Financial Reporting Council

ANNUAL REVIEW OF CORPORATE REPORTING 2015/2016

OCTOBER 2016

Characteristics of good corporate reporting

A Good Annual Report and Accounts:
Nine characteristics of good corporate reporting

Beyond basic compliance with the fundamental requirements of the law and accounting standards and the need for complete and accurate publication of accounting information, there are characteristics of corporate reporting which we believe make for a good annual report.

1 A single story

The narrative in the front-end is consistent with the back-end accounting information; significant points in the financial statements being explained in the narrative reports so that there are no surprises hidden in the accounts.

2 How the money is made

The strategic report gives a clear and balanced account which includes an explanation of the company's business model and the salient features of the company's performance and position, good and bad.

3 What worries the board

The risks and uncertainties described in the strategic report are genuinely the principal risks and uncertainties that concern the board. The descriptions are sufficiently specific that the reader can understand why they are important to the company. The report also describes the mitigating actions taken by the board to manage the impact of its principal risk and uncertainties. The links to accounting estimates and judgements are clear.

4 Consistency

Highlighted or adjusted figures, key performance indicators (KPIs) and non-GAAP measures referred to in the strategic report are clearly reconciled to the relevant amounts in the accounts and any adjustments are clearly explained, together with the reasons why they are being made.

5 Cut the clutter

Important messages, policies and transactions are highlighted and supported with relevant context and are not obscured by immaterial detail. Cross-referencing and signposting is used effectively; repetition is avoided.

6 Clarity

The language used is precise and explains complex accounting and reporting issues clearly; jargon and boilerplate are avoided.

7 Summarise

Items are reported at an appropriate level of aggregation and tables of reconciliation are supported by, and consistent with, the accompanying narrative.

8 Explain change

Significant changes from the prior period, whether matters of policy or presentation, are properly explained.

9 True and fair

The spirit as well as the letter of accounting standards is followed. A true and fair view is a requirement of both UK and EU law and applies equally to accounts prepared in accordance with UK GAAP and IFRS.

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1 EXECUTIVE SUMMARY

The FRC's mission is to promote high quality corporate governance and reporting to foster investment. The building of trust through good governance and transparent reporting is fundamental to the success of individual businesses and to a healthy economy.

This report is part of a series, following earlier reports on developments in corporate governance and audit. It provides the FRC's assessment of corporate reporting in the UK based on broad outreach and evidence, including that obtained from the FRC's own monitoring work, performed by its Corporate Reporting Review ("CRR") team, on cases opened in the year to 31 March 2016, and from more recently performed thematic reviews.

Annual reporting requirements are established by a combination of law, standards and other regulations and most public and larger private companies are also subject to audit. This report should be read in the context of significant changes to corporate reporting requirements introduced by the FRC and others in recent years; in particular, the publication of guidance for directors in preparing the strategic report so that it provides shareholders with a holistic and meaningful picture of an entity's business model, strategy, development, performance, position and future prospects.

The FRC's monitoring work focuses on those aspects of reports and accounts where we have delegated powers to monitor compliance with the law, most notably the financial statements and the strategic report. Key areas not covered by these powers include the corporate governance statement and the remuneration report. The FRC's enforcement work focuses on pursuing members in business and their auditors for misconduct.

Inevitably requirements for how items are measured and recognised in the financial statements are more specific than those designed to help directors decide the extent of disclosure particularly within the strategic report. Accordingly our findings are more subjective where the application of judgement is greater.

Overall conclusion

Given the complexity and breadth of corporate reporting it is not possible to assess the overall quality of corporate reporting in one sentence. Compliance with the accounting framework, particularly by larger public companies, is generally good and the introduction of the strategic report has improved the quality of narrative reporting. However, there is room for further improvement, particularly as not all companies provide sufficient balance. Failure to acknowledge when things have not gone so well, the excessive use of underlying profit figures or inappropriate use of alternative performance measures ("APMs") undermine the quality of corporate reporting and erode trust.

A YouGov survey of 224 stakeholders undertaken on behalf of the FRC found that over 90% of directors and auditors and 73% of investors have high levels of confidence in the quality of corporate reporting. However, there is continuing concern over the length and accessibility of the annual report and accounts.

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

Compliance with the accounting framework, particularly by larger public companies, is generally good and the introduction of the strategic report has improved the quality of narrative reporting.

There is room for further improvement, particularly as not all companies provide sufficient balance.

The FRC's monitoring programme

The FRC reviewed 192 annual and interim reports and accounts as part of its 2015/16 monitoring activities. Two thirds of those reviews were closed without the need for follow up action. The rest resulted in substantive queries being raised. Almost all the companies were able to resolve these queries and only one Review Group[1] was required, reflecting the generally positive responses of companies. All our queries resulted in some degree of improvement in the quality of companies' reporting. Two companies were required to refer, in their subsequent reports, to the action taken to address our concerns about their prior year primary financial statements.

To further support the transparency of the FRC's work, we now write to companies to acknowledge when their annual report and accounts have been reviewed and no material issues requiring further explanation have been identified. This will support the encouragement within the UK Corporate Governance Code ("the Code") for companies to voluntarily explain their interaction with the FRC on the quality of their reporting and audit.

Financial statements

The FRC's focus on cash flow statements and capital management disclosures has resulted in improved reporting and few queries being raised in those areas in 2015/16. The most significant findings on financial statements in 2015/16 include:

- **Accounting policies** – Many companies still need to provide more specific, granular accounting policies, particularly around revenue recognition. Companies should provide a clear linkage between their business models and their revenue policies and explanations of exactly when and how revenue is measured on complex long-term contracts, such as those entered into by outsourcers.

- **Judgement and estimates** – The FRC raised queries in respect of critical judgements and sources of estimation uncertainty where it could not identify the specific judgements a board had made or understand how uncertainty could affect the next year's accounts. We find too many examples of generic references to judgements and estimates that could be replaced by more concise explanations of how particular decisions or assumptions affect results. Companies should provide quantified information on how changes to estimates could affect the following year's results, such as sensitivities or ranges of potential outcomes.

- **Tax reporting** – As a result of concerns identified in previous years, we undertook a thematic review of companies' tax disclosures by pre-informing 33 companies of an intention to look at those disclosures in their next set of accounts. The pre-informing of companies prompted improvements to the overall quality of their reporting of tax matters.

  The improved quality of information provided in companies' effective tax-rate reconciliations resulted in greater visibility of the factors, including structuring, affecting the tax charge and its sustainability. However, there is scope for companies to articulate better how they account for tax uncertainties by explaining the bases for recognition and measurement. The FRC will continue to challenge companies who do not disclose the amount of uncertain tax provisions when these are subject to risk of material change in the following year.

- **Pension disclosures** – Continued low interest rates and the economics of defined benefit pension arrangements have increased the need for companies to improve the transparency of their pension arrangements. The FRC has written to companies whose funding strategy disclosures do not adequately explain the risks to which the company is

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1 Initially, the Conduct Committee raises questions with a company where there is, or may be, a question as to whether the accounts comply with relevant accounting and reporting requirements. Most matters are resolved through correspondence. If, after considering additional information and explanations, the Conduct Committee believes that there is still a possibility of a significant breach of accounting or disclosure requirements, then it will open a **Review Group** of FRRP members to consider the matters.

exposed by the pension plan. It has also written where the disclosure of the plan's assets do not reflect the nature of the plan's investments, such as whether asset repurchase obligations exist, or explain how fair values have been estimated for complex instruments such as insurance contracts or longevity derivatives.

Strategic reports

The introduction of the strategic report has been an effective tool for improving the quality of corporate reporting. Given that this is a recent development, it is understandable that there are opportunities for further improvement. Overall quality can be improved by, for example, ensuring strategic reports make linkages between different aspects of the business and tell the company's story effectively and in a way that is fair, balanced and understandable as the Code requires. The FRC recognises the legal requirement for the strategic report to be comprehensive. Comprehensiveness reflects a breadth of information that covers significant trends and changes in financial statements in a depth that is commensurate with their materiality, it does not mean including all possible information. Reports should be clear and concise. All those involved in corporate reporting are encouraged to focus on the communication and placement of information and on materiality.

One of the most common areas of challenge by the FRC was whether reports reviewed were sufficiently balanced. Often reports fail to include information of particular interest to investors, such as a discussion of effective tax rates or non-financial key performance indicators ("KPIs"). This assessment prompted the FRC to undertake its thematic review of tax disclosures. The FRC's reviews identified examples of reports that focused too much on financial performance but omitted relevant balance sheet and cash flow information. These reports tended to be produced by smaller companies.

The FRC recently introduced, through the Code, a requirement for companies to make a viability statement. This requirement has reportedly improved board discussion on risks and their mitigation. The FRC has reviewed nearly 100 FTSE 350 viability statements. This review, on which we will report more fully as part of the 2017 *Developments in Corporate Governance and Stewardship*, showed that some 75% of companies chose to use a three-year time horizon for their consideration of viability. Some good examples of why a three-year period was chosen and the underlying risks to the statement were identified. However, three years should not become the default option and directors are expected to give adequate thought to their company's particular circumstances. Companies are encouraged to provide better explanations of how they carried out the process and the underlying analysis.

A good articulation of the business model and principal risks within the strategic report gives valuable insights, not only into the business and how it generates cash, but also into how the company operates more broadly and provides insights into its prevailing culture. There is an ongoing Financial Reporting Lab ("Lab") project on business model disclosure. The project is likely to confirm the importance of information on business models to investors, and aims to establish characteristics of good reporting and practical ways that companies might consider meeting investor needs. The report will be published shortly.

Following the FRC focus in its monitoring work there has been an improvement in the quality of reporting of principal risks and uncertainties ("PRUs") with fewer queries being raised with companies.

There continue to be examples of companies giving too much emphasis to APMs or pro-forma information prepared on a non-IFRS basis and failings to adequately discuss their IFRS results. To improve performance in this area, the FRC is undertaking a thematic

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Companies need to respond to increasing stakeholder scrutiny of their tax strategies.

review on the use of APMs in companies' interim financial reports and will report its findings in November 2016.

Another area of increasing public focus is companies' tax arrangements, which can give rise to significant risk. Companies need to respond to increasing stakeholder scrutiny of their tax strategies, including where they pay tax, and consider carefully whether they are sustainable, ensuring that any material risks to which they give rise are clearly described in the report and accounts. The outcome of our thematic review of tax disclosures is summarised in section 3.

Last year, the Lab produced a report on best practice in dividend disclosures. The report suggests enhancements to dividend policy disclosures to ensure they are specific on the parameters and inherent flexibility of the approach taken, and explain why it was felt appropriate. In relation to applying the policy, disclosure of judgements taken and a scaled approach to describing available cash and distributable profits, is recommended. There is room for further improvement in linking more detailed disclosure of how dividend policies operate in practice to how those policies may be impacted by the risks and capital management decisions facing the company.

The Local Authorities Pension Fund Forum ("LAPFF") believes disclosure of the level of distributable reserves to be a legal requirement and has recently urged companies to disregard the FRC's guidance on this point. The FRC's position remains that we encourage good disclosure and companies paying close attention to their investors' views whilst noting that the Companies Act 2006 does not require the separate disclosure of a figure for distributable profits or, specifically, multiple figures for distributable profits. The Companies Act 2006 is a matter for the Department for Business, Energy and Industrial Strategy. Its public statements are consistent with the FRC's.

In July we published advice for companies on reporting the risks of a decision to exit the European Union ("EU")[2]. This is being followed up with a thematic study of how effectively companies are reporting on the implications for their company in the short-term and medium-term. Initial observations, based on companies' June 2016 interim reports, are discussed in section 3. The FRC will continue to monitor developments.

Calls for transparency on a broader range of issues and for reporting to a broader group of stakeholders continue to grow, for example, in the context of environmental, social and governance responsibilities and for country-by-country reporting of tax. Some of the calls for additional corporate reporting come from existing shareholders who are interested in how these broader non-financial matters may have an impact on the development, performance and position of the business over the longer-term. However, much of the demand comes from other stakeholders.

Whilst the primary audience for the annual report and accounts remains existing shareholders, the FRC recognises the validity of wider stakeholder interest in corporate reporting. Companies need to recognise that the concerns of stakeholders will have a bearing on their reputation and could materially affect their profitability and the interests of shareholders. It is worth noting that shareholders themselves are looking for more disclosure in relation to public interest matters. For example, FRC discussions with shareholders show a growing appetite for more disclosure on climate-related matters and an improved dialogue with companies on culture. High-quality dialogue relies on robust information. A clear description of the company's culture, values and behaviour expectations with an assessment of how they are measured can provide a valuable basis for a deeper conversation.

In addition, the FRC encourages companies to consider how they might report concisely on how their directors have discharged their duty to have regard to other stakeholders, as required by section 172 of the Companies Act 2006.

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2 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/July/Reminders-for-half-yearly-and-annual-financial-rep.aspx

The FRC recognises the challenges for companies in meeting these needs whilst seeking to deliver clear and concise reports and accounts. A number of Lab projects are being considered to help companies better meet investor needs from strategic reports. It plans to do work on principal risks and viability statements and is considering further work on APMs.

The greatest opportunities for achieving clear and concise corporate reporting arise from directors and their advisers providing clear, understandable information and paying particular attention to:

- properly explaining and quantifying key judgements and estimates;
- ensuring information is company specific and avoiding boilerplate reporting;
- ensuring only information that is relevant and material to an understanding of the business, its performance and prospects is included;
- ensuring narrative reports provide a fair and balanced account of the performance, position and prospects of the business; and
- ensuring there is adequate linkage between different parts of the annual report.

