Annual Review of Corporate Reporting 2021/22:

Corporate Reporting Highlights

Financial Reporting Council

Introduction

During these times of increased economic and geopolitical uncertainty it is even more important that investors and other stakeholders have confidence in the information that companies provide. The Corporate Reporting Review team (CRR) of the FRC plays an important role in this regard by working to ensure that company annual reports and accounts comply with the relevant financial and narrative reporting requirements and deliver high quality decision-useful information for investors and other stakeholders.

This document highlights the key messages from the FRC's Annual Review of Corporate Reporting 2021/22 (the main report). It includes:

- a summary of key issues relevant to companies' reporting in uncertain times;
- our key disclosure expectations for the next year; and
- reminders on the top ten topics we raised with companies in 2021/22.

Quality of corporate reporting

We are pleased to note that, despite the challenging environment, the quality of corporate reporting among the FTSE 350 has been maintained. We saw improvements in companies' reporting of judgements and estimation uncertainty, impairment of non-financial assets, revenue and alternative performance measures (APMs). These financial reporting matters are particularly critical to users in an uncertain environment. CRR has been driving improvements in these areas over a number of years. We are pleased with this year's positive development, which we expect to be maintained.

This year saw a significant advance in climate-related reporting with the introduction by the Financial Conduct Authority of reporting based on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations for premium listed entities on a comply-or-explain basis.

However, scope for improvement remains in some areas of financial reporting, particularly financial instruments and deferred tax. Disappointingly, we continue to find errors in cash flow statements, in most cases from desktop reviews. Companies and their auditors can, and must, do better in this area.

Companies should carefully consider the issues most frequently identified in our reviews. We also remind preparers to consider the overarching objectives of the reporting requirements, as well as the detailed disclosure requirements.

Thematic reviews

In addition to our routine monitoring work, we performed thematic reviews of:

- Discount rates
- TCFD disclosures and climate in the financial statements
- Deferred tax assets
- Business combinations
- Earnings per share
- Judgements and estimates

A summary of the findings of these reviews can be found in the main report.

Reporting in uncertain times

The Russian invasion of Ukraine in February sent geopolitical shockwaves around the world and exacerbated the economic uncertainty created by the Covid-19 pandemic. Rising inflation, slowing economic growth, increasing interest rates, stresses in supply chains, constraints in the labour market and changing consumer behaviour, are some of the challenges businesses are currently facing. In this environment of heightened uncertainty, businesses need to be agile and continually reassess the evolving risks, which they will need to reflect in their strategy and reporting.

- Companies should clearly explain the risks and changes in the business environment they are facing and how the risks and uncertainties have been reflected in the strategy, business model and going concern and viability assessments.[1]

- Explanation of the business performance and financial position at the end of the year should be made in the context of the business strategy and reflect the risks.
- Any changes to definitions and/or calculations of APMs (for example, inflation-adjusted measures) should be adequately explained (please see page 20 of our APM thematic and page 32 of our Covid-19 thematic for our expectations).

Principal risks and changes in business environment → **Strategy and business model** → **Going concern and viability** → **Business performance and position** → **Financial reporting**

Companies should consider the effect of uncertainty on the recognition, measurement and disclosures, which may include:

- The net realisable value of inventories may be affected by the changing economic environment.
- Impairment assessments of non-financial assets should reflect the most recent management expectations, budgets and forecasts and asset-specific risks.
- Expected credit loss (ECL) measurements of financial assets need to be updated to take account of forward-looking information and historical default data adjusted accordingly.
- Deferred tax assets may no longer be recoverable due to uncertainty over future profitability.
- Contracts may become onerous and a liability may need to be recognised for the unavoidable costs.
- Investing, financing and hedging strategies may need to be revisited and appropriately reflected in the financial statements.
- Entities will need to consider the impact of inflation on the business and financial reporting (please see page 47 of the main report).
- More areas of financial reporting may involve significant judgements and estimation uncertainty, which will need to be disclosed (for example, going concern assessment and fair value measurement).
- Key assumptions and estimation uncertainty involved in the measurement of recognised assets and liabilities need to be explained and appropriate sensitivity provided.

