which recognised code does the company apply
- Level of compliance
- Reasons for non-compliance
- Date of last review of this information (needs to be at least annually)

Effective from 28 September 2018

The QCA Corporate Governance Code

Revised and updated version of the Code issued

DELIVER GROWTH	
1.	Establish a strategy and business model which promote long-term value for shareholders
2.	Seek to understand and meet shareholder needs and expectations
3.	Take into account wider stakeholder and social responsibilities and their implications for long-term success
4.	Embed effective risk management, considering both opportunities and threats, throughout the organisation
MAINTAIN A DYNAMIC MANAGEMENT FRAMEWORK	
5.	Maintain the board as a well-functioning, balanced team led by the chair
6.	Ensure that between them the directors have the necessary up-to-date experience, skills and capabilities
7.	Evaluate board performance based on clear and relevant objectives, seeking continuous improvement
8.	Promote a corporate culture that is based on ethical values and behaviours
9.	Maintain governance structures and processes that are fit for purpose and support good decision-making by the board
BUILD TRUST	
10.	Communicate how the company is governed and is performing by maintaining a dialogue with shareholders and other relevant stakeholders

- **Reduction to ten principles from twelve**
- **Application guidance**
- **Disclosure requirements – annual report and website**
- **Chairman's statement**

"AIM has not defined what it is meant by 'recognised'. However, it is understood that this includes the QCA Code. The QCA Code is widely recognised as a corporate governance code, both by companies as well as by the market and the regulators."

The QCA – 25 April 2018

NEW Corporate Governance Reporting Regulations

Department for Business, Energy & Industrial Strategy

Governance in large privately-held businesses

- Confirmation of which corporate governance code, if any, has been applied and how.
- If the company has departed from any aspect of the code, it must explain which aspects and the reasons.
- If no code is followed the company must explain why and what corporate governance arrangements were applied.
- The statement will need to be included the company's Directors' Report and published on a website maintained by or on behalf of the company.

Scope

- All UK registered companies with either:
  - 2,000 or more global employees; **OR**
  - Turnover over £200 million globally and a balance sheet total of more than £2bn
- Companies already required to report on their corporate governance are not within scope.

The Wates Corporate Governance Principles for large private companies – issued for a 12 week consultation

New voluntary principles – "apply and explain"

Purpose	An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.
Composition	Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.
Responsibilities	A board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge.
Opportunity & risk	A board should promote the long-term success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.
Remuneration	A board should promote executive remuneration structures aligned to the sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.
Stakeholders	A board has a responsibility to oversee meaningful engagement with material stakeholders, including the workforce, and have regard to that discussion when taking decisions. The board has a responsibility to foster good stakeholder relationships based on the company's purpose.

So which code to apply?

Premium listed companies	**No choice – UK Corporate Governance Code** The Listing Rules call for an explanation of how the Code principles have been applied and the level of compliance with the Code provisions.
AIM companies	**Some choice – per AIM Rule 26 "a recognised code", basically FRC or QCA?** But must, by 28 September 2018, have made a clear statement on the company website of which code applying and the level of compliance – no option for no code.
Large privately-held companies	**Choice – per BEIS legislation "which corporate governance code, <u>if any</u>"** The statement of corporate governance arrangements must explain how the code was applied and if any departures. If no code applied, then must explain why and what governance arrangements were applied for that year.

The changing governance landscape for listed companies

Corporate governance update

Timeline of developments for companies

2017

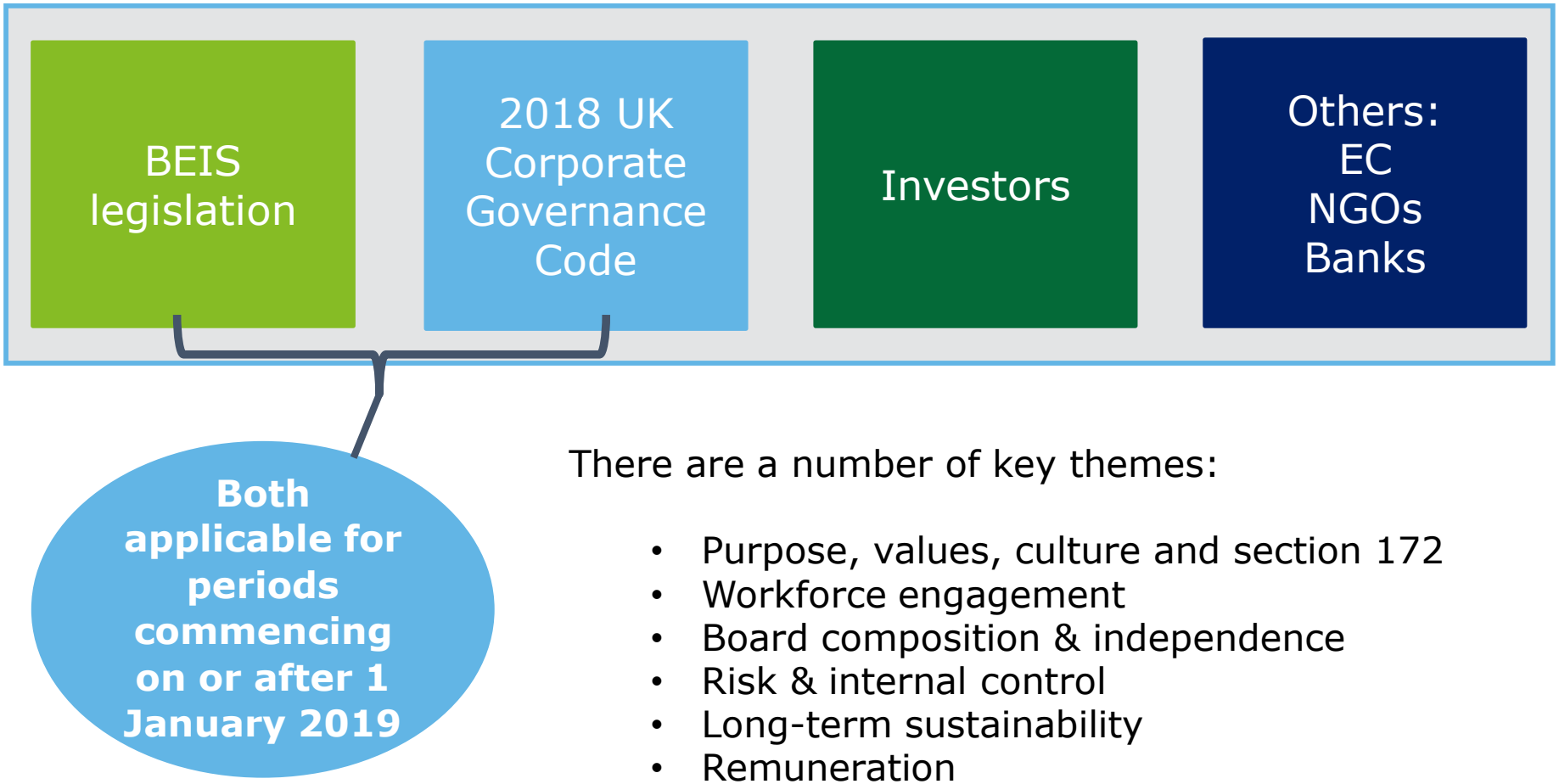
APR	JUN	JULY	AUG	OCT	NOV	DEC
BEIS Select Committee inquiry report	General election & Queen's Speech	Developments in audit	FRC consults on update to Strategic Report Guidance	CRR Annual Report FRC letter to AC Chairs & FDs	Hampton/ Alexander Report 2017	FRC consults on Code & Guidance on Board Effectiveness
			BEIS Green Paper response		FRC Thematic Reviews & Lab on Risk & Viability	Launch of the Investment Association Public Register

2018

JAN	APR	MAY	JUN	JULY	AUG	OCT	NOV
Collapse of Carillion	Kingman Review of the FRC launched	DWP/BEIS Committee Report on Carillion	BEIS legislation on CEO pay ratio, s172 & private cos	Revised UK Corporate Governance Code	Insolvency & Corporate Governance response	CMA Review of the audit sector launched	BEIS Carbon and Energy Regulations
DWP/BEIS Committee inquiry into Carillion	Gender Pay Gap reporting deadline		Wates Principles for large private companies	Updated Strategic Report Guidance		CRR Annual Report FRC letter to AC Chairs & FDs	

The changing governance landscape for listed companies

Pressures coming from a variety of sources



There are a number of key themes:

- Purpose, values, culture and section 172
- Workforce engagement
- Board composition & independence
- Risk & internal control
- Long-term sustainability
- Remuneration

The 2018 UK Corporate Governance Code

Purpose, values, culture & s172

PRINCIPLE A

A successful company is led by an **effective** and **entrepreneurial** board, whose role is to promote the **long-term sustainable success** of the company, generating **value for shareholders** and **contributing to wider society**.

FRC setting clear aspiration for companies beyond s172

All directors must act with **integrity**, lead by example and promote the desired culture

Board to **establish** and **align** company purpose, strategy, values and culture

Board should **assess and monitor culture** and ensure management take **corrective action**

Describe how the interests of **key stakeholders** and other matters in s172 impacted **board decisions**

Clear overlap with new reporting requirement for UK companies – for non-UK companies this will still be required under the Code

Think about your sources of culture insights – not just employee related

Considering wider stakeholders – central to the reform package

Duties of directors under the Companies Act 2006 – s172

GC100 issues practical advice on s172 duty

Embedding the factors into everyday decision-making

- Section 172 applies to **all aspects** of a director's role not just when making specific decisions.
- This is about **embedding** consideration of the section 172 factors so that they are a **natural and automatic** part of decision-making throughout the company**.**
- **Management** need to have a **good understanding** of the section 172 duty also.
- There is a helpful **case study** included in the guidance.

Six key areas to consider:

Strategy	Training	Information
Policies and processes	Stakeholder engagement	Culture

The 2018 UK Corporate Governance Code

Workforce policies & practices

PRINCIPLE E

The **board** should ensure that workforce policies and practices are **consistent** with the company's **values** and support its **long-term sustainable success**.

Think about link to long-term sustainable success

Workforce should be able to raise **ANY** matters of concern

Whistleblowing elevated to board agenda

Explain the approach to **investing in** and **rewarding** the workforce

One, **or a combination**, of the following methods to be used for engagement with the workforce:

- a director appointed from the workforce;
- a formal workforce advisory panel;
- a designated non-executive director.

If not one of these methods, explain what arrangements are in place and why effective.

Be careful…

Mechanism(s) must be meaningful AND effective

They will be quickly exposed if not

The 2018 UK Corporate Governance Code

Stakeholder engagement: what do companies need to do?