The FRC issued its latest year-end advice letter to audit committee chairs in October 2016 summarising key areas of focus for 2016 annual reports. This letter can be found in Appendix C.

Current and future developments in standard-setting

IFRS

The International Accounting Standards Board ("IASB") has published three significant standards: IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*. These standards are intended to provide better information to users and should lead to improvements in reporting. Whilst they are not effective until 2018 (IFRSs 9 and 15) and 2019 (IFRS 16), companies will need to plan well ahead as these standards represent significant changes for many. The FRC will continue to monitor disclosures by companies on the expected impact of implementing these standards.

The IASB also recently introduced requirements for disclosures to explain changes in a company's financing obligations over the period. This initiative can be traced back to a series of Lab reports that highlighted investor calls for improvements to debt and cash flow disclosures, including net debt reconciliations. While many UK companies provide such reconciliations, investors continue to have an interest in good quality reconciliations, for example, ones that clearly identify different components of cash and non-cash changes.

Reporting objectives, such as stewardship, prudence and accountability, guide the development of accounting standards, foster transparency and help build trust. Recent work to update the IASB's conceptual framework, will be key to future standards' development and an important guide in developing the FRC's view of the quality of those standards.

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Recent work to update the IASB's conceptual framework, will be key to future standards' development.

Any entities yet to transition to new standards should start their planning as soon as possible.

Brexit could have significant implications for the adoption of IFRS.

UK GAAP

The first UK GAAP[3] financial statements that had to be prepared in accordance with the new Financial Reporting Standards (FRSs) which became effective from 1 January 2015 have only recently been published and therefore there is insufficient evidence to assess how effectively they have been implemented by entities. Anecdotal evidence suggests that some of the private companies applying FRS 102[4] from 1 January 2015 wish they had started their planning for transition earlier; any entities yet to transition to new standards should start their planning as soon as possible in order to ensure they are prepared for a smooth transition.

Public attention on the quality of reporting by private companies has increased over the past year. In addition to the FRC's own outreach, the Institute of Chartered Accountants in England and Wales ("ICAEW") and others are gathering evidence on the impact of FRS 102. This will be taken into account as part of the first triennial review of FRS 102.

Implications of Brexit for corporate reporting

The extent to which the framework for accounting and reporting will need to change will depend to a large degree on the outcome of the UK Government's negotiations with the EU.

Looking ahead, Brexit could have significant implications for the adoption of IFRS depending on the exit arrangements negotiated by the Government. The UK may, in future, assess international standards for adoption itself. This is currently undertaken by the EU, including for EEA members. The FRC continues to support the application of a single set of high quality global financial reporting standards by listed companies. However, support for IFRS is contingent on the standards being of the requisite quality and capable of implementation at an appropriate cost. The UK should continue to be influential in their development post exit from the EU to ensure they can be adopted in the UK.

3 Approximately 3.5 million private companies and other entities report under the UK GAAP framework.

4 FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

2 INTRODUCTION

The FRC's mission is to promote high quality corporate governance and reporting to foster investment. Our supporting strategies of encouraging trustworthy information and trustworthy behaviour sit at the heart of our work.

The FRC undertakes a range of activities to underpin a robust framework for corporate reporting in the UK and to promote improvements in the quality of reporting which, in turn, increases investor confidence. In particular the FRC:

- monitors companies' compliance with accounting standards and the Act through our CRR work;
- influences the development of IFRS;
- sets UK accounting standards; and
- supports clear and concise reporting through all its activities but particularly through its work on the strategic report and the activities of the Lab to bring together investors and companies and develop good practice.

Objectives of the report

This report provides the FRC's assessment of corporate reporting in the UK based on CRR's monitoring work on cases opened in the year to 31 March 2016 and more recently performed thematic reviews, and gives an overview of the current state of corporate reporting in the UK. The ability to draw on a broad spectrum of outreach and evidence and form a holistic view of corporate reporting in the UK has benefits for our monitoring, standard-setting and other activities in the form of improved insights into the practical application of the corporate reporting framework.

The report aims to help stakeholders to improve the quality of their reporting so the key audiences for this report are preparers and auditors. The FRC hopes also that it will be of interest to investors and the executive summary has been prepared with them in mind.

Structure of the report

The report is structured around our overall assessment and two key elements of the report and accounts, the financial statements and the strategic report. Appendices A and B provide more information on CRR activities and procedures.

Section 3 sets out our assessment of how companies are doing in practice and explains our findings in respect of the financial statements and the strategic report. Whilst most of the report focuses on public companies who report under IFRS, the final part of section 3 provides information on the development of reporting by those companies using UK GAAP.

Section 4 of the report sets out the FRC's corporate reporting enforcement activity in the year to 31 March 2016.

Section 5 of the report discusses some current and future developments.

3 ANNUAL ASSESSMENT OF CORPORATE REPORTING

> Our goal is to deliver a framework for corporate reporting that fosters and supports continuous improvement in the quality of reporting by those we regulate, and provides investors and other stakeholders with information they can understand, trust and rely on.

Paul George, Executive Director, Corporate Governance and Reporting

The main focus of the FRC's work is on increasing the usefulness and robustness of corporate reporting and fostering continuous improvement in its quality. The FRC's stated focus in 2016/17 is on driving improvements in the quality of reporting under the existing framework. It does this in a number of ways, for example:

- highlighting good practice, as well as identifying that which requires correction or improvement;
- engaging with companies to support compliance and provide a spur to improve;
- undertaking thematic reviews into areas of emerging risk;
- providing guidance to support companies with their reporting;
- encouraging greater transparency, such as through extended audit committee reporting; and
- through the work of the Lab.

There is recognition that the Government's position and stakeholder needs are evolving in some areas and the FRC will tailor its focus where there are developments on issues related to the delivery of its mission.

Recent developments

This assessment should be considered in the context of the significant changes to corporate reporting requirements introduced in recent years. One of the most significant changes was the introduction by the Government in the Companies Act 2006 of the requirement for a strategic report. The strategic report is expected to give a clear articulation of the company's purpose, its strategy and business model, the principal risks to that model and how they are being mitigated, and should describe the key elements of performance. It should give investors an accessible, holistic and integrated picture of the company's current position and future prospects.

Alongside this, the FRC, through the Code, introduced a requirement for a statement by directors that their report and accounts as a whole should be fair, balanced and understandable.

Other noteworthy developments include:

- introduction of remuneration reporting regulations;
- enhanced focus on the assessment and reporting on the going concern basis of accounting and solvency and liquidity risk including the introduction of the viability statement;
- enhanced audit committee reporting; and
- introduction of a new suite of UK Accounting Standards.

In addition, major accounting changes for public companies will come into effect over the next couple of years. New IFRSs on revenue recognition, financial instruments and leases, and developments in insurance contracts' accounting will pose significant challenges for companies.

Assessment of overall quality

Given the complexity and breadth of corporate reporting, it is not possible to assess the overall quality of corporate reporting in one sentence. However, based on the monitoring work undertaken in the year, the view of the FRC is that compliance with the accounting framework, particularly by larger public companies, is generally good. Of 192 reviews undertaken by CRR, none have yet resulted in a Press Notice and only two companies were required to publish details of our intervention.

The FRC's assessment of overall quality is supported by external surveys. In a YouGov survey of 224 key stakeholders undertaken on behalf of the by the FRC in 2016, 95% of auditors, 91% of directors and 73% of investors have high levels of confidence in the quality of corporate governance and reporting in the UK.

In contrast, the Edelman business[5] trust barometer shows declining trust in business by the least wealthy suggesting there is a perception gap compared to those close to corporate reporting and that corporates are losing touch with the wider public.

There is also still work to be done to address users' continuing concerns that annual reports and accounts are too long and are still not sufficiently fair, balanced and understandable.

The introduction of the strategic report has improved the quality of narrative reporting although there is room for further improvement, particularly as not all companies provide sufficient balance. Failure to acknowledge when things have not gone so well, the excessive use of underlying profit figures or the inappropriate use of APMs undermine the quality of corporate reporting and erode trust.

New IFRSs on revenue recognition, financial instruments and leases, and developments in insurance contracts' accounting will pose significant challenges for companies.

Failure to acknowledge when things have not gone so well, the excessive use of underlying profit figures or the inappropriate use of APMs erode trust and undermine the quality of corporate reporting.

5 http://www.edelman.com/insights/intellectual-property/2016-edelman-trust-barometer/

The FRC's Clear & Concise initiative, which runs through all our activities, aims to encourage good communication in corporate reporting by:

- ensuring that information in the annual report is relevant to investors;
- encouraging greater emphasis on the application of materiality; and
- considering other digital channels for reporting information.

Some characteristics of good quality reporting that directors can consider when preparing reports and accounts are set out on the inside cover of this report.

Directors should give the same level of attention to removing immaterial disclosures as to ensuring that all material information is included. Letters to companies arising from our monitoring work emphasise that the FRC does not expect them to include information that is immaterial or irrelevant and letters should not be read as a suggestion that they do so. Directors are expected to have sufficient confidence in their own decisions to justify them.

The FRC's monitoring programme

The FRC's monitoring work, supported by the Financial Reporting Review Panel ("FRRP") and covering annual and interim reports, promotes improvements to the quality of corporate reporting in the UK which, in turn, increases investor confidence.

Monitoring activities include routine reviews of reports and accounts and, where considered appropriate, thematic reviews. Reviews focus on those aspects of the reports and accounts where the FRC has delegated powers to monitor compliance with the law, most notably the financial statements and the strategic report. Key areas not covered by these powers include the corporate governance statement and the remuneration report.

An external review of the FRC's monitoring activities has highlighted, amongst other things, that investors want greater transparency about this work, particularly in respect of company specific outcomes. A number of initiatives to provide this transparency have been instigated, including encouraging audit committees to highlight

significant interactions with the FRC within their reports to shareholders and pre-notifying companies of a review. Further details of these changes are in Appendix B.

Stakeholders interviewed during the external review suggested wider use of thematic reviews could be an effective means of improving quality. Three thematic reviews have or are in the process of being completed this year: on companies' tax reporting, early disclosure of risks associated with the result of the EU referendum decision and the use of APMs.

The use of thematic reviews is an effective way of achieving targeted improvements in corporate reporting and quickly assessing the quality of certain aspects of corporate reporting.

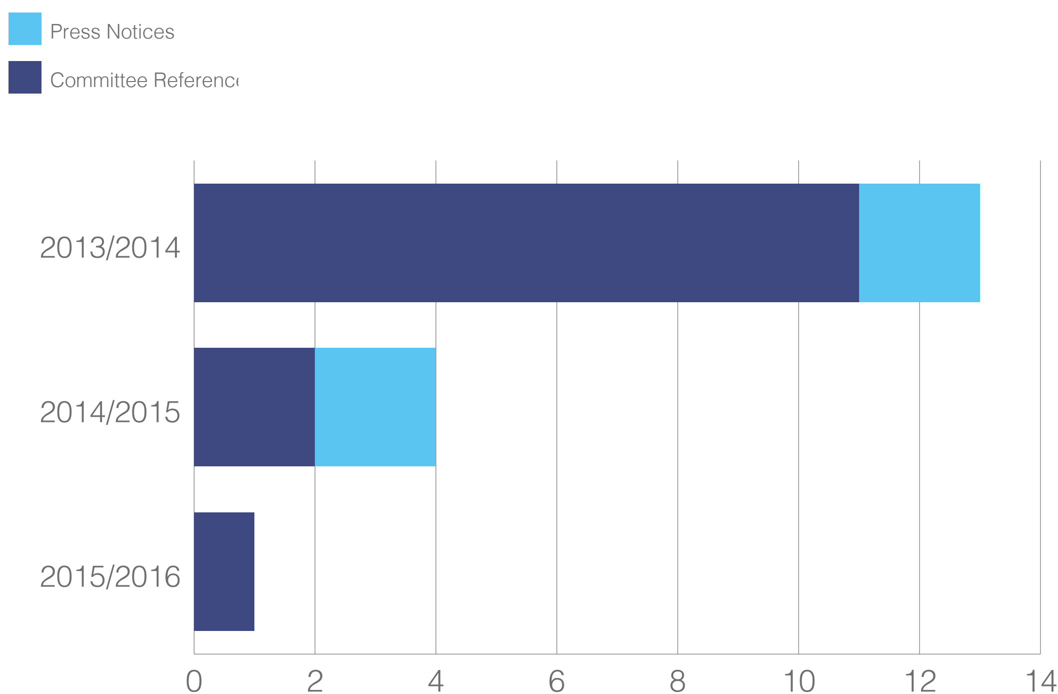
Review outcomes

The FRC reviewed 192 annual and interim reports and accounts as part of its 2015/16 monitoring activities. Two thirds of those reviews were closed without the need for follow up action. The rest resulted in substantive queries being raised. As in prior years, almost all the companies were able to resolve queries through correspondence and meetings, with only one Review Group required, reflecting the generally positive responses of companies to our enquiries. More detail about our monitoring activities during 2015/16 can be found in Appendix A.

All of our enquiries resulted in some degree of improvement in the quality of companies' reporting. In a small number of cases, where there is a material change, for example, to a primary statement, it is necessary to consider how best to inform the market. The most significant cases result in a Press Notice[6]. None were issued this year (2014/15: three; 2013/14: two).

The FRC reviewed 192 annual and interim reports and accounts as part of its 2015/16 monitoring activities. Two thirds of those reviews were closed without the need for follow up action.