1 Please see our thematic on **Viability and Going Concern** for guidance in this area.

Key disclosure expectations for 2022/23

Our overall expectations for disclosure include:

... unambiguous description in the strategic report of risks facing the business, their impact on strategy, business model, going concern and viability, and cross-referenced to relevant detail in the reports and accounts.

... specific, balanced and well-integrated information about the impact of climate change on the company in narrative reporting, and appropriate reflection of material climate-related commitments, risks and uncertainties in the financial statements; clarity about the relationship between assumptions and sensitivities considered in any TCFD scenarios[2] (including any Paris-aligned scenarios) and those applied in the financial statements.

... impairment disclosures that assign values to, and explain how, the key assumptions used have been determined, with reference to future expectations regarding external conditions and the company's own strategy.

... clear disclosure of significant management judgements and key assumptions underlying major sources of estimation uncertainty, including information about the sensitivity of reported amounts to changes in assumptions.

... transparent disclosure of the nature and extent of material risks arising from financial instruments, including changes in investing, financing and hedging arrangements; the use of factoring and reverse factoring in working capital financing and the approach to and significant assumptions made in the measurement of expected credit losses; concentrations of risks and information about covenants (where material).

... company-specific information that meets the disclosure objectives of the relevant accounting standards and not just the specific disclosure requirements. Additional information (beyond the standards' requirements) should be included where needed to understand the impact of particular transactions, events or circumstances.

... clear explanation of the nature of significant inflationary features in revenue, supply, leasing and other financing contracts, and their effect on the financial statements.

... clear, concise and understandable disclosure that omits immaterial information.

See also pages 5 to 8 for reminders to companies on the top ten areas we challenge.

2 Where required by the Listing Rules, or an explanation of the reasons for not doing so.

Reminders to companies on the top ten areas of CRR challenge

Topic	Companies should ensure that …
1. Cash flow statements	• reported cash flows are consistent with amounts reported elsewhere in the annual report and accounts. • non-cash items are excluded from the statement and adjustments for material non-cash transactions are disclosed. • classification of cash flows, cash and cash equivalents comply with relevant definitions and criteria in the standard. • cash flows are not inappropriately netted. • the parent company cash flow statement (where provided[3]) complies with the requirements of the standard.
2. Financial instruments	• the nature and extent of material risks arising from financial instruments (including inflation and rising interest rates) and related risk management are adequately disclosed, including: – the methods used to measure exposure to risks and any changes from the previous period; and – any hedging arrangements put in place to fix interest rates or hedge against the effects of inflation.[4] • the approach and significant assumptions applied in the measurement of ECL; and concentrations of risks, where material, are disclosed. • in making ECL assessments, historical default rates are reviewed and adjusted for forecast future economic conditions. • accounting policies are provided for all material financing (including factoring and reverse factoring) and hedging arrangements, and any changes in the arrangements. • information about banking covenants is provided unless the likelihood of any breach is considered remote. • the effect of refinancing and changes to covenant arrangements is explained.

3 FRS 101 'Reduced Disclosure Framework' offers entities applying FRS 101 a disclosure exemption from preparing a cash flow statement (paragraph 8(h)).
4 IFRS 9 'Financial Instruments', paragraph B6.3.13, contains a rebuttable presumption that unless inflation risk is contractually specified, it cannot be designated as a risk component of a hedged item, except for limited cases.

Reminders to companies on the top ten areas of CRR challenge (continued)

Topic	Companies should ensure that ...
3. Income taxes	• forward-looking assessments take account of the difficult economic environment ahead of us. Companies should remain alert to changes in tax regimes introduced in response to the inflationary environment. • where material deferred tax assets are recognised by loss-making entities, the nature of the evidence supporting their recognition is disclosed. Significant accounting judgements and sources of estimation uncertainty will also often need to be disclosed in such cases. • tax-related disclosures are consistent throughout the annual report and accounts, and material reconciling items in the effective tax rate reconciliation are adequately explained.
4. Strategic report and other Companies Act matters	• the strategic report: – articulates the effect of economic and other risks and uncertainties facing the business (including inflation, rising interest rates, supply chain issues and labour relations in the inflationary environment); – explains the mitigation strategies; and – where relevant, links to the discussion of the entity's strategy and business model, and information disclosed in the financial statements. • the strategic report explains significant movements in the statements of financial position and cash flows, and not be limited to an explanation of financial performance. • linkages between information presented within the strategic report and the accounts are highlighted and explained. • they comply with specific legal requirements around distributions, including the requirement to file interim accounts to support distributions in excess of distributable profits shown in the relevant accounts (usually the most recent audited accounts).

