Financial Reporting Update

FRC Corporate Reporting Review – Annual Report 2014

Areas for immediate note

Policy, judgement and estimate disclosure

A consistent theme is the FRC's dissatisfaction in this area. Rather than boilerplate, generic policies, the FRC wants to see a step-change to provide specifics, at a granular level, about how IFRS is applied to the particular circumstances of the company, e.g., with respect to different revenue streams and the key judgements and estimates taken. They will pay particular attention to accounts' disclosures about accounting areas that feature in new style audit reports.

Strategic Reports

The FRC found that Strategic Reports for some companies, particularly smaller-listed, AIM and private companies (e.g., PE-owned portfolio companies) can be unbalanced, incomplete or inappropriately brief.

Intangible asset recognition

The FRC is likely to challenge companies recording more goodwill than identifiable intangible assets in an acquisition.

Impairment testing

There remain cases where companies' impairment testing relies on heroic assumptions about future prospects.

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Our October edition of *Breaking News UK* highlighted the issue of the Financial Reporting Council's (FRC) annual report on its corporate reporting review activities which covers its reviews of reports and accounts for the year ended 31 March 2014.

In this first issue of our new-look *Financial Reporting Update*, we summarise the FRC's report findings along with particular areas that the FRC considers companies should focus on in the future.

The FRC's Report and technical findings are available here.

Overview of findings

Large public companies reporting	Generally of a high standard and consistent with prior years although queries still arise for complex transactions and areas that require difficult judgments or particularly subjective estimates.
Smaller listed and AIM companies	FRC remains concerned due to the number of poorer quality accounts it reviews for these companies. A three year project has commenced to help address this. Initially the FRC is seeking to identify the root causes of this issue and will then move on to implementing supporting actions.

November 2014, Issue 1

Overview of findings (cont.)

Audit report risks of material misstatement	The FRC intends to monitor the disclosures provided for issues identified as risks of material misstatement in audit reports and audit committee reports and consider the appropriateness of the related disclosure.
Good practices in responding to letters	The report includes a new checklist of points to assist companies in responding effectively to the FRC. These look for comprehensive responses covering all issues raised and encourage the involvement of all relevant parties including auditors. These points, along with the FAQs now on the FRC website, indicate a keenness to get companies to respond effectively and accelerate the review process.
Clear and concise (cutting clutter)	The report highlights the FRC's 'Clear & Concise' initiative and the Financial Reporting Lab's 'Towards Clear and Concise Reporting' and encourages companies to make improvements in the clarity and adequacy of their disclosures. Areas of improvement include ensuring accounting policies provided are relevant to the company and disclosure is not provided for clearly trivial items or areas that are of no consequence to the company.

Areas of focus for the future

The report sets out areas that the FRC will focus on over the next reporting season. They include:

- Ongoing monitoring of pensions structures designed to achieve an accounting effect following the conclusion of discussions on deficit reduction schemes which employed Scottish Limited Partnerships. Presence of quantitative and qualitative disclosures covering governance of pension plans, applicable regulatory frameworks, such as minimum funding requirements, funding arrangements and maturity profiles.
- How companies are adopting IFRSs 10, 11 and 12. The FRC believes the test of 'de facto' control is more relevant under IFRS 10, particularly where large minority shareholders effectively run a company.
- The FRC believes IFRS 15 *Revenue from Contracts with Customers* will have far-reaching implications for certain companies and encourage companies to disclose the effect of adopting this standard as soon as it is, or should be, reasonably estimable.
- Assessing whether companies are taking on board the guidance provided in the FRC press notice on exceptional items which looked for consistency in approach year on year and between gains and losses and requested companies to reassess whether certain recurring items should be classified as exceptional.
- Investigating circumstances in business combinations where goodwill recognised is substantially in excess of identified intangible assets. The FRC expects a clear explanation to be provided in cases where companies conclude that this is appropriate.
- Impairment review disclosures continue to be a concern particularly where the review disclosures are inconsistent with the rest of the annual report, the use of a single discount rate for CGUs with different risk profiles and deficient disclosures for the description and approach taken to key assumptions applied in the projections along with unclear sensitivity disclosures.
- The FRC will monitor compliance with other legislation and regulations that companies are required to comply with in preparing annual reports. This includes remuneration reports with disclosures regarding the disparity between the remuneration of senior executives and other employees of a company being a particular area that will be reviewed.

Operational activity

The analysis indicated that the FRC's activity remained at a similar level to 2012/13.

In 2013/14 271 annual reports were reviewed (2012/13: 264). Consequently the FRC wrote to 100 companies (37%) (2012/13: 91 (34%)), although the report indicated that more appendix-only letters were issued so letters requiring a response stayed at a similar level to 2012/13. Two company-specific press releases and a further eight references to the FRC occurred in the period (2012/13: one press release and 10 references).

The FRC acknowledged that its prioritisation of FTSE 350 reviews resulted in correspondence with smaller companies happening later in their reporting cycle, making it difficult to resolve the issues raised in the letters prior to the next publication of accounts.

The report highlights the development of a collaborative working relationship with the Audit Quality Review team. In addition the FRC is developing its review of overseas companies, where they are listed in the UK, and have formally advised an overseas company of the FRC's powers to apply to court to obtain information previously requested. It has also referred one AIM company to the London Stock Exchange.

Designed and produced by Create Graphics
Document number: CRT028905A