Table 1: Press Notices and Committee References – summary



6 **Press Notices** are usually only issued where a significant change to published accounts is being made and which may include an agreed significant change to future accounts. When the Conduct Committee considers, for example, that the change is sufficiently material to the annual report and accounts taken as a whole, or is a material error, which investors, other preparers and their advisors or the public ought to be aware of, a press notice would generally be issued. Sometimes the matter is such that dissemination cannot wait until the publication of the company's next report and accounts, for example because it is an emerging trend or setting a precedent. In those instances the press notice would be issued at the same time as the company announces the change, for example when restating or issuing its preliminary results.

Two companies were required to refer in their subsequent reports to the action taken to address our concerns about their prior year primary statements.

Press Notices and Committee References[7] provide appropriate transparency of the more significant company specific findings and action required. Table 1 shows the number of FRC Press Notices and Committee References that have been published relating to reviews starting between 2013 and 2015[8]. They are categorised by the year in which our review of the annual report and accounts commenced.

In certain circumstances the outcome is less significant but a degree of publicity is still appropriate. Two companies were required to refer in their subsequent reports, to the action taken to address our concerns about their prior year primary financial statements:

- Inland Homes plc restated the comparative amounts in its 2015 accounts to consolidate a subsidiary it controlled through a contract. The application of IFRS 10[9] is considered further below.
- Flybe Group plc corrected an error in the cash flow statement presented in its parent company accounts.

This was lower than in the two previous years (2014/15: six; 2013/14: nine).

In exceptional cases, where an unusually high number of corrections to the audited accounts is identified, or where their effect is significant, the FRC writes to the senior partner or chairman of an audit firm. No such letters were issued this or last year. Two were issued in 2013/14.

The FRC aims to resolve queries informally by agreeing voluntary improvements to companies' reports and accounts. The great majority of the companies with whom we engage adopt a constructive approach. On rare occasions, however, and usually with smaller or overseas companies, it is necessary to invoke our statutory power to receive information and explanations in order to progress an enquiry. The FRC wrote one letter this year (2014/15: two; 2013/14: one), explaining we could apply to the court for the information and explanations that had not been provided. Further details of our powers are provided on our website[10].

7 In some cases, we may ask a company to refer to its discussions with the Conduct Committee in the report and accounts in which it makes a change to a significant aspect of its reporting following our intervention. This is known as a **Committee Reference** and may be requested, for example, in respect of an error affecting classification in one of the primary statements, an omission of disclosure with a material impact, or multiple omissions of relevant information and / or the provision of poor quality information. The Conduct Committee asks for a Committee Reference where it considers that investors and other preparers ought to be aware of the correction or changes in the extent of disclosures provided by a company but that it is not necessary to inform the market at large.

8 Given the sample sizes involved, changes from one year to the next in the number of Press Notices and Committee References issued are not necessarily indicative of any overall change in the quality of reporting.

9 IFRS 10 *Consolidated financial statements*

10 https://www.frc.org.uk/Our-Work/Conduct/Corporate-Reporting-Review/FAQs/FAQs-My-company-has-received-a-corporate-reporting.aspx

There were fewer issues relating to cash flow statements, in particular relating to misclassifications between operating, investing and financing activities.

Key findings

Although compliance with the accounting framework is generally good, particularly by larger public companies, certain areas of corporate reporting have, for several years, required general improvement. The profile of these issues has been raised through annual activity reports, discussions with audit firms and the use of generic press notices.

There have been improvements in some of these areas this year, for example in respect of the disclosure of PRUs and capital management policies, which were both previously the subject of generic press notices. Fewer instances were in evidence this year of:

- boilerplate PRUs;
- lack of discussion of how risks are managed;
- capital management policies that failed to explain management's approach in sufficient detail or provide the necessary quantified information.

In addition, there were fewer issues relating to cash flow statements, in particular relating to misclassifications between operating, investing and financing activities. This particular issue was highlighted through company-specific press notices and case studies in the 2015 CRR Annual Report.

Inevitably requirements in accounting standards for measuring and recognising items in the financial statements are more specific than those provisions which help directors decide the extent of disclosure, particularly within the strategic report. Accordingly our findings are more subjective where the application of judgement is greater.

The more significant findings from this year's monitoring activity relating to (i) the financial statements and (ii) the strategic report are detailed in separate sections below.

Financial statements

This section sets out our findings from:

- a thematic review on tax reporting;
- a specific focus on judgements and estimates; and
- the other more significant findings from routine reviews.

Tax reporting

In December 2015, the FRC wrote to 33 FTSE 350 companies informing them that it would review their tax disclosures in their next annual report and accounts. The objective of the review was to encourage more transparent reporting of the relationship between tax charges and accounting profit and the factors that could affect that relationship in the future, in accordance with existing requirements.

Most companies – particularly the FTSE 250 – responded positively by proactively improving certain aspects of their disclosures. We also observed similar refinements to the quality of tax reporting by other companies outside of the tax thematic review. It was disappointing that no FTSE 100 company subject to the review stood out as a role model in their reporting of tax.

Our detailed findings are included in a separate report to be issued shortly.

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Tax in strategic reports

Overall, the FRC evidenced improvements in the transparency of tax disclosures included in companies' strategic reports. Nearly all companies reviewed included some discussion of the effective tax rate in their business reviews, covering variances on prior year, key influences and the expected future rate. The following example of good practice was seen:

"For 2015, the underlying tax rate was 29.4% (2014: 31.0% including deduction in China of 2.2% for costs incurred in prior periods). The reduction from 2014 was predominantly due to greater profits from territories with lower tax rates, such as the UK where the corporation tax rate has fallen from 21.5% to 20.25%. In addition to the movement in the underlying rate, the effective tax rate in 2015 was impacted by further recognition of US losses and deferred tax on share options which together reduced the rate by 2.4%."

Michael Page International plc, Page Group Annual report and accounts 2015

The FRC found examples of disclosures related to material tax matters where detailed information was likely to be important to investors. These examples included:

- discussion of important tax issues arising in the year and the tax impact of exceptional or non-recurring items;
- identification of major tax risks faced by the company;
- explanations of the reassessment of prior year tax estimates where these were significant, for example, changes in assumptions or resolution of open tax enquiries;
- details of large differences between the current tax charge and tax paid where the reason was not clear from the primary statements; and
- the tax impact of acquisitions, for example, the recognition of deferred tax assets relating to the historic losses of an acquiree.

Effective tax rate reconciliation disclosures

Improvements to the quality of information provided in effective tax rate ("ETR") reconciliations with greater visibility of the specific factors affecting the tax charge were observed. This was achieved by companies giving a greater level of disaggregation in their reconciliations and detailed descriptions of the reconciling items. Permanent differences, non-taxable income and disallowable expenses were often found to have the most significant effect on the ETR. Good disclosures explained the nature of these items and why they were not tax deductible or chargeable.

Informative reconciliations separately identified the tax impact of non-recurring or exceptional items or provided additional information in footnotes. The following presentations stood out as examples of good practice:

For 2015, the underlying tax rate was 29.4% (2014: 31.0% including deduction in China of 2.2% for costs incurred in prior periods). The reduction from 2014 was predominantly due to greater profits from territories with lower tax rates, such as the UK where the corporation tax rate has fallen from 21.5% to 20.25%. In addition to the movement in the underlying rate, the effective tax rate in 2015 was impacted by further recognition of US losses and deferred tax on share options which together reduced the rate by 2.4%.

Michael Page International plc, Page Group Annual report and accounts 2015

- **Categorisation between recurring and non-recurring items**

	2015	2014
Profit before tax	X	X
UK rate of X%	(X)	(X)
Adjusted for the effects of:		
Recurring items:		
Effect of overseas tax rates	(X)	(X)
Effect of overseas financing deductions	X	X
Non-recurring items:		
Release of tax provisions	X	X

- **Separate presentation of the tax impact of exceptional items**

	Underlying profit/tax	Exceptional items	Total
Profit before tax	X	(X)	X
Tax at weighted average rate of X%	(X)	X	(X)
Adjusted for the effects of:			
Disallowable expenses, impairments, fines etc	(X)	(X)	(X)

- **Additional information provided in the footnotes**

Tate & Lyle, for example, in its 2016 Annual Report disclosed:

"The Group's tax rate is favourably affected by its internal financing arrangements which involve borrowing by its US operations from the UK, the interest on which has the effect of reducing the amount of tax payable."

"This delivered a benefit of £25m in the 2016 financial year (2015 - £24m)."

Tate & Lyle PLC, Tate & Lyle Annual Report 2016

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This delivered a benefit of £25m in the 2016 financial year (2015 - £24m).

Tate & Lyle PLC
Tate & Lyle Annual Report 2016

The sustainability of the ETR was conveyed clearly by those companies who described the factors affecting the future tax charge. Common factors included:

- the ability to continue financing arrangements;
- the timing of recognition of tax losses;
- changes to local or international tax laws;
- changes to tax rates;
- the geographic mix of profits;
- new challenges or the resolution of issues by tax authorities; and
- the impact of acquisitions, disposals or restructurings.

Uncertainties relating to tax liabilities and assets

Many of the companies sampled explained how they accounted for tax uncertainties. However, descriptions were expressed in general terms in the absence of any specific requirement setting out how tax uncertainties should be reflected in the accounting for income tax. This is an area where the IASB is shortly expected to clarify the requirements and which will present companies with an opportunity to further improve the quality of their reporting. Better disclosures clearly communicated the threshold for recognition of the provision and the measurement basis.

Of the companies sampled who had identified uncertain tax provisions as involving significant judgements and estimates, 45% quantified the provision. Clarity about significant risk of short-term adjustment to uncertain tax provisions is both valuable to users of the accounts and a requirement under IAS 1[11], paragraph 125. Justification for non-quantification will continue to be a focus for CRR in future. The audit of uncertain tax provisions is also an area of particular focus of the FRC's audit monitoring activities for 2016/2017.

Companies are encouraged clearly to distinguish IAS 1 disclosures on estimation uncertainty relating to tax, which should forewarn users of reasonably possible changes in the next year, from other valuable information about medium-term tax risks and specific judgements. Where estimation uncertainties are repeated unchanged year on year, we question whether the disclosure of quantified risk specifically relating to the next year is clear.

Descriptions of tax-related significant judgements and estimation uncertainties were often bland and not sufficiently specific to the company's circumstances. Better reporters complied with the principle in IAS 1, paragraph 129, by presenting disclosures in a manner that helped users of the financial statements to understand the judgements management had made about the future and about other sources of estimation uncertainty. These disclosures covered, for example, the nature of the assumption or uncertainty, quantified the carrying amount of the asset or liability subject to uncertainty and provided sensitivity analysis or a range of possible outcomes to provide users with a better understanding of the issue. The following good practice example was seen:

"The Group's current tax provision of £37.1m relates to management's judgement of the amount of tax payable on open tax computations where the liabilities remain to be agreed with HMRC……. Principally the uncertain tax items for which a provision is made, relate to the interpretation of tax legislation regarding financing arrangements that had been entered into in the ordinary course of business…...Due to the uncertainty associated with such tax items, it is possible that at a future date, on conclusion of open tax matters, the final outcome may vary significantly. Whilst a range of outcomes is reasonably possible, the extent of this range is additional liabilities of up to £20m to a reduction in liabilities of up to £52m."

Pennon Group Plc Annual Report and Accounts 2016

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Pennon Group Plc Annual Report and Accounts 2016

11 IAS 1 *Presentation of Financial Statements*

Judgements and estimates

A significant proportion of time during routine reviews focused on understanding the judgements boards made in applying their accounting policies. The disclosure of these judgements in the accounts can be less informative than those in audit committee reports of the significant accounting issues considered by the audit committee, as they tend to refresh these disclosures each year. Companies are encouraged to think about the most clear and concise way of explaining the judgements that are relevant to the current year's accounts.

Tax reporting is an example of an area where the disclosure of significant accounting judgements and sources of estimation uncertainty may be necessary to help users understand the effect of the accounting policies applied.

Companies often provided helpful information in their responses to requests for information; including this information in their next set of accounts would help raise overall quality. This was particularly true of smaller companies, who produced more examples of boilerplate disclosures that simply referred to judgements in applying particular accounting policies but failed to explain what the particular judgements were. Concerns about the usefulness of significant judgement disclosures have been around for a number of years; The FRC is considering how best to encourage a step-change in their quality.

CRR's 2015 Annual Report explained that volatility in commodity prices and in equity and bond markets would likely affect asset valuations. Measurement sensitivity disclosures would, therefore, be important to users of accounts.

This year, particular attention was paid to the disclosures described by paragraph 129 of IAS 1, which include sensitivity analyses. Companies have to provide disclosures that help users of accounts to understand the specific judgements they make and their effects. As well as sensitivity analyses, suggested disclosures include ranges of reasonably possible outcomes and explanations of changes to past assumptions that underlie estimates. These are the types of disclosures the FRC would, as a minimum, expect to see more frequently than is currently the case when companies apply paragraph 129. In more complex circumstances, however, companies may have to go further than simply providing these example disclosures in order for users to fully understand the estimates and judgements made by the directors.

These disclosures were most useful when companies focussed on the particular sources of estimation uncertainty that were likely to have a material effect. Conversely, disclosures that simply listed balance sheet items, such as pensions or provisions, that required the use of estimates, did not add to users' understanding of accounts.

A case study that illustrates the type of improved disclosures that could be provided is in the next section.

Other significant findings from routine reviews

This section explains the other more significant findings from our monitoring work and how companies are expected to respond to them. We illustrate two topics with case studies based on reviews closed in 2015/16.

