Key matters for 2021/22 reports and accounts

Introduction

Welcome to the FRC's summary of key matters that are relevant to the 2021/22 financial reporting season. This summary addresses the FRC's areas of focus for the coming year and identifies what we expect to see in high quality reports and accounts. It highlights key messages and provides links to other documents in which more information can be found, including sections outlining relevant FRC publications and year-end developments. It also discusses recent changes to corporate governance, and narrative and financial reporting.

This summary replaces the annual year-end advice letter to preparers of annual reports. It is primarily targeted at CEOs, CFOs and Audit Committee Chairs but is likely to be helpful for all preparers, reviewers and auditors. We encourage all reporting teams and relevant committees to consider the messages when they prepare and review annual reports. We would welcome any feedback on this bulletin.

Companies continue to experience the ongoing economic and operational effects of the Covid-19 pandemic. Working patterns have changed, with home- or hybrid-working becoming more common and some companies continuing to encounter disruption. We draw companies' attention to the reporting extensions that remain available on application.

We were reassured that our detailed monitoring work did not identify a decline in reporting quality as a result of the pandemic. However, uncertainties around the continuing impact of the pandemic still have a material effect on many companies. Disclosures of judgements and assumptions about the future remain important to users of reports, particularly when considering matters such as going concern and liquidity. Companies should ensure that the disclosure objectives of standards are met, as well as satisfying their detailed disclosure requirements, where material. We provide more guidance, below, on what makes for better quality reporting, and where our detailed monitoring work has identified shortcomings requiring improvement. We also explain our expectations for the next reporting season.

1. FRC publications

1.1 Annual Review of Corporate Reporting

Our Annual Review of Corporate Reporting ('the Annual Review') provides detailed findings from our Corporate Reporting Review activities during the year, as well as illustrating good practice examples. A short Corporate Reporting Highlights document is specifically designed for readers who may find a high-level summary more helpful.

We found incremental improvements in the quality of information reported in strategic reports and better linkage of this information to the financial statements. However, we continue to note examples of material items not discussed in strategic reports, often relating to balance sheet items or cash flows.

This year, we raised an increased number of queries in relation to some more recently introduced standards; specifically, IFRS 15, 'Revenue from Contracts with Customers', IFRS 16, 'Leases' and financial instruments standards (IFRS 9, 'Financial Instruments' and IFRS 7, 'Financial Instruments: Disclosures'), where better practices are continuing to develop.

In common with previous experience, many issues raised regarding these new standards concerned disclosures around the most judgemental areas, such as the recognition of variable consideration for revenue and sources of variability for leases. We expect companies to provide detailed and specific explanations of such features, as well as information regarding assumptions and sensitivities where relevant and material.

Our initial desk-top reviews continue to identify errors in cash flow statements that could have been identified by companies' own internal review processes. We expect companies to consider this important primary statement in sufficient detail as part of their own report completion process. A focus on any novel or unusual cash flows may help identify items that could be misclassified. Our thematic review of cash flow and liquidity disclosures provides additional detail about the nature of the questions we raise more often in this area. Further information about these matters (and other frequently raised issues) and how to address them is provided on page 3 of the Corporate Reporting Highlights document.

Following our 2020 thematic review of the reporting of climate change, we saw some improvements in related narrative disclosures, including better explanations of net zero commitments and scenarios used in some cases. There is, however, still considerable scope for further enhancement.

Climate change also increasingly affects a number of areas of financial statements. During 2020/21 we challenged companies' assessment of the effect of climate change on financial statement areas including impairment reviews, asset lives and carrying values, decommissioning and restoration provisions, and segmental reporting. Further details can be found in our Annual Review of Corporate Reporting.

We also continue to focus on the disclosure of judgements and estimation uncertainties arising from the continuing effects of the Covid-19 pandemic, particularly regarding matters such as going concern and liquidity. Where uncertainties identified elsewhere in the corporate reporting signal possible impairment indicators, users need to know how this was taken into account in the impairment reviews. Additional focus should also be given to the recoverability of deferred tax assets.

Our routine monitoring of annual reports and accounts during the 2021/22 cycle will continue to focus on both climate change and the effects of the pandemic.

Our Annual Review also includes an update on the effect of the FRC's transformation programme on the work of the Corporate Reporting Review (CRR) team. Please refer to section 6.5 of our Annual Review.