Reminders to companies on the top ten areas of CRR challenge (continued)

Topic	Companies should ensure that ...
5. Revenue	• inflationary features in contracts with customers and accounting for such clauses (that is, whether the feature is an embedded derivative or variable consideration) are disclosed. • accounting policies are provided for all significant performance obligations and address: – the timing of revenue recognition; – the basis for recognising any revenue over time; and – the methodology applied. • significant judgements made in relation to revenue recognition are disclosed (for example, in relation to the allocation of the transaction price and the timing of satisfaction of performance obligations).
6. Provisions and contingencies	• the inputs used in measuring provisions follow a consistent approach in incorporating the effects of inflation. Nominal cash flows, which include the effect of inflation, should be discounted at a nominal rate and real cash flows, which exclude the effect of inflation, should be discounted at a real rate.[5] • details of how the inflation assumptions have been calculated are provided where they have a material impact on the financial statements. • clear and specific descriptions of the nature and uncertainties are disclosed for each material exposure for which a provision is recognised or a contingent liability is disclosed, as well as the timeframe over which it is expected to crystallise and the basis for determining the best estimate of the probable or possible outflow.
7. Alternative performance measures (APMs)	• APMs are not displayed with more prominence, emphasis or authority than measures directly stemming from financial statements. • the basis for classifying amounts as adjusting, ‘non-underlying’ or ‘non-core’ and any changes to APMs are explained, together with the reasons for those changes. • APMs are reconciled to the most directly reconcilable line item of the financial statements.

5 Please see page 11 of our thematic on discount rates.

Reminders to companies on the top ten areas of CRR challenge (continued)

Topic	Companies should ensure that ...
8. Judgements and estimates	• significant judgements involved in going concern assessment and accounting for inflationary features are explained and sensitivity quantified where inflation represents a significant source of estimation uncertainty. • sources of estimation uncertainty and the related disclosures are updated at the balance sheet date. • sensitivity disclosures are provided in the most meaningful way for readers, by, for example, sensitising the most relevant assumptions, choosing alternative assumptions that are considered reasonably possible and explaining changes to the assumptions, particularly, where the range of possible outcomes has widened under the more uncertain environment. • estimates with a significant risk of a material adjustment to the carrying amounts of assets and liabilities within the next financial year are clearly distinguished from other sources of estimation uncertainty.
9. Impairment of assets	• they explain the sensitivity of recoverable amounts to changes in assumptions, particularly where the range of reasonably possible outcomes has widened under a more uncertain outlook.[6] • the effects on the assumptions made in the impairment assessment relating to potential reduced customer demand, increased costs and other factors that affect the business in the current environment are disclosed. • the inputs used in value in use calculations are consistent in incorporating the effect of inflation (nominal cash flows are discounted at a nominal rate and real cash flows are discounted at a real rate).[7] • impairment reviews and/or disclosures appropriately reflect information elsewhere in the report and accounts. • the composition of cash generating units (CGUs) and the basis for the allocation of goodwill to CGUs or groups of CGUs is adequately explained.
10. Presentation of financial statements and related disclosures	• material accounting policy information is clearly disclosed.[8] • additional company-specific disclosures are provided when compliance with the specific requirements in IFRS is insufficient to explain the impact of particular transactions, events and conditions on the company's financial position and financial performance.[9]

6 Pages 44 – 47 of our **Covid-19 thematic review** set out further considerations in relation to the impairment of non-financial assets in an uncertain environment.
7 IAS 36 'Impairment of assets', paragraph 40
8 IAS 1 'Presentation of Financial Statements', paragraph 117, as amended for accounting periods beginning on or after 1 January 2023 (please **see page 52** of the main report).
9 IAS 1, paragraph 31

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