Accounting policy disclosures

Accounting policy disclosures are an important source of information for investors to help them understand the basis on which the accounts are presented. The FRC considers whether the policies are clear, complete and sufficiently tailored, as well as whether they comply with the relevant standards, such as IAS 18[12], discussed further in the section on revenue recognition.

Companies are encouraged to think about the most clear and concise way of explaining the judgements that are relevant to the current year's accounts.

Disclosures that simply listed balance sheet items, such as pensions or provisions, that required the use of estimates, did not add to users' understanding of accounts.

12 IAS 18 *Revenue*

Where missing policies are identified, these often relate to transactions which, although material, are not part of the company's core business. This year, examples identified included:

- transfer of a business to an associate;
- recognition of pension assets;
- cash-settled share-based payments;
- inclusion of common costs in inventory;
- invoice factoring arrangements; and
- long-term service contracts, such as those entered into by companies providing outsourcing services.

When companies are dealing with complex accounting issues, they should consider whether the policy applied, and any judgement exercised, have been adequately described in the accounts.

Accounting policy disclosures remain an area where there are more straightforward opportunities to make accounts more clear and concise. Examples of irrelevant policies, or where policies were needlessly repeated, included separate policies for the impairment of goodwill and long-lived intangibles.

As noted above in the discussion of judgements and estimates, accounting policy disclosures must be supported by identification of the significant judgements made when applying them and the sources of estimation uncertainty that result. The following case study illustrates how we considered such disclosures made by one company.

When companies are dealing with complex accounting issues, they should consider whether the policy applied, and any judgement exercised, have been adequately described in the accounts.

Case study

Significant accounting judgements and estimates

Background

A company provides outsourcing services to its customers through long-term contracts. The significant judgement disclosures in its accounts explain that there are risks around revenue recognition. However, the detailed judgements disclosed referred only to onerous contract provisions.

In addition, although the company referred to judgements and estimates relating to provisions for onerous contracts for customers, it did not provide the relevant amounts or present these separately from other onerous contract provisions.

FRC's view

The disclosures were not sufficient to understand the significant judgements and estimates. Outsourcing contracts are often complex and require judgements and estimates to be made on the total amount of revenue expected, including claims and variations, and the point at which the various contracted services are provided. We asked the company to reconsider whether its disclosures were complete and sufficiently specific when it produced its next annual report and accounts.

Company's amended view

The company improved its disclosures by explaining the specific judgements made when recognising and measuring revenue on long-term contracts. It explained that these may be complex and contain unique terms, so there are judgements around interpreting contract terms, the likelihood of claims, variations and penalties, and estimating future profit margins.

The company also separately disclosed its provision for onerous customer contracts. It provided specific details of a contract that was a source of estimation uncertainty with a significant risk of material adjustment in the next twelve months and quantified the sensitivity of this particular provision to a change in the key assumption.

FRC focus points

Disclosures of significant judgements and estimates are important because investors can use them to assess the quality of management's judgements and the degree of uncertainty around the balance sheet position. Providing this information means investors will not be surprised by the impact on next year's profit of a particular estimate having been made.

The FRC may challenge the completeness of a company's disclosures when, for example, the strategic report or audit committee report imply that the company has made significant judgements in applying its accounting policies but these are not explained in the accounts. Improving these disclosures does not necessarily increase the length of the accounts. For example, boilerplate statements that there are significant estimates required when estimating provisions could be replaced by specific disclosures about individual provisions that are material, as in this case.

This case also illustrates that providing sensitivity or range of outcome information is useful in explaining the significance of sources of estimation uncertainty. The FRC does not see specific, quantified information as often as we would expect. The FRC will write to companies where this information is relevant as it believes it reduces the risk of investors being surprised by changes to estimates in the following year.

Revenue recognition

The most frequent challenges of accounting policy disclosures relate to revenue recognition.

The most effective revenue recognition policies are those where there is a clear link between the sources of income described in the business model and the accounting policies. Where the link is unclear, for example, where the policy describes the differing treatment of income from principal and agent relationships but there is no reference to these relationships in the business model disclosures, users may be confused as to the relevance of the policies provided.

This year, a number of cases were focused on how companies, and in particular those providing outsourcing services, applied the percentage-of-completion basis to long-term contracts. The basis for recognising revenue from claims and variations as well as the capitalisation of bid and mobilisation costs was challenged and improvements to policy disclosures were required.

Consolidation

The revised consolidation standard, IFRS 10, has been monitored since it became effective in the EU[13]. It introduced additional guidance on the circumstances in which a company controls a subsidiary despite not owning a majority of the voting shares. One company was identified in the year that should have consolidated a subsidiary because a contract existed that gave it control.

The FRC continues to challenge companies where they have slightly less than a voting majority but the diverse nature of the other shareholders may mean that they have, in substance, control. IFRS 10 provides additional guidance on when such 'de facto' control exists and the FRC would expect companies to consider the indicators of de facto control when identifying subsidiaries.

Financial instruments

Following the introduction of IFRS 13[14, 15], companies are required to give more informative disclosures about how fair values are calculated. The FRC requested that companies enhanced their disclosures around assets and liabilities classified in "level 3" of the fair value hierarchy, that is, those where there are significant unobservable inputs. Improvements include additional disclosure of unobservable inputs, such as assumptions around options and swaps and rental values for a property company, a description of the valuation process and narrative disclosures around sensitivities.

Financial instrument disclosures should clearly explain the risks to which the company is exposed. Following the FRC's intervention, companies agreed to provide additional disclosure relating to:

- complex financial instruments, including their nature and hedging arrangements;
- loan covenants, where these were closely monitored and material to the company; and
- additional disclosures of maximum credit risk and the aging of accounts receivable.

A number of companies were reminded about the requirement to give fair value disclosures for assets and liabilities held at amortised cost.

Business combinations

The FRC challenged the recognition and measurement of assets and liabilities arising from business combinations. Where a company recognises significant goodwill in an acquisition but little or no intangible assets the FRC will consider whether the rationale for the acquisition implies that, for example, customer related intangibles should be recognised. Companies will be challenged where the FRC expects to see separate intangible assets.

The most frequent challenges of accounting policy disclosures relate to revenue recognition.

The most effective revenue recognition policies are those where there is a clear link between the sources of income described in the business model and the accounting policies.

One company was identified in the year that should have consolidated a subsidiary because a contract existed that gave it control.

… the FRC would expect companies to consider the indicators of de facto control when identifying subsidiaries

13 From 1 January 2014

14 IFRS 13 *Fair Value Measurement*

15 Applicable to annual periods beginning on or after 1 January 2013

There have been steady improvements to companies' impairment disclosures.

The FRC would expect to see assumptions such as revenue growth, margins or operating costs to be disclosed more often than they are.

During the year, companies were challenged where it did not appear that assets and liabilities recognised in a business combination were measured at fair value, where this was required. The FRC questioned whether the measurement of deferred revenue reflected the fair value of the obligations assumed and whether the fair value of customer-related intangibles reflected market-participant assumptions.

Impairment disclosures

There have been steady improvements to companies' impairment disclosures since the FRC first raised the issue through a thematic review in 2008. As we approach a period of prolonged economic uncertainty, post the EU referendum result, these disclosures will have particular significance.

Companies are required[16] to disclose the key assumptions made when estimating the recoverable amount of cash generating units ("CGUs"). The FRC would expect to see assumptions such as revenue growth, margins or operating costs to be disclosed more often than they are and will request that companies do so in future. Companies are also expected to comply with the requirement to explain how the assumptions were determined, including whether they reflect past performance or whether external sources of information have been used.

The FRC will write to companies where their impairment disclosures imply that a reasonably possible change in assumptions would lead to a goodwill impairment but the required sensitivity disclosures have not been given. These enable a user to form their own view of the likelihood of the changes that would be required before an impairment charge crystalises.

Where companies perform impairment tests of property, plant and equipment ("PPE") the FRC would also expect them to consider whether disclosures around sources of estimation uncertainty are required in order for users to understand the sensitivity of the carrying amount of the PPE to changes in assumptions[17].

Companies are also reminded that goodwill should not be allocated to groups of CGUs that are larger than an operating segment[18], for the purposes of impairment testing.

16 IAS 36 *Impairment of Assets*, paragraphs 134 (d) (i) and (e) (i)

17 IAS 1, paragraphs 125 to 129

18 IAS 36, paragraph 80 (b)

Pensions

CRR's 2015 Annual Report explained that the IASB is contemplating amending IAS 19[19] and IFRIC 14[20] to clarify how companies should assess the rights of pension fund trustees when considering whether the company has an unconditional right to a pension surplus. This affects the accounting for pension assets as well as the recognition of additional liabilities for deficit funding requirements. The IASB has issued an exposure draft ("ED") and is considering the responses received.

Examples exist of companies making material changes to their accounting policies in the light of the expected changes to IAS 19 and IFRIC 14. Until the ED is finalised and effective, and IAS 19 and IFRIC 14 amended, the FRC would expect companies to disclose any significant accounting judgements made when assessing trustees' rights, including the extent to which their policies are consistent with the ED.

An increasing number of defined benefit pension schemes are closing to new members or to further accrual of benefits by existing members. This has led to changes in funding strategy and increases in liability-matching, through the use of contracts with insurers or through the selection of assets that match the expected terms of the pension obligations.

The FRC has written to companies where the disclosures of the company's funding strategy do not adequately explain the risks to which the company is exposed by the pension plan. Similarly, the FRC has highlighted where the disclosure of the plan's assets do not reflect the nature of the plan's investments, such as whether asset repurchase obligations exist, or explain how fair values have been estimated for complex instruments such as insurance contracts or longevity derivatives. Such interventions aim to improve the transparency of companies' pension arrangements.

19 IAS19 *Employee Benefits*

20 IFRIC14 *IAS19–The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Case study

Pensions

Background

A company disclosed that its pension scheme had purchased an annuity contract during the year and that only a small percentage of the policy exactly matched the corresponding member benefits. The fair value of the annuity contract accounted for almost all of the insurance policies' class of plan asset and was nearly 40% of total plan assets. The accounts also disclosed that the annuity contract covered the risks relating to a specified proportion of the defined benefit obligation.

There was, however, no disclosure of whether the exact match related to:

- a small percentage of the policy by value, the number of members or some other measure;
- the nature of the risks covered by the annuity contract and those retained by the pension scheme;
- whether the annuity contract covered risks relating to a proportion of the defined benefit obligation by value, by members, for specific risks, or by some other measure;
- the amount of the defined benefit obligation covered by the element of the annuity contract that was not an exact match of member benefits; and
- the amount that was an exact match.

Company's initial view

Where the amount and timing of the benefits payable to members of a pension scheme do not exactly match those under an insurance policy, IAS 19[21] requires the fair value of the policy to be determined in accordance with IFRS 13. Where there is an exact match the fair value of the policy is deemed to be the present value of the related obligation.

The company had focused its attention on the recognition and measurement requirements of IFRS when accounting for the purchase of the annuity contract.

FRC's view

The FRC took the view that the disclosures relating to the use of an annuity contract as a matching strategy should be clear about the specific nature of the risks covered and those retained to help investors understand the company's exposure to risk that is not covered by the contract. The disclosures should also quantify the amount of the defined benefit obligation for which the annuity contract does and does not provide an exact match.

This information, required by IAS 19[22] helps investors to understand how the defined benefit plan may affect the amount, timing and uncertainty of the company's future cash flows.

Company's amended view

The company agreed to provide, in its future accounts:

- a description of the nature of the benefits insured under the annuity contract and how they differed from the benefits to which members are entitled;
- the amount of the defined benefit obligation covered by the element of the annuity contract that is and is not exactly matched;
- clarity that the exact match related to a small percentage of the policy by value; and
- the judgement made for the extent to which the annuity contract exactly matched the member benefits.

FRC focus points

We welcome this company's example of good practice in providing specific information about the nature of the annuity contract, which helps investors understand the extent to which the cash inflows from the contract match the outflows to members of the pension scheme. We consider that investors appreciate quantified disclosures that explain the nature of complex financial instruments held by pension schemes, the rationale for entering into them and how they enable a pension scheme to manage risk.

21 IAS 19, paragraphs 8 and 119

22 IAS 19, paragraph 146

Strategic reports

This section sets out some background to the strategic report requirements and the FRC's assessment from:

- CRR routine monitoring work and thematic reviews;
- Lab work; and
- other FRC activities.

The introduction of strategic reports has provided a clearer focus on the links between business models, strategies, risks and performance and led to an improvement in narrative reporting generally. Improvement has been further stimulated by the Code requirement for the annual report as a whole to be fair, balanced and understandable. Furthermore, the strategic report regulations have reportedly increased the level of board engagement in the delivery of high quality narrative reporting.

However, more can be done to improve narrative reporting in general, including strategic reports, through a commitment by boards to continuous improvement. The FRC's statutory monitoring powers, as exercised by CRR, are limited outside the financial statements, to the strategic and directors' reports. Despite this, the FRC continues to encourage boards to improve the annual report as a whole through the work of the Lab, guidance and other forms of engagement. The FRC is also considering reviewing all aspects of the annual report against the criteria that, taken as a whole, it should be fair, balanced and understandable.

The strategic report regulations set out the minimum content of the report, such as descriptions of the company's business models, the risks it faces and explanations of performance including the use of KPIs. Importantly, they also require the review of the business to be fair, balanced and comprehensive. Comprehensiveness reflects a breadth of information that covers significant trends and changes in financial statements in a depth that is commensurate with their materiality, it does not mean including all possible information. Reports should be clear and concise. High quality reporting requires both the inclusion of the content elements and compliance with the less tangible qualitative characteristics. The FRC's Guidance on the Strategic Report expands further on the principles of good communication companies should consider in telling their story.