Report on engagement activities

Reporting on engagement activities must demonstrate to shareholders that directors met their duty under s.172. In order to satisfy investors, disclosures will need to focus on the specific outcomes and impact of engagement activities.

Develop an approach for gathering workforce views

The Code sets out three potential structures to enable the board to engage with the workforce. These may require adaptation to reflect the specific circumstances of the business.

Analyse and act on feedback

Rigorous analysis of feedback will be necessary in order to distil a wide range of views into clear findings for the board. Companies will need to develop realistic, practical actions which genuinely respond to feedback received.

Establish a robust framework

A robust governance framework will link engagement activities to the board decision-making process, and should include terms of reference, as well as policies and procedures to ensure documentation.

Plan and conduct engagement events

Engagement events can be conducted via a range of channels in order receive a reliable range of feedback, as well as to maximise the reach of engagement activities.

Build capacity for engagement

Companies will need to build the knowledge and capacity necessary to conduct effective engagement activities. This applies to the board, staff involved in planning and conducting engagement activities, as well as stakeholders themselves.

The 2018 UK Corporate Governance Code

Board composition & independence

Strengthening consideration of 'overboarding'

PRINCIPLE H - Non-executive directors should have **sufficient time** to meet their board responsibilities.

PRINCIPLE K – Consideration should be given to the length of service of the board as a whole and membership regularly refreshed

Two key areas where the FRC has changed view

Independence of non-executives reverts to being a matter for board judgement **BUT clearer explanations** called for where independence may appear impaired

Chairman reverts to just needing to independent on appointment **BUT** a **nine year maximum tenure** is imposed (from date of joining the board)

This period can be extended for a "limited time" to help succession planning

Appointments and succession plans should **promote diversity** of gender, social and ethnic backgrounds, cognitive and personal strengths

Hampton/ Alexander reporting requirement introduced

Greater emphasis on the quality of the external board evaluation including clarity of outcomes and level of interaction with the board

Outside FTSE 350 exemption from external evaluation retained

The 2018 UK Corporate Governance Code

Emerging risks & internal assurance

Two new matters introduced which were not consulted on:

Emerging risks

The board should carry out a robust assessment of the company's **emerging and** principal risks. The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, **what procedures are in place to identify emerging risks**, and an explanation of how these are being managed or mitigated.

Internal assurance

Where there is no internal audit function, an explanation for the absence, **how internal assurance is achieved**, and how this affects the work of external audit

Internal assurance

An increasing focus on the quality of corporate reporting systems

Extract from FRC Letter to AC Chairs and CFOs

"This year, we identified an increase in the number of basic errors in the reports and accounts we reviewed."

"[Compliance procedures] need to be sufficiently robust to ensure that reporting remains free of basic errors which can detract both from the integrity of the company's report and accounts and trust in management."

New UK Corporate Governance Code Provision:

Where there is no internal audit function, an explanation for the absence, **how internal assurance is achieved**, and how this affects the work of external audit

Emerging risks

What procedures are in place to identify emerging risks?

In which areas is the **business model** vulnerable to disruption?

What is our exposure to **technology** disruption?

How could material **environmental & social risks** affect the company's short and long term value?

What planning is the board doing around the **implications of Brexit** (in whatever form it may take)?

What are the exposures to **data** and **cyber security risks** both directly and for key suppliers?

What are the drivers of **productivity** in the business and how are these managed?

Brexit uncertainty

Deal or no deal

Distinguish specific, direct challenges to business model

Clearly identify threats & actions to manage impact

Consider financial statement impact – for instance remeasurement

What is useful?

Essentra has upgraded the risk impact from Brexit to a principal risk, and explained the change. They have also provided further clarity to users by identifying who owns the risk in the company. Investors considered the mitigating action disclosure to be helpful as a prompt to ask further questions.

Brexit could impact the Company in a number of ways, for example:

- A material element of the operations of the Components division involves manufacturing products in the UK and distributing them into the EU. Should trade tariffs and / or a customs border be imposed this could lead to increased costs and complexity within the division's existing business model.
- The Company has multiple manufacturing sites in the UK. Should trade tariffs or a customs border be imposed, this could restrict the supply chain opportunities available to these sites.
- Depending on the outcome of negotiations, Brexit could increase the cost of, or restrict funding for, the Group's current and future investment plans.

Brexit has previously been identified as a key but not Principal Risk to the Company. As UK / EU negotiations continue, the Company has determined that it should now be managed, mitigated and monitored as a Principal Risk.

During 2017 and the early part of 2018, the Company conducted a thorough review of Brexit risks, including understanding Essentra's exposure. This included consultation with external experts and used third party support.

Coming out of this review, a range of potential mitigation options were identified, which the Company is now in the process of reviewing. These include:

- Potential changes to the European asset and manufacturing footprint to optimise material flows
- Optimisation of product manufacturing locations versus customer locations
- Seeking alternative raw material supply sources to minimise cross-border flows
- Seeking "Approved Economic Operator" status to minimise inspection delays

Essentra plc, Annual Report 2017 p46

Extract from the Lab's Implementation Study

Forecasting should include clear scenarios

Assess impact on the viability statement

Confirm ability to continue as a going concern

Narrative reporting developments

Amanda Swaffield

What's new in narrative reporting?

Why is this such an area of focus?

Company purpose and culture still hot topics

Responsible business trying to restore trust, reflected in governance reforms

Observing a boom in ethical investment portfolios

An increased focus on non-financial information [*Non-financial information 'frequently' or 'occasionally' plays a pivotal role in 68% of investment – decision making* (EY, 2017)]

Quality of non-financial information and level of assurance?

Increasing expectation gap: what we actually do vis a vis narrative reporting vs. what do shareholders & broader stakeholders think we do?

FRC Thematic area – Strategic Report & APMs

What's new in narrative reporting?

Non-Financial Reporting Directive

First year of implementation already completed.

FRC change of direction re: requirement to have a separate statement.

The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016

s172(1) statement

Part of BEIS legislation on CEO pay ratio, s172 & private cos corporate governance

Three new statements required, s172(1) in the strategic report, plus two others in the directors' report.

Effective 1 Jan 2019

The Companies (Miscellaneous Reporting) Regulations 2018

Updated FRC Guidance on the Strategic Report

Revisions made to reflect increasing importance of non-financial information and a greater focus on the directors' duty to promote the success of the company under section 172.

FRC Lab reports

A few reports issued this year.

Remains pertinent as sources of guidance.

Financial Reporting LAB

Energy and Carbon Report Regulations

New directors' report disclosure, effective 1 April 2019:

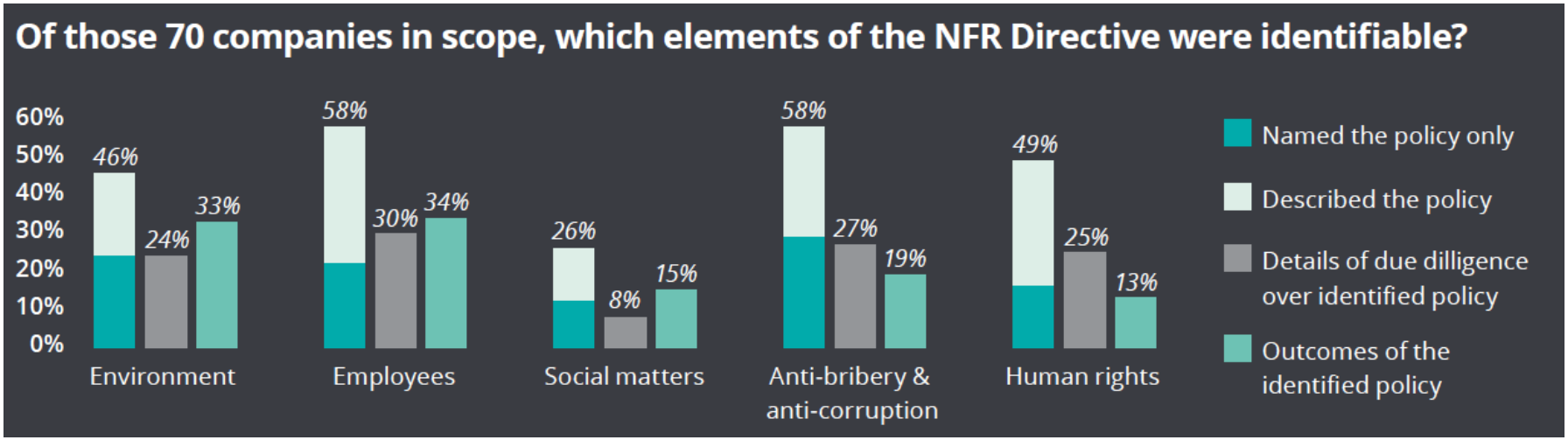
- Quoted companies – energy use and efficiency
- Large unquoted companies – GHG, energy used, energy efficiency in the UK

The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018

What's new in narrative reporting?

1. Non-Financial Reporting Regulations

- Apply to periods commencing on or after 1 January 2017
- Similar to the strategic report requirements – extends disclosure on diversity and bribery and corruption
- Slightly different scope – some large unquoted companies within scope
- Must be a **SEPARATE STATEMENT** that either includes all relevant information or else x-refs to where the information can be found [para 7B.83]



- Often difficult to clearly identify description of policy; some policies named in Principal Risks.
- If no policy, company must state a clear & reasoned explanation as to why.

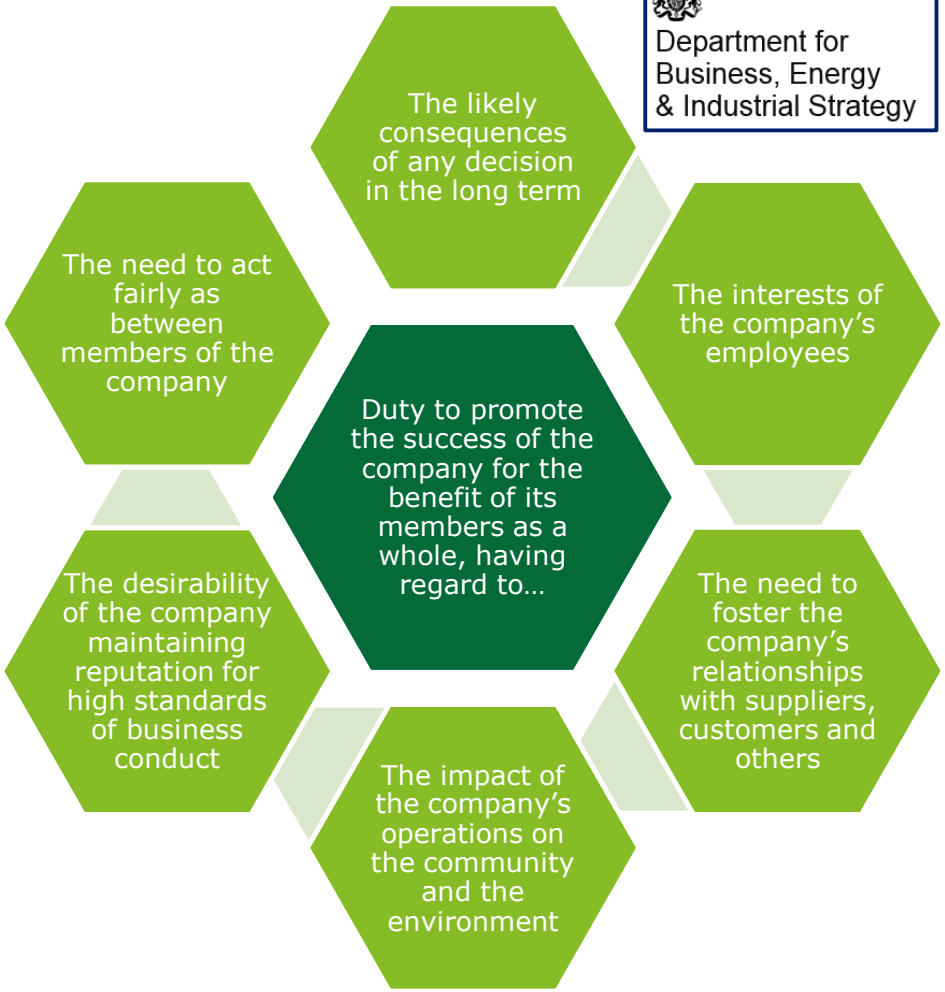
What's new in narrative reporting?

2. s172(1) statement

Effective periods beginning on/after 1 Jan 2019

- Part of the Companies (Miscellaneous Reporting) Regulations 2018
- Large companies will need to include:
  - A statement in the **Strategic Report** (and website) describing how the directors have complied with their duties under s172(1)(a) to (f).
  - A statement in the **Directors' Report** summarising how the directors have had regard to the need to foster the company's business relationships with suppliers, customers & others, and the effect of that regard, including on the principal decisions taken by the company during the year.
- All UK companies with more than 250 employees will have to include:
  - A statement in the **Directors' Report** summarising how their directors have engaged with employees, how they have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the year.
- Must be a **SEPARATE STATEMENT** that either includes all relevant information or else x-refs to where the information can be found [para 8.5]

Department for Business, Energy & Industrial Strategy



s172(1) statement
FRC Guidance

- Revised FRC Guidance on the Strategic Report – new section 8
- Companies will probably want to include information on some or all of the following [para 8.11]:

The issues, factors and stakeholders the directors consider relevant in complying with section 172(1) (a) to (f) and how they have formed that opinion;

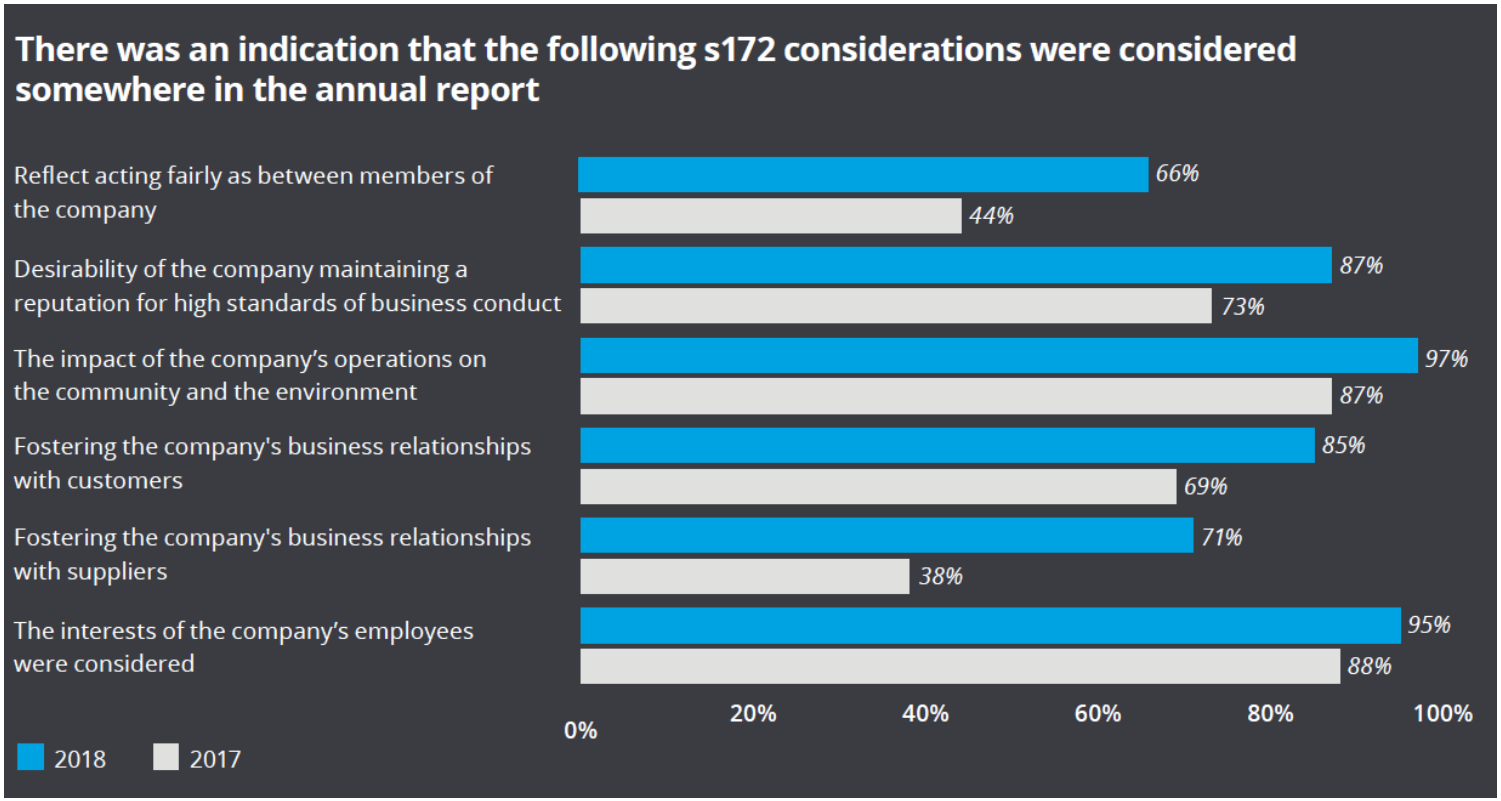
The main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and

Information on the effect of that regard on the company's decisions and strategies during the financial year.

- "decisions in the long term…" → consider linkage to principal risks [para 8.15]
- Information explaining the benefits created for other stakeholders → a developing area of disclosure; companies are encouraged to innovate and experiment! [para 8.17]
- Principal decisions made → one example could be capital allocation determination [para 8.26]
- Company culture impacts this → both affects activities with stakeholders and acting fairly between members of the company [para 8.30]

s172(1) statement

What's the current status of disclosure?



- Although not effective until 1 Jan 2019, more disclosure in this area appears to be given.
- Fostering relationships with suppliers often linked with human rights policies, and how working with suppliers to ensure standards maintained throughout their supply chain.
- Acting fairly between members usually demonstrated through description of engagement with private shareholders, as well as institutional investors.
- 29% referred to the responsibilities required by s172 (2017:17), with 8% explaining how the directors had fulfilled those responsibilities and had regard to their s172 duties

What's new in narrative reporting?

3. Energy and Carbon Regulations

Effective periods beginning on/after 1 April 2019

- Consultation on a "streamlined and more effective energy and carbon reporting framework" for the UK issued August 2017
- Resulting Regulations published in November 2018
- Quoted companies to make a statement in their directors' report:
  - GHG emissions
  - Energy use
  - Action taken to increase energy efficiency
- Large unquoted companies:
  - GHG emissions
  - Energy use
  - Action taken to increase energy efficiency in the UK
- Applies to LLPs
- Doesn't apply to subs (if included in a group directors' report)
- Other exemptions :
  - consume less than 40,000kWh of energy during the period (must state this)
  - Would be seriously prejudicial

Department for Business, Energy & Industrial Strategy

STATUTORY INSTRUMENTS

2018 No. 1155

COMPANIES

LIMITED LIABILITY PARTNERSHIPS

The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018

Made - - - - 6th November 2018

Coming into force - - 1st April 2019

The Secretary of State makes the following Regulations in exercise of the powers conferred by sections 416(4) and 1292(1) of the Companies Act 2006(a) and sections 15 and 17 of the Limited Liability Partnerships Act 2000(b).

In accordance with sections 473(3) and 1290 of the Companies Act 2006 and section 17(6) of the Limited Liability Partnerships Act 2000, a draft of this instrument has been laid before Parliament and approved by a resolution of each House of Parliament.

PART 1

Introductory

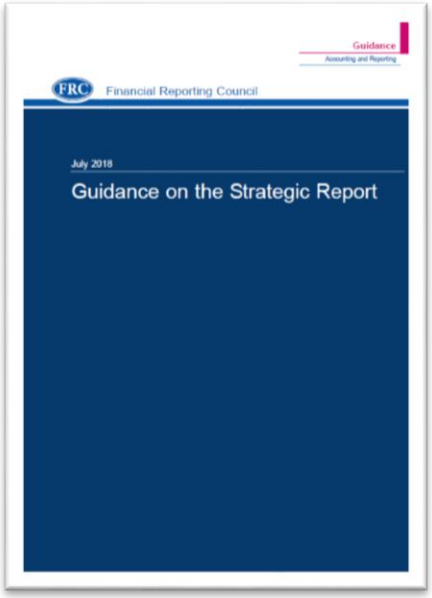
Citation

1. These Regulations may be cited as the Companies (Directors' Report) and Limited Liability

Link available on www.ukaccountingplus.co.uk

What's new in narrative reporting?