Areas for further improvement in strategic reports include but are not limited to:

- the provision of a fair and balanced assessment that covers both positive and negative aspects of performance and developments;
- ensuring the links between discussions of performance, financial position and cash flows, including the use of APMs, and the financial statements are clear;
- providing information on the company, the environment in which it operates and the risks it faces that is specific to the company and not explained in general terms;
- removing immaterial items; and
- explaining the links between information in the annual report, such as objectives, KPIs and risks.

The introduction of strategic reports has provided a clearer focus on the links between business models, strategies, risks and performance and led to an improvement in narrative reporting generally.

However, more can be done to improve narrative reporting.

CRR findings on strategic reports

CRR continued to identify situations where it is not clear whether a company has complied with the Companies Act 2006 requirement[23] for the strategic report to contain a review of the business that is fair, balanced and comprehensive.

The balance of strategic reports was challenged where:

- the narrative focused solely on positive trend information but certain trends were negative;
- there was no discussion of the results of material parts of the business; or
- the discussion focused exclusively on the income statement.

A comprehensive review of the business should include all aspects of performance, including cash flows, and the company's closing financial position.

Examples of missing information identified in the year included lack of discussion of:

- a company's effective tax rate and its sustainability which informed our decision to launch a thematic review of tax reporting in December 2015;
- relevant non-financial KPIs, such as order book status;
- working capital movements; and
- the effect of a business combination on the balance sheet.

Missing balance sheet or cash flow narrative was identified more often in smaller company accounts.

The FRC's monitoring of strategic reports was supplemented with thematic reviews on:

- tax reporting (tax in strategic reports is discussed earlier);
- APMs; and
- the effects of the EU referendum decision

Alternative performance measures

APMs can provide valuable insight into a company and the extent to which its business model is successful and its objectives achieved. However, the way APMs are presented and how they relate to the information presented in the financial statements can be improved.

The 2015 CRR Annual Report noted challenges made to companies on the basis that the undue prominence given to APMs, such as adjusted profit, over the equivalent IFRS measures, called into question the balance of the strategic report.

Whilst no queries were raised in respect of the majority of current period reviews of reports and accounts drawn up to 31 December 2015, many of which are still in progress, a number of areas of concern were identified.

The concerns identified include:

- Strategic reports which discussed the results for the period entirely, or almost entirely, in terms of APMs such as adjusted, underlying, management basis or look through profits or similar wording. IFRS amounts were sometimes not mentioned at all.
- Lack of definitions or reconciliations of APMs. Lack of cross-references to where definitions or reconciliations can be found.

APMs can provide valuable insight into a company and the extent to which its business model is successful and its objectives achieved. However, the way APMs are presented and how they relate to the information presented in the financial statements can be improved.

23 CA06 paragraph 414C 2 and 3

- Details not given of adjusting items. Explanations not given as to why it is believed necessary to adjust for certain items. Possible bias in the choice of adjusting items, for example, to exclude losses but not apparently similar gains.
- Lack of clarity of when a measure is an APM, for example, referring to "profit before tax" when the amount shown is actually calculated on a non-GAAP basis. Referring to an APM as the "true" result.

Some companies also present APMs in their accounts, for example, by presenting a sub-total on the face of the income statement for operating profit before exceptional items. The FRC issued a Press Notice in December 2013[24] which set out the principles companies were expected to consider when presenting such items.

During the year, the consistency of the use of exceptional items was challenged, both within a single set of accounts and year on year; for example, whether companies also described items as exceptional when they related to tax or financing, rather than operating, items. Companies were also asked to explain their policy for presenting APMs that adjust for recurring items, in addition to items described as exceptional.

The need for balance and for the relationship between APMs and IFRS measures to be explained is reflected in the European Securities and Markets Authority's ("ESMA") Guidelines on Alternative Performance Measures that became effective on 3 July 2016. The ESMA Guidelines apply to regulated information and prospectuses of listed companies with the exception of APMs disclosed in the financial statements. To assist directors with application of the ESMA Guidelines, the FRC issued *ESMA Guidelines on Alternative Performance Measures – Frequently Asked Questions*[25].

The ESMA Guidelines can be seen as a codification of best practice in this area. The FRC expects companies to consider whether they should make changes in response.

The FRC's reviews of reports and accounts will consider whether strategic reports are consistent with the Guidelines and, where there are material inconsistencies, companies concerned will be asked for explanations. Such inconsistencies will be assessed when deciding whether strategic reports are fair, balanced and comprehensive.

The FRC's thematic study on the use of APMs will report findings in November. This may lead to some companies being pre-informed of the intention to review their reports and accounts based on material which emerges from that study.

Effects of the EU referendum decision

The UK's decision on 23 June 2016 to leave the EU brought a range of existing reporting requirements into sharper focus. The FRC published a reminder of these in early July, acknowledging that not all businesses would be affected to the same extent.

The FRC subsequently conducted a targeted thematic review of 22 sets of interim reports largely drawn from the FTSE 350 and published between 24 June and mid-August. The sample aimed to give a fair representation of companies across a range of sectors that could be expected to be either significantly, or marginally, affected by the referendum result.

"Uncertainty" was the key reference point in virtually all of the interim reports reviewed, with most companies pinpointing the areas in which that uncertainty could play out and indicating, albeit in broad terms, the potential impact on their strategy and performance.

Whilst most companies considered it too early to provide any more specific commentary on the impact of Brexit, they explained their future monitoring arrangements.

During the year, the consistency of the use of exceptional items was challenged, both within a single set of accounts and year on year.

24 https://frc.org.uk/News-and-Events/FRC-Press/Press/2013/December/FRC-seeks-consistency-in-the-reporting-of-exceptio.aspx

25 https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FAQs-ESMA-Guidelines-on-Alternative-Performance-M.pdf

As the economic and political effects become more certain in the medium and longer term, the FRC expects boards to provide increasingly company specific disclosures with quantification of the effects, which, so early after the vote, few had been able to achieve. The FRC will continue to monitor disclosures and report publicly on our findings.

Other strategic report issues

The Lab is a key part of the FRC's continuous improvement philosophy. Through discussions with companies and the investment community the Lab seeks to provide an environment to develop pragmatic solutions to today's corporate reporting challenges. Market participants are currently working with the Lab on projects to enhance business model reporting, to consider opportunities for corporate reporting in an increasingly digital world, and to develop, through a case study approach, a more clear and concise approach to reporting. Past areas of focus include dividend disclosure[26].

FOCUS ON THE LAB:

Dividend Disclosure

One area of interest to companies and investors has been disclosure of dividend policy and practice, in other words how the policy is applied in taking decisions to declare dividends.

The Lab developed suggestions on this, based on input from 19 company and 31 investment organisation participants published in November 2015. Participants identified opportunities for improvement in dividend policy disclosures to ensure they are specific on the parameters and inherent flexibility, and explain why the approach taken was felt appropriate. In addressing disclosure of dividend declaration and decisions taken in applying the policy, the report also suggests a scaled approach to disclosure of available cash and distributable profits. Virtually all participants felt there were significant opportunities for companies to bring elements of disclosure on dividends together, or to link related disclosures to provide a clear discussion of decision making and results, from policy to declaration and payment.

The Lab has already noted examples of improved disclosure, and expects to see more over the coming reporting period as companies have greater opportunity to consider the suggestions this year. The FRC expects practice to continue to develop and consider that room for further improvement lies in more detailed disclosure of how dividend policies operate in practice to how those policies may be impacted by the risks and capital management decisions facing the company.

As the economic and political effects are developed and become more certain in the medium and longer term, the FRC expects boards to provide increasingly company specific disclosures with quantification of the effects.

26 https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-Project-Report-Disclosure-of-dividends-–-poli.pdf

Business model disclosures

Whilst many companies had been presenting disclosures on their business model for a number of years, with this becoming a requirement of the strategic report the Lab identified an opportunity to make them more useful for the investment community and explore improvements to existing practice. The Lab report, due to be published shortly, will confirm the importance of this disclosure to investors and suggest both characteristics of good reporting and practical ways that companies might consider meeting investor needs.

Risk reporting and viability statements

In identifying the risks and uncertainties a company faces, directors should consider a range of factors. These should include operational and financial factors, and risks in the broader environment in which it operates, such as cyber security and climate change. However, the disclosures in the strategic report should focus on the principal risks and uncertainties the company specifically faces, describing them and their potential impact clearly and succinctly. Links to KPIs and the achievement of strategic objectives should also be clear.

Amendments to the Code in 2014 introduced reporting of a longer-term view of a company's prospects in a viability statement. Companies should consider whether solvency, liquidity or other risks may impact the long-term viability of the business. The FRC is assessing the quality of viability statements across 10 FTSE 350 sectors (covering nearly 100 companies) and will report on this assessment more fully in its *Developments in Corporate Governance and Stewardship* report to be published in January 2017. The initial assessment of viability statements suggests that there is little variation in disclosures between the different business sectors. Some 75% of companies chose to use a three-year time horizon for their consideration of viability. Some good examples of why a three-year period was chosen and the underlying risks to the statement were identified. However, three years should not become the default option and directors are expected to give adequate thought to their company's particular circumstances. The FRC encourages companies to provide clearer disclosure of why the period of assessment selected is appropriate for the particular circumstances of the company, and how the underlying analysis was performed.

There is also room for improvement in noting what qualifications and assumptions have been made. Understanding how the underlying analysis was performed and what judgements the company made in arriving at its statement could be more meaningfully disclosed. While there may have been some reluctance in this first year to provide extensive information, it would now be helpful for shareholders to engage with companies to discuss what improvements they wish to see so to stem any criticism of future boilerplate reporting. Around 15% of our sample provided an excellent statement and there was no difference in quality between the FTSE 100 or 250. These disclosures on viability included good quality disclosure on the process taken, who had been involved, how specific principal risks had been stress tested, and included detail on the range of assumptions that had been considered.

There is an increasing emphasis by shareholders on the need for companies to consider the risks that may impact their business over the longer term. There is interest from some investors in reporting on how climate change may impact on the future performance and prospects of a business where material and relevant.

The Financial Stability Board has set up a Task Force on Climate Related Financial Disclosures to develop voluntary guidelines on disclosure of climate-related financial risks, which it will publish by the end of 2016. We aim to support this initiative to the extent it can provide a practical and proportionate approach to addressing investor concerns.

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Three years should not become the default option and directors are expected to give adequate thought to their company's particular circumstances.

The FRC encourages companies to provide clearer disclosure of why the period of assessment selected is appropriate for the particular circumstances of the company, and how the underlying analysis was performed.

There is also the opportunity as part of the Lab work on principal risk disclosure to look at what companies and investors identify as good integration of climate disclosure into the strategic report.

Tax has become a particular area of focus for a broad range of stakeholders. The Finance Act 2016 introduces a requirement for larger listed companies to publish a separate tax strategy annually on their website.

The public interest in corporate tax arrangements is high, as is the potential for companies to tarnish their reputation, which may impact future performance, by adopting tax strategies that are perceived to be inappropriate or that lack transparency or clarity. Companies need to reflect carefully about their tax strategy and its sustainability and to be transparent in their reporting about the material risks to which it may give rise.

Pensions

Recent high profile corporate failures have highlighted the potential risks to a company's financial position and future viability arising from defined benefit scheme deficits, especially in the current low interest rate environment with suppressed returns on scheme assets. Directors should consider whether a company's obligations under pension agreements with current and future employees create principal risks and uncertainties to be disclosed and explained in the strategic report.

Low interest rates also lead to higher reported pension liabilities as expected future payments to pensions are discounted using rates derived from current corporate bond yields. It is not always clear to users of the annual report how and when the liability will crystalise, either in terms of cash flows from scheme to pensioners or, more immediately, funding cash flows from company to pension scheme. The FRC's monitoring work looks at pension disclosures; the findings are discussed earlier in this report. Information on funding arrangements can be helpful in understanding the risks arising from pension schemes and the short to medium-term implications for the company.

The inputs used to determine pension scheme deficits for financial reporting purposes and for funding purposes can differ. Some consider these differences to be justified given the different measurement objectives of each calculation. However, others argue that the current low interest rate environment has highlighted weaknesses in the accounting measurement approach. The FRC will continue to monitor debates and will consider the need for detailed review of current accounting standards.

Remuneration Reporting

Remuneration reports should be clear, concise and provide transparent disclosure without adding to the length of annual reports unnecessarily. In 2015, the average length of remuneration reports was consistent at approximately 18 pages[27]. Investors would like more clarity and brevity in remuneration reporting. It is not clear whether the root cause of length and complexity lies in the reporting requirements, a failure by preparers to communicate clearly and concisely, or because the remuneration arrangements are in themselves complex and opaque. Anecdotal evidence would suggest it is a combination of all factors to varying degrees.

To improve users' understanding of how directors are incentivised to deliver the company's strategy, companies can do more to clearly articulate the link between company KPIs, long-term objectives and performance-related payouts.

Reporting requirements in this area are set out in legislation and the FRC currently has no statutory powers to monitor compliance. However, companies required to apply the Code should prepare annual reports which, when taken as a whole, are fair, balanced and understandable. The remuneration report falls within the scope of this requirement. The communication principles set out in the FRC's Guidance on the Strategic Report can equally be applied to remuneration reports.

Directors should consider whether a company's obligations under pension agreements with current and future employees create principal risks and uncertainties to be disclosed and explained in the strategic report.

It is not clear whether the root cause of length and complexity lies in the reporting requirements, a failure by preparers to communicate clearly and concisely, or because the remuneration arrangements are in themselves complex and opaque.

27 EY Annual reporting in 2015, September 2016

UK GAAP

First time application of new UK and Ireland standards (UK GAAP)

In addition to its responsibilities for corporate reporting by UK listed groups the FRC sets UK financial reporting standards. With effect from 1 January 2015 the FRC issued new FRSs which seek to enable users of accounts to receive high quality understandable accounts based on international standards which are proportionate to the size and complexity of the entity and users' information needs.

This fundamental reform of financial reporting for UK and Republic of Ireland companies and other entities not applying IFRS, meant extant standards were replaced with five FRSs and a sixth with effect from 1 January 2016 (FRS 105). These standards are a fraction of the size of those they replaced, and are designed to provide more transparent information for users, particularly in respect of financial instruments.

The publication of these standards brought to a close a period of uncertainty about the future of UK GAAP, and how it should be brought up-to-date and converged with international standards, in a proportionate way. It also meant the end of a long period in which relatively few changes had been made to UK GAAP. The changes have been fundamental, the standards are more succinct, there are more cost-effective options for the individual company accounts in listed groups, and there is more information for users of financial statements about the use of financial instruments and the risks associated with them. However, there has been new terminology to become familiar with, some financial assets and liabilities being measured and recognised in the statement of financial position for the first time, and more judgement necessary as entities, their advisors and auditors apply the new requirements for the first time.

FRS 100	*Application of Financial Reporting Requirements*
FRS 101	*Reduced Disclosure Framework*
FRS 102	*The Financial Reporting Standard applicable in the UK and Republic of Ireland*
FRS 103	*Insurance Contracts*
FRS 104	*Interim Financial Reporting*
FRS 105	*The Financial Reporting Standard applicable to the Micro-entities Regime*

There has been limited early adoption of the new standards, and financial statements for years ending on or after 31 December 2015 will be prepared during 2016, making it difficult to assess any improvement in the quality of financial reporting as a result of the introduction of FRS 102. However, more information will be available to users on financial risks and commitments, which should assist in their decision-making, and feedback on the standards themselves has generally been very supportive of the new framework. As part of the FRC's triennial review feedback has been sought on the implementation of FRS 102, which will be used to inform its future development.

Small entities will also be applying FRS102 for the first time from 1 January 2016, which may pose some challenges for preparers, but should improve reporting in certain areas, as well as offering opportunities to reconsider the necessary disclosures. Anecdotal evidence suggests that some of the larger private companies applying FRS 102 from 1 January 2015 could have started their planning for transition earlier; any entities yet to transition to new standards should start their planning as soon as possible in order to ensure they are prepared for a smooth transition.

Public attention on the quality of reporting by private companies has increased over the past year. In addition to the FRC's own outreach, the ICAEW and others are gathering evidence on the impact of FRS 102. This will be taken into account as part of the first triennial review of FRS 102.

These standards are a fraction of the size of those they replaced, and are designed to provide more transparent information for users, particularly in respect of financial instruments.

4 CORPORATE REPORTING ENFORCEMENT ACTIVITY

This section provides an overview of the disciplinary cases which have been concluded under the FRC Accountancy Scheme[28] in the year to 31 March 2016. In April 2016 the FRC introduced changes to its enforcement and disciplinary arrangements in preparation for the implementation of the EU Audit Regulation and Directive. With effect from 17 June 2016 the FRC implemented a new Audit Enforcement Procedure for new statutory audit cases. The FRC Accountancy Scheme will continue to apply to individual Members and Member Firms[29] but will no longer cover statutory audit cases.

Overview of concluded cases involving Members in business

The Members in business who the FRC investigates commonly hold senior positions within organisations, with significant influence on the preparation of the financial statements[30].

The investigations relating to Members in business are often complex and can take a number of years to conclude. Commonly they arise in conjunction with an investigation into the audit of the entity where the Member in business was employed. Executive Counsel's investigative powers[31] in relation to Members in business rely on voluntary co-operation by the companies concerned, primarily because Executive Counsel has no power to compel entities which are not Member Firms to provide documents or explanation.

Considerable resources have been invested by the FRC in cases involving Members in business, with a concerted effort to conclude older cases.

In the relevant period, a total of 6 investigations have been concluded involving 8 Members in business, each of which resulted in an admission of Misconduct[32] and the sanctions set out in Table 2. A case study in relation to Connaught plc follows the table.

28 The FRC can commence a disciplinary investigation either by referral from one of the professional bodies or of its own accord. This will often follow the receipt of information from other regulators or similar bodies. In the majority of cases, related investigations are being, or have been, carried out by other regulators or similar bodies. These bodies include the Serious Fraud Office, Prudential Regulation Authority, Financial Conduct Authority, Lloyd's and The Charity Commission. In addition, there is often ongoing litigation relating to the subject matter we are investigating.

29 The terms "Member" and "Member Firm" are defined in the FRC Accountancy Scheme. A "Member Firm" is a firm which is a member of a Participant body such as ICAEW.

30 For example, as Chief Finance Officer or Finance Director.

31 Pursuant to the FRC Accountancy Scheme.

32 Acts or omissions by a Member in the course of his/her or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or has brought, or is likely to bring, discredit to the Member or the Member firm or to the accountancy profession.

Table 2: Cases concluded in the year to 31 March 2016

Company	Member	Investigation Commenced	Outcome	Date	Sanction	Costs
Aero Inventory plc	Hugh Bevan	10-Feb-11	Misconduct admitted Sanction agreed	10-Jun-15	Exclusion from the ICAEW for a period of 3 years	£170,000
Manchester Building Society	Christopher Gee	07-Aug-13	Misconduct admitted Sanction agreed	19-Jun-15	Reprimand	Fine of £25,000
Manchester Building Society	Christopher Gee	07-Aug-13	Misconduct admitted Sanction agreed	19-Jun-15	Reprimand Fine of £25,000	£5,000
Healthcare Locums plc	Diane Jarvis	13-Oct-11	Misconduct admitted Sanction agreed	07-Jul -15	Exclusion from the ICAEW for a period of 10 years	£25,000
Presbyterian Mutual Society	Philip Black	18-Jun-09	Misconduct admitted Sanction agreed	05-Oct-15	Reprimand	£50,000
iSoft Group plc	John Whelan	12-Oct-06	Misconduct admitted Sanction agreed	09-Dec-15	Exclusion from the ICAEW for a period of 8 years	
iSoft Group plc	Timothy Whiston	12-Oct-06	Misconduct admitted Sanction agreed	02-Dec-15	Exclusion from the ICAEW for a period of 8 years	£50,000
Connaught plc	David Wells	11-Nov-10	Misconduct admitted Sanction agreed	19-Jul-16	Exclusion from the ICAEW for a period of 3 years	£125,198
Connaught plc	Stephen Hill	11-Nov-10	Misconduct admitted Sanction agreed	14-Jul-16	Exclusion from the ICAEW for a period of 5 years	£133,397

Case study

Connaught plc

A settlement was agreed in July 2016 in relation to the conduct of Mr Stephen Hill (former Finance Director) and Mr David Wells (former Deputy Financial Director with responsibility for treasury functions) of Connaught plc. Both were members of the ICAEW.

The disciplinary case related to Mr Hill's and Mr Wells' conduct regarding their role in relation to the incorrect accounting of a £4 million short-term loan in Connaught's 2010 interim financial statements.

The short-term loan was made by the CEO of Connaught shortly before the 28 February half-year end, and substantially repaid between 15 March and 29 April 2010. The £4 million was not accounted for as a loan, but as operating cash flow in Connaught's interim financial statements, which were issued on 27 April 2010. The interim statements were therefore materially misleading in that cash flows from operating activities were overstated by £4 million and net cash generated from financing activities was understated by £4 million.

This materially increased Connaught's cash conversion rate. But for the loan, the Group would have fallen somewhere between 6% and 11% short of their 70% cash conversion target. This ratio was one of a number of key measures used by analysts and one upon which investors rely – and a figure that was especially important to Connaught at the beginning of 2010.

In addition, the loan was not disclosed to the audit committee or to the auditors, nor disclosed in the financial statements as a related party transaction, as it should have been.

Settlements agreed between the FRC's Executive Counsel, Gareth Rees QC, and both Mr Hill and Mr Wells were approved by the Independent Tribunal. The Executive Counsel accepted that neither Mr Hill nor Mr Wells acted dishonestly in failing to account accurately for the sums in question. For their part, Mr Hill and Mr Wells admitted that their conduct fell significantly short of the standards to be expected of Members of the ICAEW.

Mr Hill admitted that his conduct was sufficiently reckless to have amounted to acting with a lack of integrity. He agreed the following terms of settlement:

- Exclusion from the ICAEW for a recommended period of 5 years.
- Payment of £133,397 towards the Executive Counsel's costs.

Mr Wells admitted that he failed to act in accordance with the ICAEW's fundamental principles of objectivity and professional competence and due care. He agreed the following terms of settlement:

- Exclusion from the ICAEW for a recommended period of 3 years.
- Payment of £125,198 towards the Executive Counsel's costs.

5 CURRENT AND FUTURE DEVELOPMENTS

The decision to leave the EU may have significant implications for the corporate reporting framework in the UK.

The corporate reporting landscape has changed significantly over recent years and will continue to change in the near and longer term. These changes are determined by amendments to the underlying framework of legislation, standards and guidance, by the changing demands of stakeholders and their recognition by companies, and by developments in technology. In this section we provide an overview of current and future developments in corporate reporting and the impacts we expect to see.

Implications of Brexit for corporate reporting

The legislation underpinning the preparation of financial statements in the UK is generally derived from European law. Listed companies are required to apply EU-adopted IFRS under the EU's IAS Regulation, and the requirements in the Companies Act 2006 governing the preparation of financial statements for other companies reflect the EU's Accounting Directive. Therefore, the decision to leave the EU may have significant implications for the corporate reporting framework in the UK, subject to the form and content of the UK settlement with the EU. The UK may, in future, assess international standards for adoption itself. This is currently undertaken by the EU, including for EEA members.

The FRC continues to support the application of a single set of high quality global financial reporting standards by listed companies. However, support for IFRS is contingent on the standards being of the requisite quality and capable of implementation at an appropriate cost. The UK should continue to be influential in their development post exit from the EU to ensure they can be adopted in the UK.

Over the coming months the FRC will carry out a review to identify potential risks to the reporting framework at, and subsequent to, the date of exit from the EU. The FRC will also consider opportunities for improvement to more closely meet the needs of UK stakeholders.

Current debates on the future of corporate reporting

The annual report continues to focus primarily on the information needs of investors, but increasingly there are calls for the provision of information to a more diverse set of stakeholders reflecting the wider societal impact of companies. Given developments in digital communication which are changing the ways people

distribute, consume and analyse information and facilitating the reporting of some information outside the annual report, the annual report can be seen as one part of a wider framework of reporting by companies to their stakeholders. These two drivers- calls for greater accountability to stakeholders other than shareholders and new communication channels arising from technological developments - will continue to change the form and content of corporate reporting in the broadest sense.

In parallel, the FRC anticipates significant developments in corporate governance in response to the Government's desire to see employees and consumers having a stronger voice in the boardroom, with the potential for consequential impacts on reporting. The FRC anticipates a stronger focus on how boards discharge their duties to have regard to different stakeholders, as required by section 172 of the Companies' Act 2006, and for boards to be asked increasingly to explain how they listen to a range of stakeholders, such as employees and customers. The FRC does not undertake monitoring in this area, however more can be done to encourage directors to focus on how they discharge their duties under section 172.

These debates could lead to fundamental questions about the current reporting framework which is primarily focussed on the annual report and accounts. Can the needs of multiple stakeholders be met through a single report whilst maintaining clarity and concision of communication? If not, how can credible alternative frameworks be developed? Is that credibility dependent on independent assurance and, if so, how can the framework be developed to facilitate forms of assurance?

New disclosure requirements arise either in the law or through voluntary guidelines to address specific policy objectives. New legal requirements that are in the pipeline include gender pay gap reporting and country-by-country reporting of tax. Policy makers are increasingly giving consideration to alternative channels for providing information where investors are not the primary audience, for example on websites.

There is, at present, no encompassing framework for reporting beyond the annual report. Indeed, there are multiple, often competing frameworks focusing on different discrete issues such as the environment, human rights or diversity and equality. The FRC anticipate there will be increasing demand in the coming years for international co-operation in the development of a reporting framework that can be applied beyond the annual report. The FRC will be an active participant in such developments and will consider how the communication principles such as fair, balanced and understandable and those applied in the preparation of a strategic report can be applied across corporate reporting.

Technology is significantly changing the way that information is gathered, aggregated, communicated and analysed. Technology has enabled improvements in public accessibility of corporate reporting data, for example, through company websites and PDF versions of annual and other reports and communications. However, the benefits technology might offer for providing and using corporate reporting data are not widely exploited. The market is now reaching the point where the volume of data generated by and about companies is increasing exponentially. In a data-rich future, it is crucial for all stakeholders to understand how the communication of corporate reporting data might be enhanced through the use of technology.

The Lab project Digital Future: Data, announced in June 2016 is looking at how technology might evolve to communicate corporate reporting to the investment community. This work builds on the attributes of digital annual reporting that investors identified as desirable, described in the Lab's previous Digital Present report, as being key attributes for annual reporting via PDF (timely, searchable, downloadable, bounded,

The FRC anticipates a stronger focus on how boards discharge their duties to have regard to different stakeholders, as required by section 172 of the Companies' Act 2006, and for boards to be asked increasingly to explain how they listen to a range of stakeholders, such as employees and customers.