4. Revised FRC Guidance on the Strategic Report



- Consultation issued August 2017; revised version published July 2018
- Enhanced to recognise the increasing importance of non-financial reporting
- Greater focus on the directors' duty to promote the success of the company under section 172 of the Companies Act 2006
- Complements the new legislation
- Structure slightly altered:
  - Section 7 *Strategic report: Content Elements* now in two parts:
    - 7A for medium & large companies which are not PIEs (whether quoted or not)
    - 7B for PIEs (whether quoted or not)
  - Section 8 – new section *Content elements for s172 reporting*

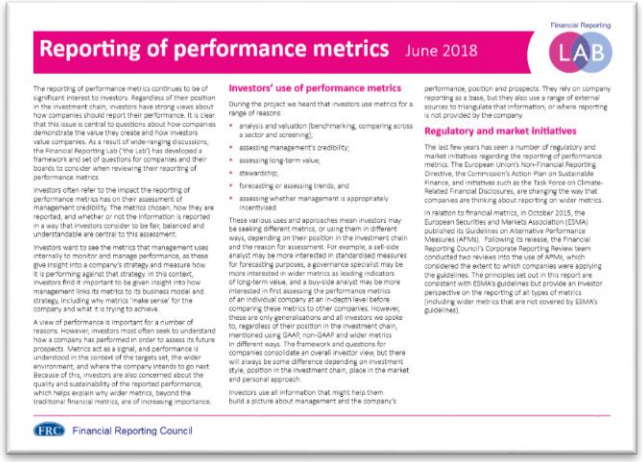
414C Contents of strategic report

(1)The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)

Available at www.frc.org.uk

What's new in narrative reporting?

5. FRC Lab reports - Reporting of performance metrics



Financial Reporting LAB

Reporting of performance metrics June 2018

The reporting of performance metrics continues to be of significant interest to investors. Regardless of their position in the investment chain, investors have strong views about how companies should report their performance. It is clear that this issue is central to questions about how companies demonstrate the value they create and how investors value companies. As a result of wide-ranging discussions, the Financial Reporting Lab ('the Lab') has developed a framework and set of questions for companies and their boards to consider when reviewing their reporting of performance metrics.

Investors often refer to the impact the reporting of performance metrics has on their assessment of management credibility. The metrics chosen, how they are reported, and whether or not the information is reported in a way that investors consider to be fair, balanced and understandable are central to this assessment.

Investors want to see the metrics that management uses internally to monitor and manage performance, as these give insight into a company's strategy and measure how it is performing against that strategy. In this context, investors find it important to be given insight into how management links its metrics to its business model and strategy, including why metrics 'make sense' for the company and what it is trying to achieve.

A view of performance is important for a number of reasons. However, investors most often seek to understand how a company has performed in order to assess its future prospects. Metrics act as a signal, and performance is understood in the context of the targets set, the wider environment, and where the company intends to go next. Because of this, investors are also concerned about the quality and sustainability of the reported performance, which helps explain why wider metrics, beyond the traditional financial metrics, are of increasing importance.

Investors' use of performance metrics

During the project we heard that investors use metrics for a range of reasons:

- analysis and valuation (benchmarking, comparing across a sector and screening);
- assessing management's credibility;
- assessing long-term value;
- stewardship;
- forecasting or assessing trends; and
- assessing whether management is appropriately incentivised.

These various uses and approaches mean investors may be seeking different metrics, or using them in different ways, depending on their position in the investment chain and the reason for assessment. For example, a sell-side analyst may be more interested in standardised measures for forecasting purposes, a governance specialist may be more interested in wider metrics as leading indicators of long-term value, and a buy-side analyst may be more interested in first assessing the performance metrics of an individual company at an in-depth level before comparing these metrics to other companies. However, these are only generalisations and all investors we spoke to, regardless of their position in the investment chain, mentioned using GAAP, non-GAAP and wider metrics in different ways. The framework and questions for companies consolidate an overall investor view, but there will always be some difference depending on investment style, position in the investment chain, place in the market and personal approach.

Investors use all information that might help them build a picture about management and the company's performance, position and prospects. They rely on company reporting as a base, but they also use a range of external sources to triangulate that information, or where reporting is not provided by the company.

Regulatory and market initiatives

The last few years has seen a number of regulatory and market initiatives regarding the reporting of performance metrics. The European Union's Non-Financial Reporting Directive, the Commission's Action Plan on Sustainable Finance, and initiatives such as the Task Force on Climate-Related Financial Disclosures, are changing the way that companies are thinking about reporting on wider metrics.

In relation to financial metrics, in October 2015, the European Securities and Markets Association (ESMA) published its Guidelines on Alternative Performance Measures (APMs). Following its release, the Financial Reporting Council's Corporate Reporting Review team conducted two reviews into the use of APMs, which considered the extent to which companies were applying the guidelines. The principles set out in this report are consistent with ESMA's guidelines but provide an investor perspective on the reporting of all types of metrics (including wider metrics that are not covered by ESMA's guidelines).

FRC Financial Reporting Council

- June 2018 – 4 page summary arising from investor discussions
- Identified 5 principles for reporting metrics
- Investors want to see the metrics management use to monitor the business
- A framework and set of questions for boards to consider when reviewing metrics

Financial Reporting LAB

Performance metrics – Principles and practice

November 2018

FRC Financial Reporting Council

- November 18 – final part of the project
- Provides guidance to companies and examples of how companies can apply those principles.

What's new in narrative reporting?

5. Lab reports - Business model reporting; Risk and viability reporting

- October 2018 – post implementation study
- Builds on:
  - Oct 16 – Business model reporting
  - Nov 17 – Risk and viability reporting
- Investors still want to see more linkage
- Practical examples
- Includes questions for Boards

All available at www.frc.org.uk/investors/financial-reporting-lab/publications

Ongoing work includes Climate & workforce reporting and Digital future: artificial intelligence.

Other recent projects include Blockchain and the future of corporate reporting

Taskforce on Climate-related Financial Disclosures

Final report issued in June 2017

Recommended Disclosures

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.

How the organisation identifies, assesses, and manages climate-related risks.

The metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Applicable to all organisations, aiming to encourage market-led, industry-focused initiatives.

Responds to systemic risk in the financial system related to climate change.

Who has signed up?

Over 250 companies. Including CFOs of British Land, Burberry, M&S, National Grid, Tata Steel, Tesco, Unilever

Just under 20% of the over 250 are UK companies

TCFD climate-related risk disclosures

HSBC Holdings plc summarises its response to climate risk, utilising the TCFD's recommendations

Task Force on Climate-related Financial Disclosures ('TCFD')

Initial response to the Financial Stability Board

Reducing global carbon dioxide emissions is a critical challenge for everyone. We recognise its importance and seek to be a leader in managing climate change risk while developing opportunities with – and for – our customers. We welcome the new disclosure recommendations from the FSB taskforce, which assist the understanding of climate-related risks, and we were a signatory to the June 2017 TCFD report. This represents our first disclosure under the framework. We recognise this will evolve and expand over time.

Governance

Sustainability is a key concern of the HSBC Group Management Board, with five presentations taking place during 2017.

HSBC's 2016 Statement on Climate Change may be found on our website at www.hsbc.com/our-approach/measuring-our-impact. The site gives information on our approach to low/high carbon transition, managing our direct impact and partnerships.

Our Climate Business Council ('CBC'), established in 2010, is an internal strategic committee whose role is to coordinate across the bank, identifying and developing products and services to meet customers' sustainable finance needs. There is also a group-wide ESG steering group, chaired by the Group Finance Director, leading our approach to ESG issues, including external disclosure and materiality considerations.

Strategy

HSBC's strategy is to connect customers to opportunities across a diversified range of products and services. This, along with our geographical presence in developing markets, gives us a unique opportunity to engage with our customers and support their transition strategies. HSBC has committed to directing $100bn of financing and investment to the low-carbon economy by 2025.

In order to facilitate the transition to the low-carbon economy for us and our clients, during 2017 we created a 'Global Head of Sustainable Finance' and an 'HSBC Centre of Sustainable Finance'. Additionally, via training, we have expanded our in-house sustainability expertise to approximately 1,300 employees across the Group. We are committed to strengthening our role as a thought leader in the financial services industry.

During 2017, HSBC's Global Research Climate Change Centre was ranked number one by Extel and HSBC was the second-ranked bookrunner by Dealogic for green, social and sustainability bonds. We will work with our customers in all our businesses to develop sustainable products and support innovation.

Risk Management

Climate risk, both physical and transition, is an increasing risk. During 2017 the Executive Risk Management Committee approved a framework for measuring transition risks across our loan portfolio. We have identified the higher transition risk sectors as oil and gas, metals and mining, power and utilities, automobiles, building and construction, and chemicals. We actively engage with clients in these sectors to support their transition strategies. We monitor and report our exposure internally, and will do so externally in 2018. Over time we expect a reduction in the carbon intensity of our portfolio.

Our Sustainability risk policies cover all our lending to sensitive sectors and we apply the Equator Principles to project finance. Details are available at www.hsbc.com/our-approach/measuring-our-impact. We also manage the physical risks to our global network relating to climate change by undertaking regular operational stress testing and contingency planning.

Next steps

The HSBC Centre of Sustainable Finance, Risk Management and Finance will work with external experts to develop climate-related scenario analysis and related disclosures.

HSBC Holdings plc Annual Report and Accounts 2017 (p.27)

Annual report survey

Key narrative reporting findings

Narrative content remains at 61%, although total report length up to 162 pages

Value creation

- **32%** of reports gave a clear description of a company purpose that went beyond making profits for shareholders
- **92%** identified key inputs in the form of off-balance sheet resources and relationships
- **35** companies clearly considering the <IR> notion of 'capitals' in their business models
- **82%** described, to varying extents, how they engaged with wider stakeholders
- **76** companies discussed value created for at least one stakeholder other than shareholders
- **71%** provided non-financial KPIs

Risks

- **25** identified Brexit as a principal risk; **34** referred to Brexit in the context of a broader risk around marketplace and economic uncertainty
- **19%** set out a principal risk that they might not keep up with the pace of technological change
- **27** companies identified principal risks related to anti-bribery or anti-corruption matters
- **1** company with climate-change principal risk and **9** companies referring to Task Force on Climate-related Financial Disclosures

APMs

46% had a dedicated section or appendix on APMs, providing much of the information required by ESMA's guidelines

Remuneration

David Cullington

New UK Corporate Governance Code (FRC)

Remuneration elements

Applies to FY starting 1 January 2019

Remuneration committee - remit and responsibilities

Senior management	Determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management.
Workforce remuneration	Review workforce remuneration and related policies, and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration.
Remuneration committee chair	Remuneration committee chair to have served on a remuneration committee for at least 12 months.

Remuneration design and structure

Pension alignment	The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce.
Holding periods	Remuneration schemes should promote long-term shareholdings by executive directors. In normal circumstances, share awards should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more.
Post-employment shareholding	Remuneration committees should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.

Discretion and recovery

Apply discretion and judgement	Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.
Enforceability	Remuneration schemes and policies should enable the use of discretion to override formulaic outcomes and include provisions that would enable the company to recover and/or withhold sums or share awards.