These debates could lead to fundamental questions about the current reporting framework.

There is, at present, no encompassing framework for reporting beyond the annual report.

etc.). The Lab is considering whether these attributes might be applied more widely to other forms of digital communication, and expanded to form a set of desired components for future digital reporting against which various technologies and approaches can be assessed.

Debates on the form and content of non-financial reporting will continue. Many investors are increasingly interested in information on non-financial matters that may affect the company's development, performance and position over the longer term, for example impacts on the environment, employees and society at large.

The FRC's recent work on corporate culture[33] identified a growing interest in the impact of culture on business performance. The FRC expects governance and reporting to evolve to take on board demand for information about how culture impacts different aspects of a company's operations and its relations with its stakeholders.

The FRC's discussions with shareholders identified a growing appetite for an improved dialogue with companies on culture. High-quality dialogue relies on robust information. A clear description of the company's culture, values and behaviour expectations with an assessment of how they are measured can provide a valuable basis for a deeper conversation.

Non-financial reporting is an evolving area and we have seen an increase in regulation in this space. The EU non-financial reporting Directive, which applies to large Public Interest Entities with more than 500 employees, aims is to create a level-playing field across Europe for reporting non-financial information.

The government is in the process of implementing the Directive into UK Company Law by 6 December 2016. Many of the disclosure requirements in the Directive are similar to existing requirements in the strategic report, so many listed companies will already be providing these kinds of disclosures.

New IFRSs and their adoption in Europe

Whilst the UK remains in the EU the legislative framework for the adoption of new IFRS will remain the same. New IFRS are reviewed and adopted on a standard-by-standard basis. Recently issued standards and an overview of their current adoption status is provided below.

IFRS requires disclosures in the financial statements on the future impact of standards before their effective date and as that date approaches we expect those disclosures to become more detailed and descriptive.

IFRS 15 *Revenue from contracts with customers*

IFRS 15 becomes mandatory for years commencing on or after 1 January 2018. The EU endorsement process is almost complete. The impact on the timing and measurement of revenue will be significant for some sectors and companies, particularly those providing multiple goods and services, such as telecommunication providers, and those providing goods and services through long-term contracts. For some companies there may be little change in the recognition of revenue, but all companies should already be considering the requirements of the standard carefully in order to plan for any necessary system changes and to explain to stakeholders the likely impact of the standard before its effective date.

Many investors are increasingly interested in information on non-financial matters that may affect the company's development, performance and position over the longer term, for example impacts on the environment, employees and society at large.

33 Corporate culture and the role of boards: a report of observations, July 2016

IFRS 9 *Financial instruments*

IFRS 9 also becomes mandatory for years commencing on or after 1 January 2018 and the EU endorsement process is almost complete. Applying IFRS 9 will result in changes in the presentation and/or measurement of financial assets and liabilities by all companies, but will have the most significant impact on financial institutions, including banks, especially in respect of the measurement and recognition of provisions for future expected losses on financial assets. Banks are in the process of making the significant system changes needed to implement the standard, but we still expect disclosures of its future impact to be more detailed and entity specific as they approach the date of first application.

IFRS 16 *Leases*

EFRAG has begun its review of IFRS 16 which has an IASB effective date of years commencing on or after 1 January 2019. This will be the first standard subjected to the broader form of review and analysis, which will consider more fully the potential impacts on the European economy.

EU adoption process

The European Financial Reporting Advisory Group ("EFRAG"), which provides advice to the European Commission on the adoption of new IFRSs, has recently undergone significant reforms aimed at strengthening European influence over the IASB's standard setting, and broadening the scope of EFRAG's endorsement advice on new standards to include consideration of their potential broader economic impacts alongside the traditional technical analysis. Consideration will be given to matters such as the potential impact on economic growth and financial stability. The FRC has supported these changes and continues to play an active role in the work of EFRAG.

Future work of the IASB

Reporting objectives, such as stewardship, prudence and accountability, guide the development of accounting standards, foster transparency and help build trust. Recent work to update the IASB's conceptual framework, will be key to future standards' development and an important guide in developing the FRC's view on the quality of those standards.

The IASB is close to finalising its new standard on insurance contracts' accounting. This will have a significant impact on accounting by insurance companies and will be subject to the usual EU endorsement process once completed.

With most of its major standard-setting projects completed, the IASB has identified the provision of more relevant information and improving the communication of that information as primary objectives for their work in the coming years. The FRC welcomes this initiative, entitled "Better communication", which brings together a number of long-standing research projects, as its objectives echo those of the FRC, i.e. to embed recent technical changes and seek improvements in the quality and relevance of reporting.

Elements of the initiative of particular note are the Principles of Disclosure project, aimed at improving the relevance of disclosures by moving from a checklist approach to a more principles-based approach, and the Primary Financial Statements project, aimed, in part, at improving the presentation of financial performance in the income statement. Many stakeholders, including the FRC, have been calling for these projects to be further advanced so the priority they are now being given is welcomed.

IASB's conceptual framework, will be key to future standards' development and an important guide in developing the FRC's view on the quality of those standards.

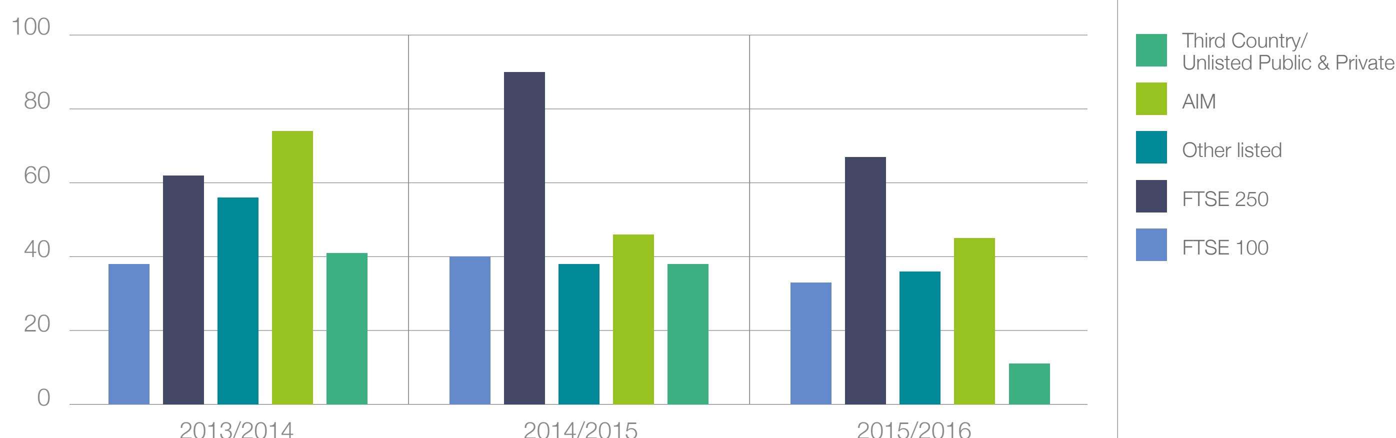
APPENDIX A:
CRR ACTIVITIES

APPENDIX A

CRR Activities

This section provides an overview of the FRC's monitoring activities during 2015/16, which provide most of the evidence for our views on the quality of corporate reporting in the UK. In 2015/16 the FRC reviewed 192 sets of accounts (2014/15: 252; 2013/14: 271).

Table A: Reviews by Market



The FRC directed its resources to the review of the reports of the largest listed companies, in which some £2,111 bn[34] of total UK investment is held. Satisfaction that these are of high quality is likely to have the greatest effect on market confidence. The reduction in total reviews since 2013/14 is a result of competing demands on CRR resources, including certain complex long-running cases and staff being involved in implementing the results of the Effectiveness Review (Appendix B). The FRC is actively recruiting additional CRR team members.

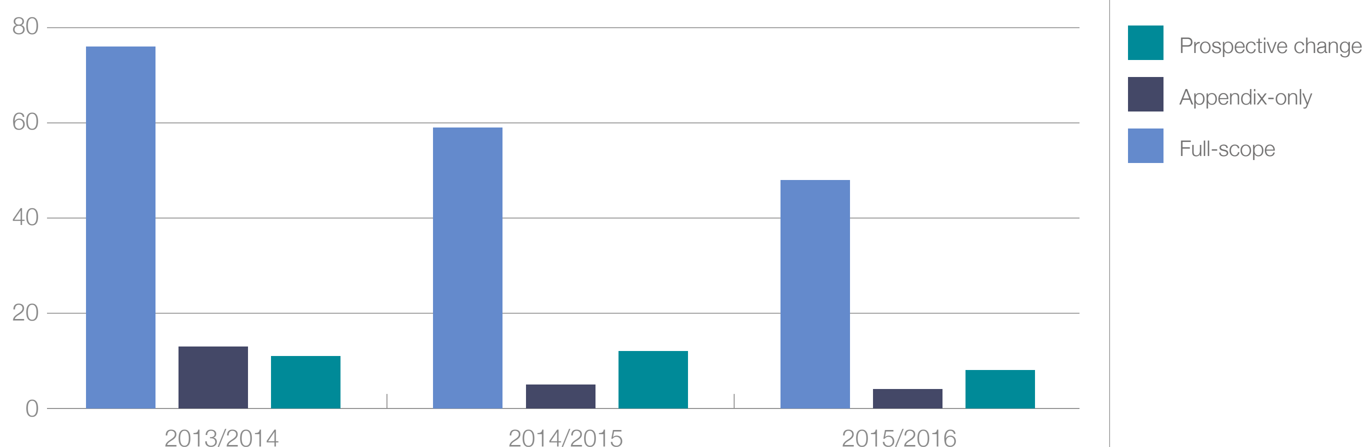
Reports were selected for review through a combination of our rotational approach to FTSE 350 companies, the referrals and complaints received and FRC priority sectors.

The FRC aims to complete its reviews in time for agreed improvements to be reflected in the companies' next reports and accounts, ensuring that better quality information is in the public domain at an early opportunity. 69% of 2015/16 cases were completed before the next set of reports and accounts were due for publication. This percentage was reduced by complaints and referrals received late in the reporting cycle.

95% of 2015/16 reviews were completed by the date of this publication (93%: 2014/15; 90%: 2015/16).

34 Market capitalisation of FTSE 350 @ 29 September 2016, Source: www.ftse.com

Table B: Approaches to Companies



The FRC wrote to 60 companies (2014/15: 76; 2013/14: 100), which is 31% (2014/15: 30%; 2013/14: 37%) of reports we reviewed.

The types of letters are explained on the FRC's website, together with the approach to identifying when it would be proportionate to write[35].

Letters to companies emphasise that the FRC does not expect them to include information that is immaterial or irrelevant and letters should not be read as a suggestion that they do so. A question about the materiality of disclosures no longer provided is not an implied suggestion that they be reinstated. Directors are expected to have sufficient confidence in their own decisions to justify them to us.

The FRC's operating procedures provide for a Review Group of FRRP members to be set up where an enquiry by peers into a company's report and accounts is likely to be better placed to progress an enquiry – whether because of the complexity of the issue involved or because it has not been possible to reach a common understanding of the issue with the company. One Review Group of FRRP members was set up during the year (2014/15 and 2013/14: nil). The findings of the Review Group may be publicly reported once it has completed its work, depending on the outcome.

Companies are asked to respond to our initial letters within 28 days, so that potential matters are addressed promptly. Reasonable requests for extensions are usually granted. The FRC welcomes the improvement in the average response time for our letters since 2013, when a 28 day response was introduced. The average response time to all letters is now 33 days (2014/15: 36 days; 2013/14: 40 days).

Where possible, the FRC responds to companies' letters within 28 days. However, the response time increases on more complex cases. The average for 2015/16 was 29 days (2014/15: 34 days; 2013/14: 35 days).

The FRC issued a generic announcement about the quality of tax disclosures and undertook a thematic review that involved pre-informing a sample of companies that we would review those disclosures in their next accounts.

Complaints and Referrals

A substantial amount of time is allocated to considering complaints and referrals received. Nine complaints were received in 2016/15 (2015/14: 24, 2014/13: 16) of which one was a referral from another regulator (2015/14: 9). The FRC welcomes those that are well-informed and provide additional

35 https://frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-Reporting-Review/FAQs.aspx

insight that may not be observable from a review of the accounts. Further information on how the FRC addresses complaints and referrals is available on the FRC's website[36].

Working with other regulators

Working with audit regulators

The FRC restructuring in April 2016 means that our CRR and Audit Quality Review ("AQR") activities are no longer performed within the same division. However, the teams continue to collaborate when they are able to assist each other's reviews. CRR advises AQR if it has concerns around the quality of the audit work performed. Where AQR reviews an audit and identifies potential issues with a set of accounts, CRR will then consider whether to open correspondence with the company. This is a more efficient way of working together than through formal joint reviews, which can result in delays for one or other team.

The FRC also receives referrals regarding company accounts stemming from audits inspected by the ICAEW's Quality Assurance Division. The insights into companies' accounts that other regulators can bring are valuable and the FRC welcomes their referrals.

ESMA

The effects of the decision to leave the European Union are still being assessed and will take several years to be quantified. In the meantime, we continue to be an active participant in the European Enforcers' Coordination Sessions ("EECS"), the committee established by ESMA for European National Enforcers to deliver its mandate in strengthening European Supervisory convergence. The FRC contributes to discussions on significant emerging issues and enforcement decisions that affect the broader European market. ESMA publishes a selection of these decisions twice a year.