Culture, risk and behaviours

Risk and behaviours	When determining executive director pay, committees should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated.
Culture and incentives	Incentive schemes should drive behaviours consistent with company purpose, values and strategy.

Along with risk and culture, remuneration committees should also address clarity, simplicity, predictability of outcomes and proportionality of awards for performance when determining executive director remuneration.

Reporting and other

Additional reporting	Remuneration committee to report on its work including: • Strategic rationale for executive remuneration policies, structures and metrics • Why remuneration is appropriate (including use of pay ratios and pay gaps) • Whether remuneration policy operated as intended • Engagement with workforce to explain how executive remuneration aligns with wider company pay policy • Use of discretion and reasons why
'Low votes'	Where more than 20% votes against a resolution, provide update on shareholder views and actions taken no later than six months after shareholder meeting.

CEO pay ratio disclosure

What is it?	Comparison of CEO total remuneration to total remuneration of the UK employees with 25th, 50th and 75th highest full-time equivalent remuneration
When does it apply?	FY beginning on or after 1 January 2019 (reporting in 2020) BUT likely widespread voluntary adoption (in some form) for 2018 year-ends
Who does it apply to?	UK incorporated companies: • whose shares are quoted on the Main List of the London Stock Exchange (excludes AIM listed), the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area; and • who have >250 UK employees in Group
What CEO figure?	Total remuneration from single figure table

How to calculate employee figures?	• Total remuneration calculated on same basis as CEO single figure.
	
	• Three methodologies to identify 25th / 50th / 75th percentile employees
	  ○ Method A – calculate for all UK employees
	  ○ Methods B & C – use gender pay or other available data

What else?	Providing salary and total remuneration data for median, lower quartile and upper quartile employees.

CEO pay ratio disclosure - example

In line with the reporting regulations, we have compiled the following pay ratios using [Method A / B / C[1]].

25th percentile	Median	75th percentile
X:1	X:1	X:1

Table will build up to 10 years of data

[1] Method A: determine total full-time equivalent total remuneration for all UK employees for relevant financial year; rank the data and identify employees whose remuneration places them at median, 25th and 75th percentile.

The table below provides details of the total UK employee pay and benefits for 2018 which have been used to calculate the above ratios and the salary component of each figure.

	25th percentile	Median	75th percentile
UK employee pay and benefits	£X	£X	£X
Salary component	£X	£X	£X

Understanding the CEO pay ratios

A substantial proportion of the CEO's pay is based on performance and delivered in shares. Performance can vary year on year resulting in changes in the pay ratios. Additionally, •'s share price may increase or decrease further impacting the pay receivable by the CEO.

[Insert commentary on this year's ratios.]

[N.B. Additional disclosure would be required if Methods B or C are used to calculate the ratio, namely:
•Why that method was chosen.
•What estimates /adjustments were made [for example if estimates need to be included in relation to bonus payouts for 2018]
•Modelling used to calculate full-time equivalent remuneration]

Gender & ethnicity pay reporting

Gender pay

- Year 2 disclosures required by April 2019
- Increasing focus on steps being taken / direction of travel etc.
- Government Equalities Office published report with ideas on how to address the gender pay gap

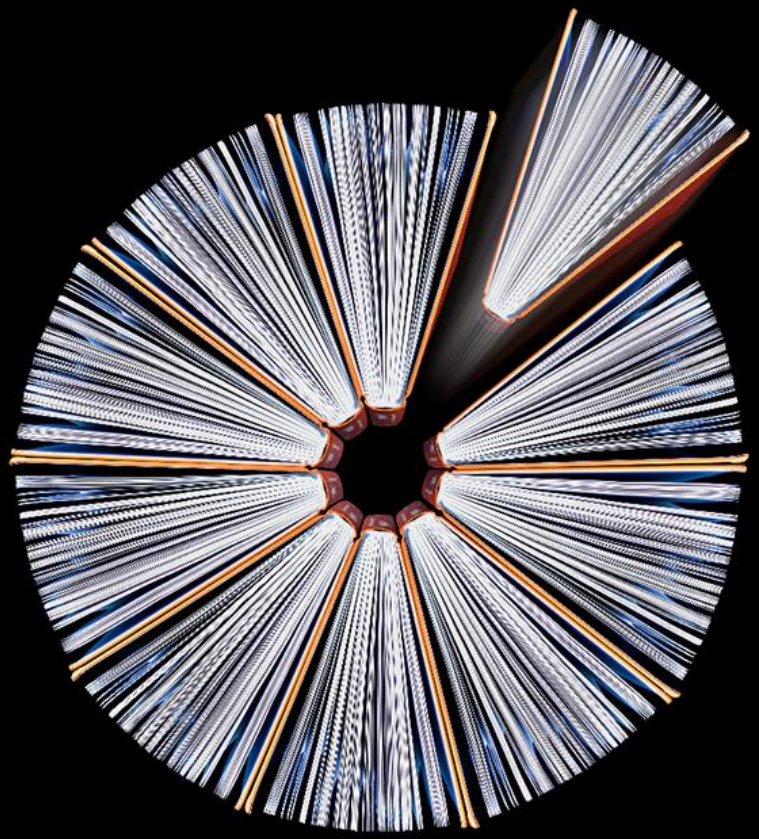
Ethnicity pay

- BEIS department undertaking consultation on potential introduction of ethnicity pay reporting
- It gives the following alternatives to consider:
    - *One pay gap figure comparing average hourly earnings of ethnic minority employees as a percentage of white employees*
    - *Several pay gap figures comparing average hourly earnings of different groups of ethnic minority employees as a percentage of white employees*
    - *Ethnicity pay information by pay band or quartile, showing the proportion of employees from different ethnic groups by £20,000 pay bands or by pay quartiles*
- Consultation runs to January 2019

IFRS 16

Lucy Newman

Deloitte.



IFRS 16

How ready are you?

13 November 2018

Market trends and challenges

Discount rate

Stakeholder management

Financial impact

Modified retrospective

Lease term

Rate implicit in the lease

IBR

Tax

Operations

Impact analysis

Audit approach

Modelling

Systems

Fully retrospective

Data collection

Practical expedients

Disclosure

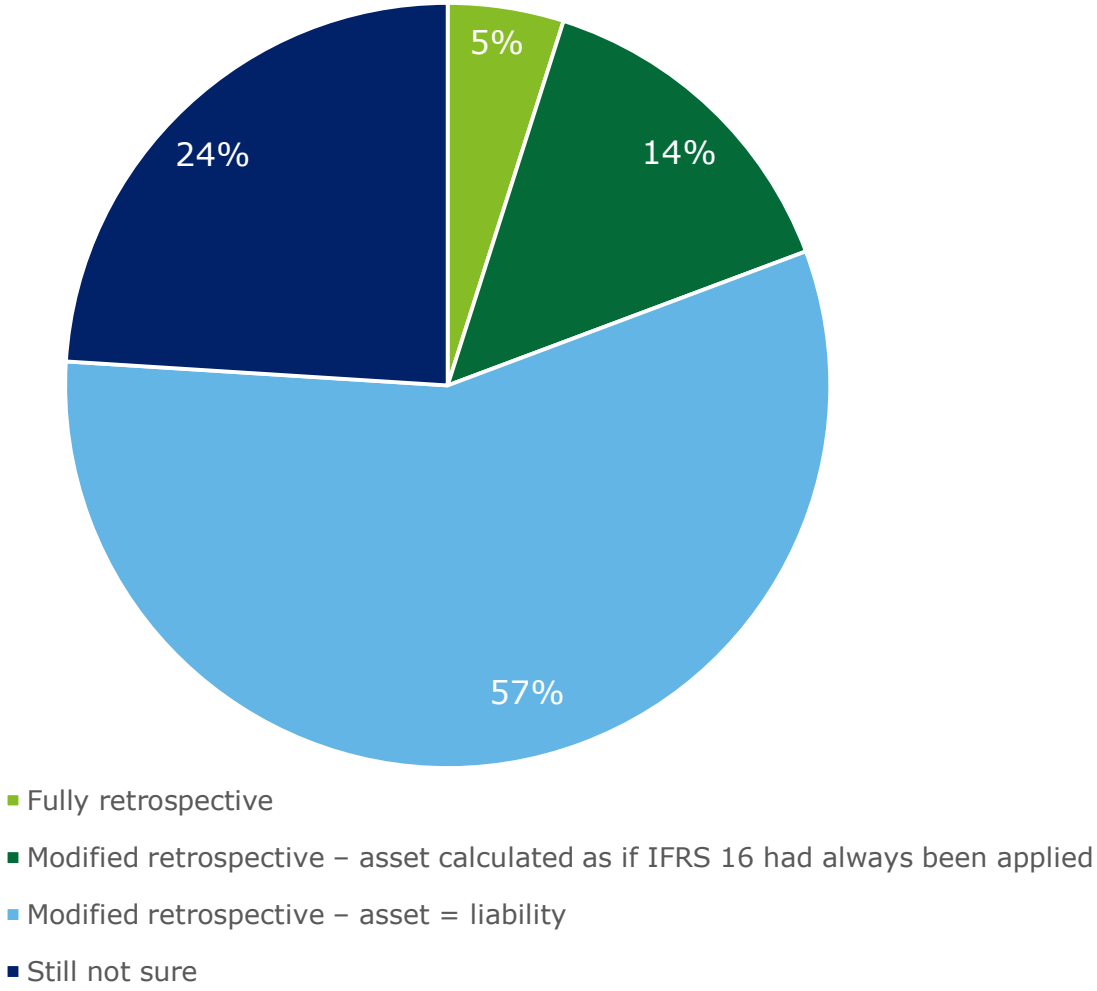
Transition approach

Definition of a lease

1 January 2019

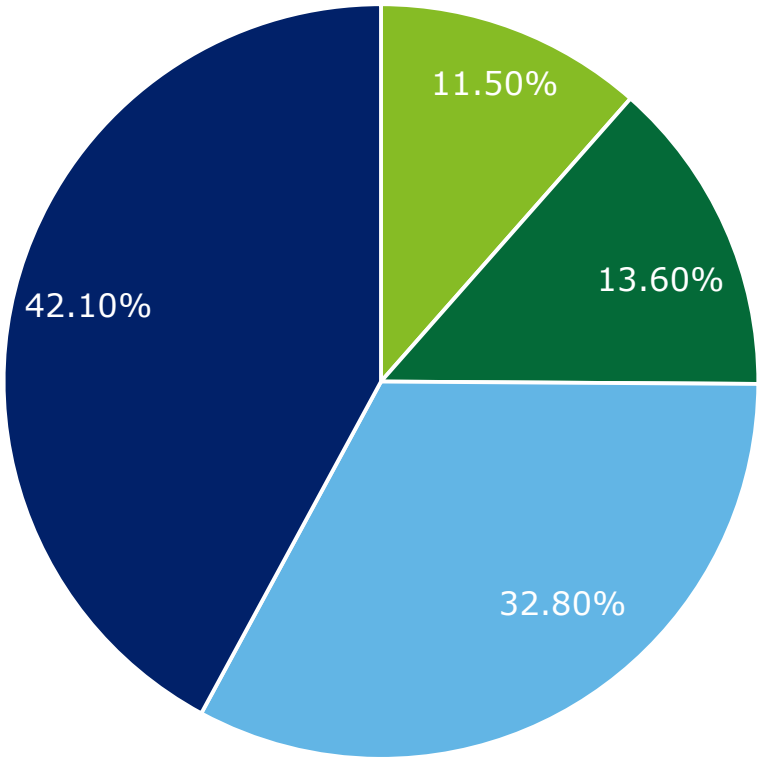
Responses to this question from September webinar

Which approach do you intend to take on transitioning to IFRS 16? (104 respondents)



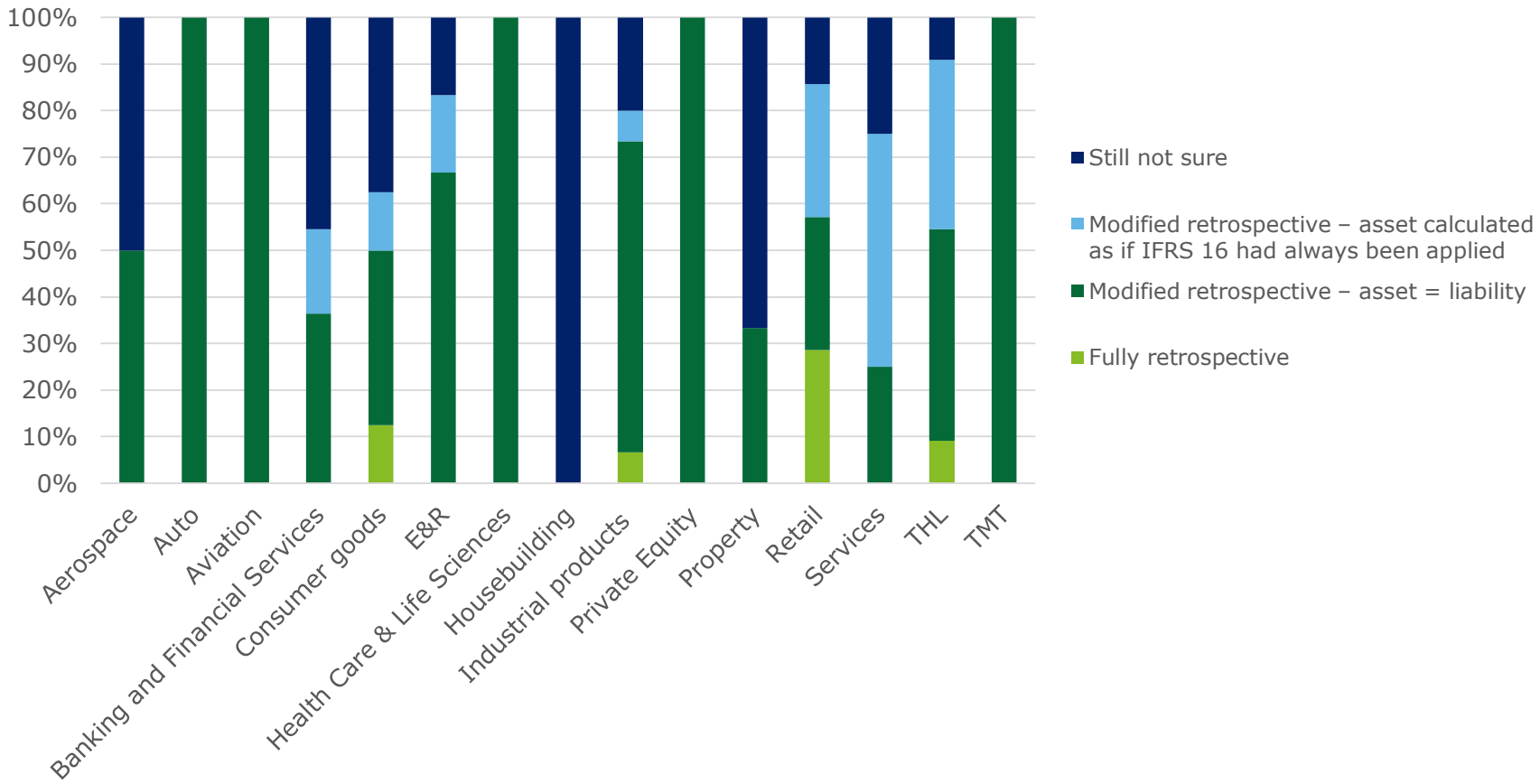
Responses to this question from April webinar

What approach do you intend to take on transitioning to IFRS 16? (140 respondents)



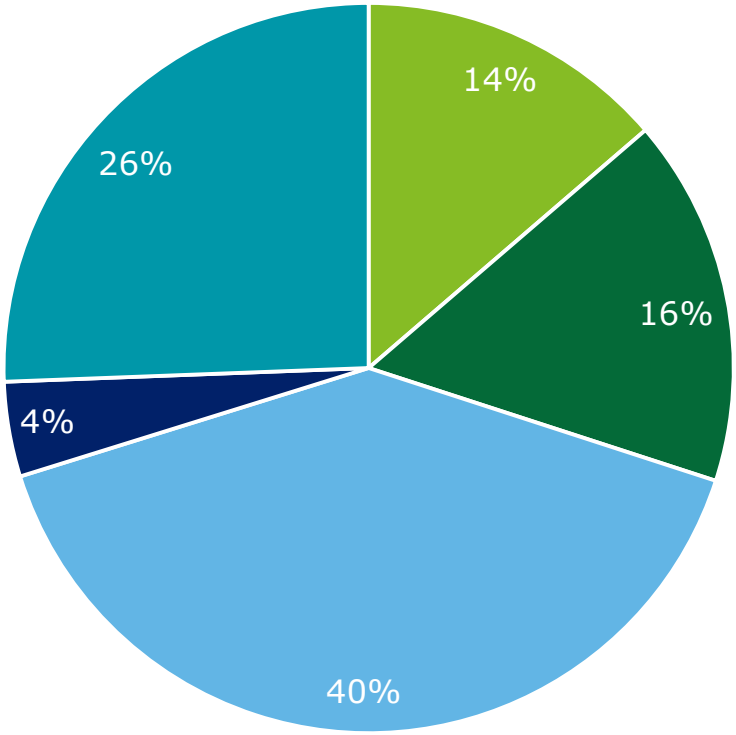
- A) Fully retrospective
- B) Modified retrospective – asset calculated as if IFRS 16 had always been applied
- C) Modified retrospective – asset = liability
- D) Still not sure

Approach to IFRS 16 transitioning by industry group (104 respondents)



Responses to this question from September webinar

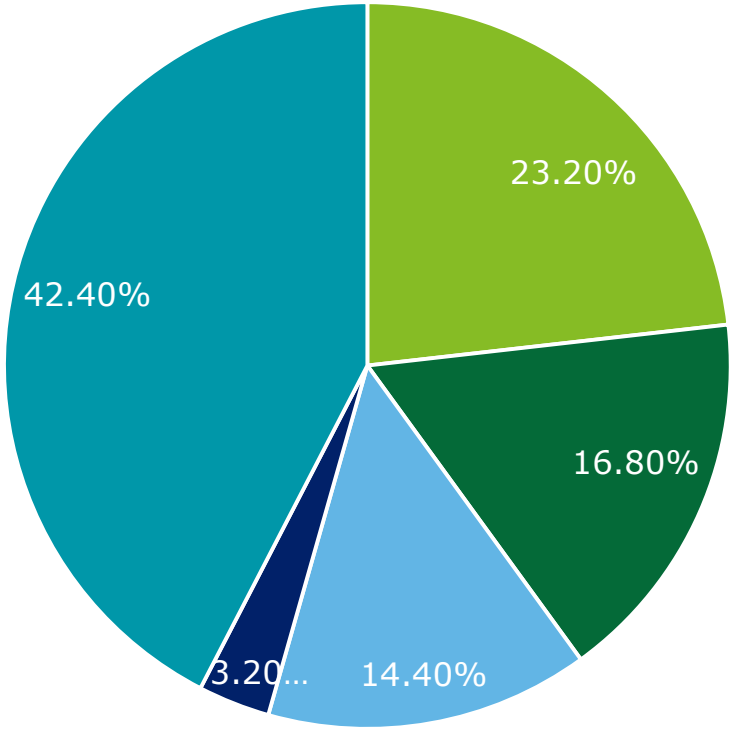
If you require a new system solution, please indicate stage of implementation



- Options analysis - Initial requirements and strategic approach to short list options
- Selection / procurement – procurement exercise to secure a solution is underway
- Implementation – Implementation of chosen solution is in progress
- Delivered – parallel running in progress to test BAU processes
- N/A – no technology change is required

Responses to this question from April webinar

If you require a new system solution, please indicate your stage of implementation (125 respondents)



- 1) Options analysis - Initial requirements and strategic approach to short list options
- 2) Selection / procurement – procurement exercise to secure a solution is underway
- 3) Implementation – Implementation of chosen solution is in progress
- 4) Delivered – parallel running in progress to test BAU processes
- 5) N/A – no technology change is required