Each year, ESMA issues European common enforcement priorities, which it identifies after consultation with the national Competent Authorities. The FRC reflects these in its reviews and reports the results to ESMA. For reviews undertaken in 2015/16 the priorities were:

- preparation and presentation of consolidated financial statements and related disclosures;
- financial reporting by entities which have joint arrangements and related disclosures; and
- recognition and measurement of deferred tax assets.

The FRC's work did not identify any new concerns about these topics.

In June 2015, ESMA published Guidelines on APMs presented in companies' Annual Reports and Accounts (other than financial statements) and other information such as press releases and prospectuses. It applies to companies from July 2016 and guides them on how to present, explain and reconcile APMs. The FRC's approach to the ESMA Guidelines is considered in section 3.

Other UK regulators

Regular meetings are held with the Financial Conduct Authority ("FCA") to share the outcome of the FRC's work on regulated companies and discuss ongoing matters of joint interest. Where the work relates to interim reporting or the reports of non-UK companies, the FRC's findings are passed to the FCA under the Companies (Audit, Investigations and Community Enterprise) Act 2004 for further consideration. The FCA may refer corporate reporting matters to the FRC when it is best suited to investigate further.

The FRC also liaises with the Prudential Regulation Authority on matters of mutual interest regarding financial institutions and may share information, for example on complaints that affect both corporate and prudential reporting.

36 https://frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-Reporting-Review/FAQs.aspx

APPENDIX B:

CHANGES TO OPERATING PROCEDURES FOR REVIEWING CORPORATE REPORTING

APPENDIX B

Changes to Operating Procedures for reviewing corporate reporting

In 2015, the FRC conducted an Effectiveness review of its AQR and CRR activities, with input from external consultants. They provided a number of suggestions on how to improve the effectiveness and transparency of CRR's work, providing a more useful information set for investors. Resulting changes to the FRC's operating procedures are being consulted upon.

Publicity

Investors told us that they wanted more information about the companies whose accounts were reviewed. The FRC intends to publish the names of those companies whose accounts were reviewed in any year, once the relevant reviews have closed.

The FRC has started to inform companies when a review of their accounts has been performed but has not identified any substantive questions to raise. This gives all audit committees the opportunity to disclose the nature and extent of their interaction with the FRC when a company has been selected for review. The FRC's *Guidance on Audit Committees* (revised April 2016)[37] expects companies complying with the Code to explain the nature and extent of interaction (if any) with CRR. The inherent limitations of the scope of the CRR's reviews are discussed on the FRC's website.

Pre-informing

The FRC has also piloted a programme of pre-informing a limited sample of companies that their next set of report and accounts will be reviewed. In the past this strategy has been applied when performing a focused review of a particular topic and found to be an effective and efficient way of encouraging improvements in disclosures. The effectiveness of this approach based on the sample selected will be assessed and the FRC will decide whether to pre-inform companies of reviews more widely.

Quality review

The review also looked at the efficiency of CRR's processes and the involvement of the FRRP Chairs in regulatory decisions. Opportunities were identified to focus the FRRP Chairs' involvement on only the more significant potential issues identified by reviews and for additional decision-making to be performed by the CRR executive. This will help us to become more nimble in our regulatory responses. Structural changes will be implemented within the team to effect the revised approach.

Feedback

As part of the drive for continuous improvement, the FRC will follow up closed reviews by requesting feedback on the process from a sample of the companies approached. The FRC will focus on the efficiency and effectiveness of the review process and the clarity of communications with a view to identifying ways to introduce further improvements.

37 https://frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-(2).pdf

APPENDIX C:

FRC YEAR-END ADVICE LETTER TO AUDIT COMMITTEE CHAIRS AND FINANCE DIRECTORS

APPENDIX C

10 October 2016

Dear Audit Committee Chairs and Finance Directors

Summary of key developments for 2016 annual reports

I am writing ahead of the 2016 reporting season with the FRC's perspective on aspects of annual reports that companies should aim to improve and to highlight changes to UK reporting requirements.

Strategic report

Investors tell us that they would like annual reports to be more user-friendly and information to be communicated more clearly. Companies should consider whether the information in the strategic report is presented in a clear and concise manner. They should not, however, overlook the legal requirement to provide a fair review of the business that is balanced and comprehensive. A strategic report is comprehensive if it complies with the law and explains all material matters in sufficient detail to be useful and understandable. Such explanations, if focussed only on those material matters, can still be clear and concise. In particular, we note room for improvement in the strategic reports of many smaller companies, including the need to consider whether they have adequately discussed their financial position and cash flows as well as their company's performance.

Business model reporting

Whilst many companies had been presenting disclosures on their business model for a number of years, with this becoming a requirement of the strategic report the FRC's Financial Reporting Lab has this year worked with companies and investors to explore improvements to existing practice. Our Lab report, due to be published in October, will confirm the importance of disclosure to investors and suggest practical ways that companies might consider meeting investor needs. The biggest areas for improvement are the clarity of the explanation of how the company makes money and what differentiates it from its peers.

Alternative performance measures (APMs)

There is increasing regulatory focus on the use of APMs (or 'non-GAAP' measures). APMs are often used in strategic reports, to supplement information prepared in accordance with IFRS or UK GAAP. It is important that their use does not replace or obscure IFRS or UK GAAP information.

In June 2015, the European Securities and Markets Authority (ESMA) published 'Guidelines on Alternative Performance Measures'. The guidelines apply to all regulated information, which includes annual reports (but excludes the financial statements), published on or after 3 July 2016.

The guidelines codify best practice in this area. Companies should consider whether they need to make changes in response to the guidelines. We issued FAQs on this topic in May 2016 and in November will publish a thematic study on the use of APMs in interim reports issued since the guidelines became effective.

Risk reporting and viability statements

We encourage companies to consider a broad range of factors when determining the principal risks and uncertainties facing the business, for example cyber-crime and climate change.

Amendments to 'The UK Corporate Governance Code' (the Code) in 2014 introduced reporting of a longer-term view of a company's prospects in a viability statement. Companies should consider how solvency, liquidity or other principal risks affect the long-term viability of the business. Our initial assessment of statements suggests that there is little variation in disclosures between business sectors. We encourage companies to provide clear disclosure of why the period of assessment selected is appropriate for the particular circumstances of the company, what qualifications and assumptions were made, and how the underlying analysis was performed.

UK referendum result

In light of the referendum vote in favour of the UK leaving the EU, companies will need to consider the consequential risks and uncertainties in the political and economic environment and the impacts of those risks and uncertainties on their business. Not all businesses will be affected to the same extent. Boards must determine what disclosures, if any, are required to meet the needs of investors and comply with regulatory requirements.

We highlighted matters that Boards should consider in relation to the potential impact of the referendum result in our press release of 12 July, 'Reminders for half-yearly and annual financial reports following the EU referendum'.

We subsequently conducted a targeted thematic review of interim reports and noted that 'uncertainty' remained the key reference point, with most companies considering it too early to provide any more specific commentary on the impact of the referendum result. As the economic and political effects are developed and become more certain in the medium and longer term, we expect Boards to provide increasingly company specific disclosures with quantification of the effects.

Financial statement disclosures

Tax

The FRC's thematic study of tax reporting identified areas for improved disclosure. Although we saw some improvements in companies' explanations of their effective tax rates, there remains scope for greater visibility of the factors affecting the rates and their sustainability. Companies should articulate better how they account for material tax uncertainties by explaining the bases for recognition and measurement and we expect more companies to disclose the amount of their tax provisions than do so presently. Disclosures of estimates and judgements may be particularly relevant in this context. The FRC's report will be published in October 2016.

Companies' tax arrangements are an area of increasing public focus, which can give rise to significant risk. Companies need to respond to increasing stakeholder scrutiny

of their tax strategies, including where they pay tax, and to consider carefully whether they are sustainable and any material risks to which this gives rise are clearly described in the report and accounts.

Dividends

Last year the FRC's Financial Reporting Lab produced a report on best practice in dividend disclosures. The report suggests a scaled approach to disclosure of available cash and distributable profits. We have already noted examples of improved disclosure, and expect to see more over the coming reporting period. We consider that there is room for further improvement in linking more detailed disclosure of how dividend policies operate in practice to how those policies may be impacted by the risks and capital management decisions facing the company.

The Local Authorities Pension Fund Forum (LAPFF) recently wrote to a number of listed companies urging companies to disregard the position taken by the FRC in response to their previous letter of November 2015. Our position remains that we encourage good disclosure and companies paying close attention to their investors' views whilst noting that the Companies Act 2006 does not require the separate disclosure of a figure for distributable profits or, specifically, multiple figures for distributable profits. The Act is a matter for the Department for Business, Energy and Industrial Strategy. Its public statements are consistent with the FRC's.

Low interest rates

Companies should consider the impact of low interest rates on the amounts reported in their financial statements. In particular, careful consideration should be given to the valuation of long term assets and liabilities, for example the effects of adjusted discount rates on pension scheme liabilities and suppressed returns on pension scheme assets. Companies may need to provide sensitivity analysis to highlight the potential impacts.

Critical judgements and estimates

Disclosures of critical judgements should explain clearly the specific judgements the Board has made and their effect on the financial statements. In some cases, the quality of explanation of the particular sources of estimation uncertainty that are likely to have a material effect on the following year's results could be improved. Companies should consider whether quantitative disclosures, such as sensitivities or ranges of outcomes, are required so that users of the accounts can fully understand the potential effect of estimates.

Accounting policies

There continues to be room for improvement in the disclosure of accounting policies, particularly in relation to revenue recognition. Investors benefit from specific, granular policy information and there should be a clear link between the sources of income described in the business model and revenue recognition policies. We expect companies to explain exactly when revenue from complex long-term contracts is measured.

Developments in IFRS

The International Accounting Standards Board has published three major standards that will become effective in the next few years: IFRS 15 *Revenue from Contracts with Customers* (effective for periods beginning 1 January 2018), IFRS 9 *Financial Instruments* (effective 1 January 2018), and IFRS 16 *Leases* (effective 1 January 2019). Given that comparative periods for IFRS 15 and IFRS 9 will be commencing from 1 January 2017, we expect that most companies that apply IFRS will have made substantial progress in their implementation of these standards. Companies should provide information on this progress and disclose the likely impacts of each of the new standards once they can be reasonably estimated.

The IASB also recently added requirements to IAS 7 *Statement of Cash Flows* for disclosure explaining changes in a company's financing obligations over the period (effective 1 January 2017). This initative can be traced back to a series of reports from the FRC's Financial Reporting Lab that highlighted investor calls for improvements to debt and cash flow disclosures, including net debt reconciliations. While many UK companies provide such reconciliations, investors continue to have an interest in good quality reconciliations that clearly identify cash and non-cash drivers of changes.

Developments in UK GAAP

There are choices available to companies in relation to the accounting standards that can be applied in the individual financial statements of entities within a group, including for example, FRS 101 *Reduced Disclosure Framework* and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Unless the changes to the standards that were made during 2015 were applied early, there will be some, limited, changes to take into account for the current year. In particular, there is greater flexibility over the format of the primary statements. In addition, FRS 101 has been subject to an annual review so that it remains effective as IFRS changes. Amendments to FRS 101 that were issued in July 2016 gave exemptions from many of the disclosure requirements of IFRS 15.

In order to take advantage of the reduced disclosure options in FRS 101 and FRS 102 an entity must first notify its shareholders in writing. However, in FRED 65 *Draft amendments to FRS 101 - Notification of shareholders* we are currently consulting on removing this requirement, reducing administrative burdens. Subject to the results of the consultation, we expect to finalise these amendments in December 2016 and they will be effective for accounting periods beginning on or after 1 January 2016.

Remuneration reporting

Investors would like more clarity and brevity in remuneration reporting. In August 2016, the GC100 and Investor Group published a revised version of its 'Directors' Remuneration Reporting Guidance'. The revisions include additional guidance in relation to explaining the link between remuneration and strategy, justifying non-disclose of performance measures or targets on the basis of commercial sensitivity, disclosure of remuneration policy, and clarification of items to be included in the single total figure of remuneration.

Audit Committee reporting

Investors would like to see more informative reporting about the specific actions taken by Audit Committees. The Code looks to Audit Committees to disclose the significant issues that they have considered, including:

- issues in relation to the financial statements and how these were addressed, having regard to matters communicated to the Committee by the auditors;
- the nature and extent of interaction (if any) with the FRC's Corporate Reporting Review team; and
- where a company's audit has been reviewed by the FRC's Audit Quality Review team, the Committee should discuss the findings with their auditors and consider whether any of those findings are significant and, if so, make disclosures about the findings and the actions they and the auditors plan to take. This discussion should not include disclosure of the audit quality category.

In 2015, the FRC issued 'Audit Quality Practice Aid for Audit Committees' to assist Audit Committees in evaluating and reporting on audit quality in their assessment of the effectiveness of the external audit process.

The practice aid draws on feedback from Audit Committee members and investors, and sets out practical suggestions on how Audit Committees might tailor their evaluation and reporting in the context of the company's business model and strategy, the business risks it faces, and the perception of the reasonable expectations of the company's investors and other stakeholders.

We hope that you find this letter useful. Further information on the areas covered above, including sources of FRC guidance and best practice examples, are noted overleaf. The FRC will also shortly publish a detailed review of corporate reporting in 2015/16.

Yours sincerely

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