Problem areas

Problem areas

Things to watch out for

Discount rate methodology

- Lease vs bond term
- Subsidiaries
- No debt

Systems

- Calculation assurance
- Functionality

KPIs and stakeholder comms

- Adjusted KPIs?
- Analyst/ investor strategy

Lease identification completeness

- IT/ cloud/ DR
- Marketing/ periodic
- Company cars

Processes and controls

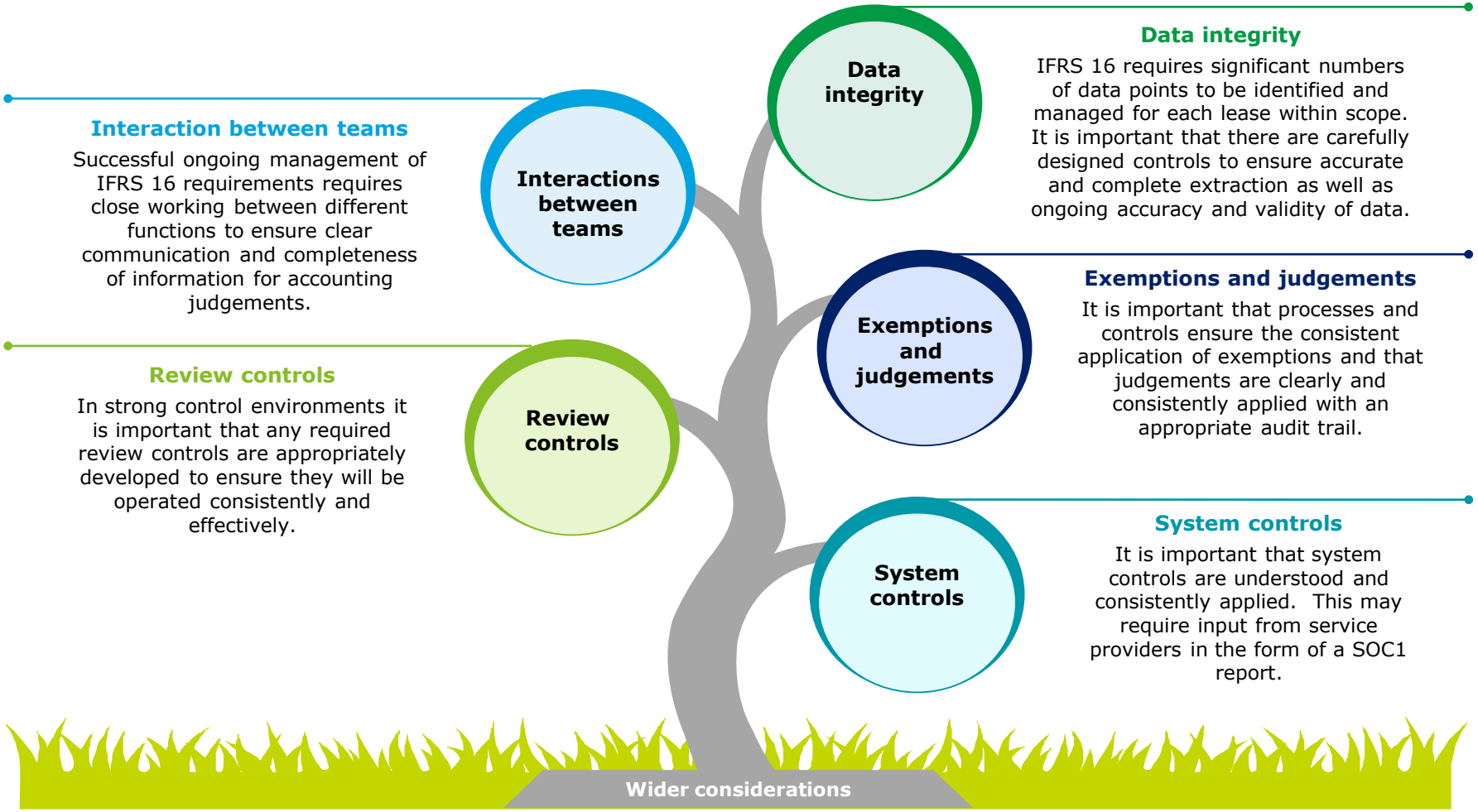
IFRS 16: Process design and control considerations

Why this is important

1. Significant change required by IFRS 16
2. Complexity and scope of the change
3. Wide-ranging – many stakeholders
4. Judgement: application and inputs
5. Material impact? Significant audit risk

IFRS 16: Process design and control considerations

Deloitte observations



Data integrity

IFRS 16 requires significant numbers of data points to be identified and managed for each lease within scope. It is important that there are carefully designed controls to ensure accurate and complete extraction as well as ongoing accuracy and validity of data.

Interaction between teams

Successful ongoing management of IFRS 16 requirements requires close working between different functions to ensure clear communication and completeness of information for accounting judgements.

Exemptions and judgements

It is important that processes and controls ensure the consistent application of exemptions and that judgements are clearly and consistently applied with an appropriate audit trail.

Review controls

In strong control environments it is important that any required review controls are appropriately developed to ensure they will be operated consistently and effectively.

System controls

It is important that system controls are understood and consistently applied. This may require input from service providers in the form of a SOC1 report.

Tax changes

Tax changes

Where are we now?

UK tax position

Existing UK corporation tax legislation starts with the position in the accounts prepared under generally accepted accounting principles (IFRS or UK GAAP) and layers on the tax rules.

Existing tax legislation sets out the different tax treatment for operating leases and finance leases (including long funding leases and HP agreements).

After consultation in December 2017, On 6 July 2018 the UK government published the Income Tax and Corporation Tax response to accounting changes for leasing policy paper together with draft legislation. Final legislation will be introduced in Finance Bill 2018-19. The UK tax law amendments have effect for **periods of account beginning on or after 1 January 2019**.

Main elements of the draft legislation:

- amendments will be made to the **long funding lease rules** including the provisions to grandfather leases held upon adoption of IFRS16;
- the definition of a finance lease will be amended in the **Corporate interest restriction rules**, which will require an IFRS 16 lessee to classify their leases between operating and finance leases for CIR purposes;
- Provisions for the **tax treatment of any transitional adjustment** recognised upon adoption of IFRS 16 – this will be spread for tax purposes with effect for periods of account beginning on or after 1 January 2019.

In addition, legislation will be introduced in Finance Bill 2018-19 that will repeal section 53 of FA 2011, which prevents certain changes in lease accounting standards having effect for tax purposes.

Tax changes

Where are we now?

Corporate interest restrictions

- Per the consultation response, the aim of the draft legislation is to maintain the status quo.
- Companies adopting IFRS 16 will need to continue to classify their leases as either 'finance leases' or 'operating leases'
- Limited further details available.

Transitional adjustment

Transitional adjustments recognised upon adoption of IFRS 16 will be **spread for tax purposes** with effect for periods of account beginning on or after 1 January 2019, i.e. the debit or credit to reserves will be deductible or taxable for tax purposes:

- Transitional adjustment to be spread over the average length of the leases which have given rise to the transitional adjustment.
- This will have both a **current** tax impact and a **deferred tax** impact.
- For **early adopters** – this can be complicated as Section 53 Finance Act 2011 continues to apply until formerly repealed. Therefore no tax relief / taxable amount in year of adoption

Tax changes

Where are we now?

Key points

- Consultation on the draft UK tax legislation taken place. We do expect some changes / points to be clarified further.
- **This isn't just UK** - Tax authorities globally are considering the impact of the accounting change and releasing updated legislation / guidance
- Businesses should begin modelling **the tax impact** of any transitional adjustment debit/credits and the changes to the Long Funding Lease legislation.
- Businesses should consider **internal systems / processes** to enable the continued distinction between operating and finance leases for CIR purposes.

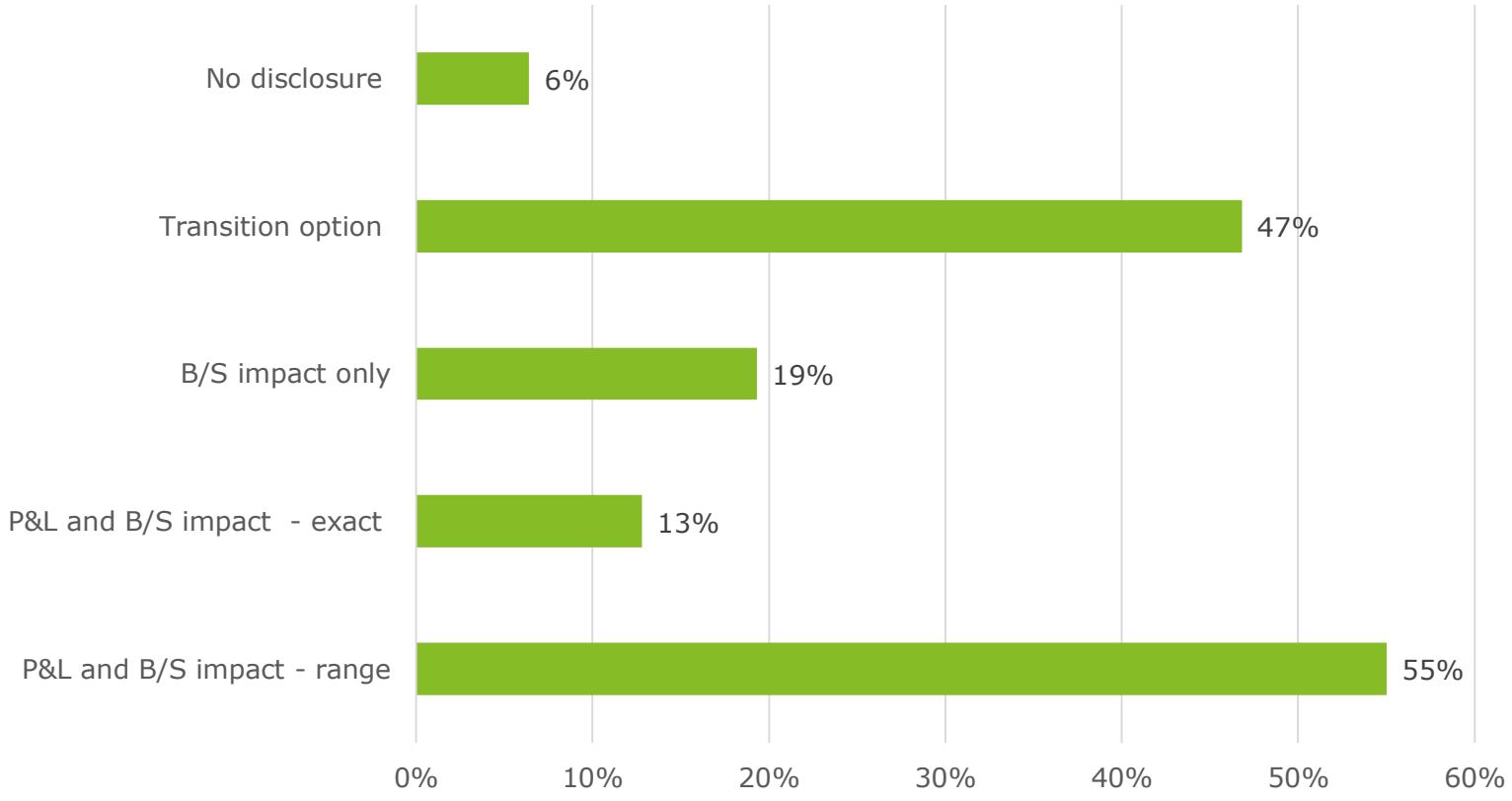
Impact and disclosures

Disclosure

IAS 8 impact disclosures before implementation

- Disclose anticipated impact
- Quantitative information
- Take care in cross-referring to IAS 17 commitments
- Entity-specific
- Practical expedients
- Approach to transition
- Could be key audit matter
- Expect further reminders from FRC

In your next annual report what are you planning to disclose in respect of IFRS 16? (109 respondents) (please tick all that apply)



Disclosure
Early adopters

Air France KLM

DHL Group

Axel Springer

Nestlé

Tom Tom

Medserve Energy

Kion

ProSieben SAT1

Amadeus

RELX

Disclosure
Model disclosures

Available at www.ukaccountingplus.co.uk - search "early adoption of IFRS 16"

2.1. Financial impact of initial application of IFRS 16

The tables below show the amount of adjustment for each financial statement line item affected by the application of IFRS 16 for the current and prior year.

Commentary:

Unlike other recent Standards (e.g. IFRS 15 Revenue from Contracts with Customers*), for entities that adopt the new Standard using a full retrospective approach, IFRS 16 does not provide an exception from the requirement of IAS 8.28(f) to present the effect of the new Standard on the current period amounts.*

Impact on profit or loss	Year ended 31/12/17	Year ended 31/12/16
	CU'000	CU'000
Impact on profit (loss) for the year		
Increase in investment income (f)		
Increase in depreciation and amortisation expense (a)		
Increase in finance costs (a)		
Decrease in other expenses (a), (e)		
Increase (Decrease) in profit for the year		
Increase (Decrease) in other comprehensive income for the year		

Q&A

Deloitte IFRS 16 team

Lucy Newman
Partner (IFRS 16 lead)

lcnewman@deloitte.co.uk

Kate Waite
Director (IFRS 16 assurance)

kwaite@deloitte.co.uk

Peter Westaway
Director (IFRS 16 Technical)

pwestaway@deloitte.co.uk

Phil McManus
Assistant Director (Debt advisory)

phmcmanus@deloitte.co.uk

Lucy Small
Director (IFRS 16 Tax)

lsmall@deloitte.co.uk

Bob Dee
Partner (Business modelling)

rdee@deloitte.co.uk

Russell McMillan
Partner (Real Estate)

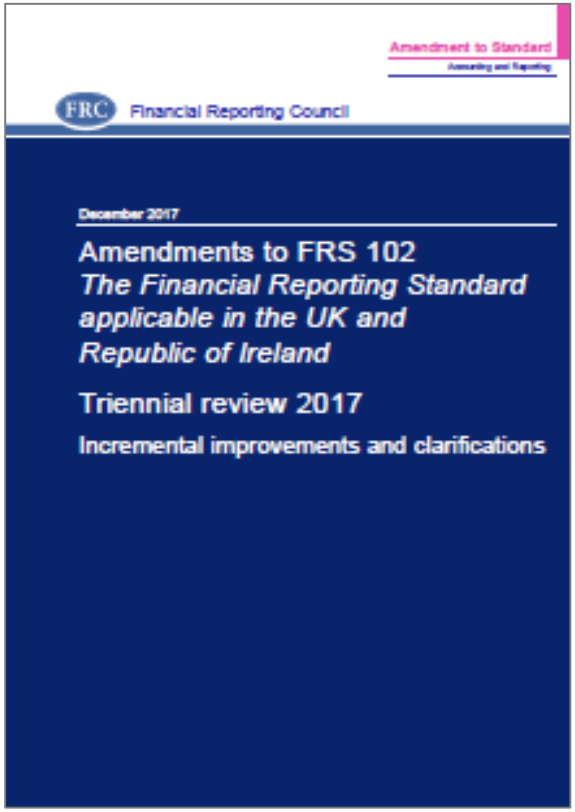
rmcmillan@deloitte.co.uk

Deloitte.

UK GAAP

Amanda Swaffield

Triennial review of FRS 102 – Amendments published


Amendment to Standard

Financial Reporting Council

December 2017

Amendments to FRS 102
The Financial Reporting Standard applicable in the UK and Republic of Ireland

Triennial review 2017

Incremental improvements and clarifications

Incremental improvements and clarifications

Does not incorporate major changes in IFRSs

Effective periods beginning 1 January 2019

Early adoption permitted

FRS 102 Triennial review

Financial instruments

Basic v 'other'

- Rules-based classification retained, but…
- Principle added to capture instruments intended to be basic
- Apply rules first then look to principle if rules don't get you to basic by applying rules

Loans from directors to small entities

- Can measure at amount of advance
- Applies to loans from directors and close family
- Also applies to loans from members to small LLP
- Can adopt early in isolation

FRS 102 Triennial review

Investment properties

- Undue cost or effort exemptions removed
- Accounting policy choice to measure investment property rented to another group entity at cost less depreciation and amortisation
- Other investment property is at fair value through profit or loss

Net debt reconciliation

- Additional note in support of cash flow statement
- Does **not** copy across IAS 7 changes
- Goes back to old UK GAAP FRS 1

Business combinations

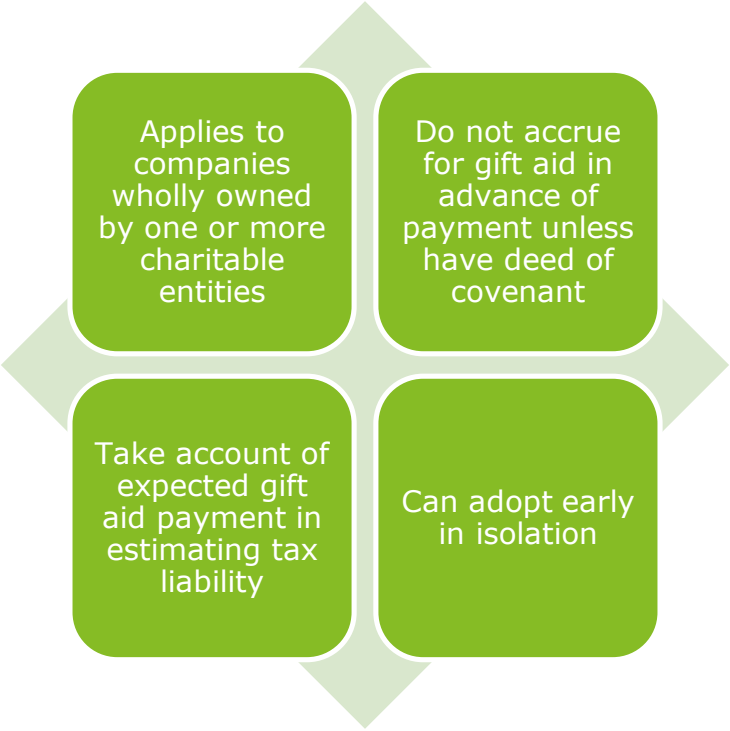
- Fewer intangibles will need to be recognised separately on a business combination
- Still need to recognise if separable **and** arise from contractual or legal rights
- Policy option to recognise more intangibles separately

Definition of a financial institution

- 'Catch-all' component of definition simplified:
- "…any other entity whose principal activity is similar to those listed above but is not specifically included in that list"
- Stockbrokers and retirement benefit plans removed from definition

FRS 102 Triennial review

Gift aid payments to charitable owners



FRS 102 Triennial review

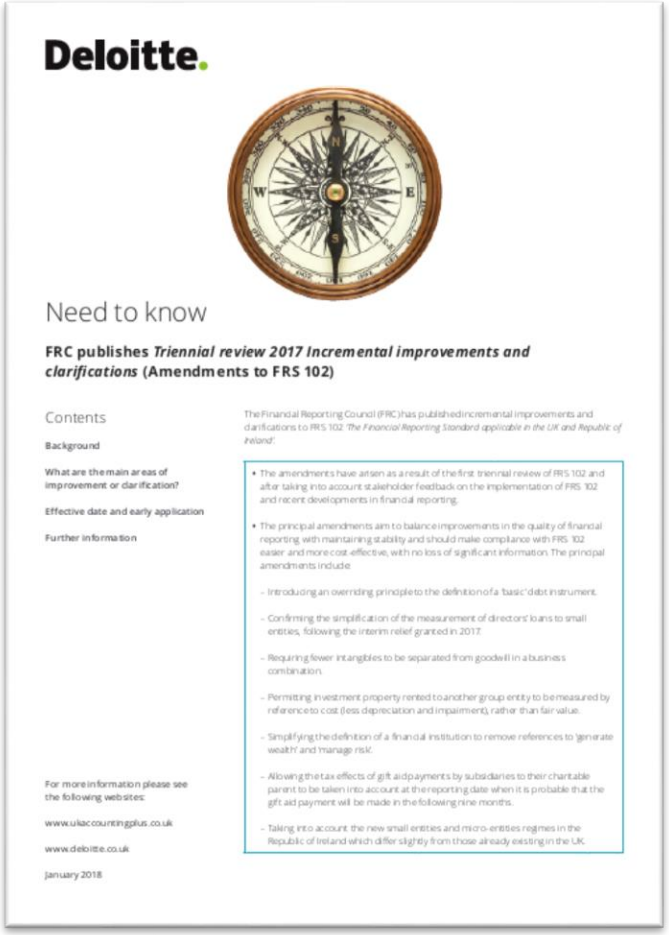
Summary

Lots of changes of detail

Principal v agent

Debt for equity swaps

Consequential amendments



Deloitte.

Need to know

FRC publishes *Triennial review 2017 Incremental improvements and clarifications* (Amendments to FRS 102)

Contents

The Financial Reporting Council (FRC) has published incremental improvements and clarifications to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

- The amendments have arisen as a result of the first triennial review of FRS 102 and after taking into account stakeholder feedback on the implementation of FRS 102 and recent developments in financial reporting.
- The principal amendments aim to balance improvements in the quality of financial reporting with maintaining stability and should make compliance with FRS 102 easier and more cost-effective, with no loss of significant information. The principal amendments include:
  - Introducing an overriding principle to the definition of a 'basic' debt instrument.
  - Confirming the simplification of the measurement of directors' loans to small entities, following the interim relief granted in 2017.
  - Requiring fewer intangibles to be separated from goodwill in a business combination.
  - Permitting investment property rented to another group entity to be measured by reference to cost (less depreciation and impairment), rather than fair value.
  - Simplifying the definition of a financial institution to remove references to 'generate wealth' and 'manage risk'.
  - Allowing the tax effects of gift aid payments by subsidiaries to their charitable parent to be taken into account at the reporting date when it is probable that the gift aid payment will be made in the following nine months.
  - Taking into account the new small entities and micro-entities regimes in the Republic of Ireland which differ slightly from those already existing in the UK.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

January 2018

See our Need to know publication

www.ukaccounitngplus.co.uk

Closing remarks

Tom Murray

Deloitte.