1.2 CRR thematic reviews

During the year, CRR published the following thematic reports:

- Interim Reporting: we considered compliance with the requirements of the FCA's Disclosure Guidance and Transparency Rules and IAS 34 'Interim Financial Reporting', to identify areas of better practice or where improvements are required. Overall, we were pleased with the quality of interim reports, with most companies reflecting our Covid-19 recommendations to enhance their disclosures, particularly in relation to going concern. For significant events and transactions in the interim period, such as impairments, many companies provided detailed explanations and other helpful information normally reserved for annual reports and accounts. However, significant balance sheet movements were not always explained.
- Viability and Going Concern: we found that the disclosure of inputs and assumptions used to support viability and going concern assessments often lacked sufficient qualitative and quantitative detail. In some cases, there was evidence indicating that significant judgements may have been applied in these assessments, but they were neither identified nor explained. As well as providing more detailed disclosure in these areas, we encourage companies to extend the period over which they assess viability, and provide longer-term information where possible.
- Provisions, Contingent Liabilities and Contingent Assets: we identified examples of good practice across each individual aspect of disclosure. However, there remains scope for improvement in areas including the disclosure of quantitative information on the expected timing of future economic outflows, the key assumptions used to estimate those outflows, and the associated uncertainties. We also identified opportunities to clarify the nature of the costs included in certain types of provision, to disclose more specific accounting policies and to provide more quantitative information about contingent liabilities.
- Alternative Performance Measures (APMs): we noted that APMs are widely used and are broad in nature, ranging from well-understood measures, such as EBITDA, to complex and bespoke measures. We found that adjustments mainly resulted in the exclusion of costs, resulting in more favourable adjusted results than IFRS results. Companies should do more to ensure that APMs are not given more prominence or authority than statutory measures, by focusing more on the discussion of IFRS measures and avoiding descriptions of APMs that imply they are more useful or reliable than their IFRS equivalents. Companies can improve the quality of their explanations of APMs and adjusting items by providing more granular information and, where relevant, by providing those explanations at the level of individual APMs or adjusting items.
- Streamlined Energy and Carbon Reporting (SECR): we found that most of the entities in our sample largely complied with the minimum statutory disclosure requirements. However, more needs to be done to make these disclosures understandable and relevant for users, including explaining the methodologies used and the extent of any third-party assurance. We were pleased to see some examples of emerging good practice, including disclosure of Scope 3 emissions and information about emissions-reduction targets, 'net zero' strategies, or other emissions-reduction commitments.

The individual thematic reports provide more detail on the main findings as well as our key reporting and disclosure expectations for the next year in each of the areas covered.

1.3 Principles of good quality corporate reporting

The FRC recently consulted on the Future of Corporate Reporting. The discussion paper proposed one common set of principles for a corporate reporting network which includes multiple reports. This will help maintain cohesiveness across the corporate reporting system and establish the adequacy of information. Following the consultation and subsequent feedback from the stakeholders, we are further developing these principles for clear communication in corporate reporting.

1.4 Financial Reporting Lab reports

The Financial Reporting Lab (the Lab) produced reports for the year providing detailed commentary on current practice and highlighting the information that investors tell us they find most critical in the following areas:

- Stakeholders, decisions and Section 172: this report outlines investors' preferences regarding these disclosures, noting that users want to understand how a company is progressing towards fulfilling its purpose and achieving long-term success. The report notes that information on both stakeholders and decisions can help with that understanding, and section 172 statements can act as a helpful bridge between these two types of information. The report poses a series of questions for companies and provides practical examples of corporate reporting considered by investors to represent better practice.
- Risks and scenarios: this report highlights the information on risks, uncertainties and opportunities that contributes to investors' understanding of a company's business model, longer-term strategy, resilience and viability. Many companies have evolved their internal processes and conversations on risks, uncertainties and opportunities, which are becoming more integral to strategy and operations, particularly since the emergence of the Covid-19 pandemic. However, there remains a gap between the information investors want and the disclosures that companies provide.
- European Single Electronic Format: The European Single Electronic Format (ESEF) is the new standard for digital financial reporting by companies admitted to trading on EU and UK regulated markets. It is applicable for financial years starting on or after 1 January 2021 (under DTR 4.1.14). The Lab published a report setting out some of the better, and poorer, practice it had seen in the voluntary tagging ahead of the mandatory requirement.

1.5 Review of corporate governance

In order to continue to improve reporting against the UK Corporate Governance Code (the Code), the FRC issued its review of corporate governance reporting in November 2020. More recently it issued a report on 'Improving the quality of "comply or explain"'. These reports promote the importance of reporting on outcomes, rather than process, and remind companies to report clearly any departures from the Code, supported by effective explanations.

The FRC's published research into the disclosure of remuneration, workforce engagement and diversity in FTSE 350 companies all noted areas of good reporting; however, a common theme was that disclosures often lacked detail and tended to be boilerplate. We would like to see reporting improved by the use of examples and outcomes, especially for those matters that have been discussed at board level and resulted in actions to improve governance or engagement with stakeholders.

We plan to issue our 2021 review of corporate governance reporting in November. Like last year, this will be an assessment of the application of the UK Corporate Governance Codes Principles and compliance with the Provisions based on a random sample of 100 companies, which included mostly premium listed and a small number of Small Cap companies. We hope companies have taken on board the FRC expectations highlighted in last year's report.

During 2021 we undertook a pilot, as part of our response to the Government's consultation into restoring trust in audit and corporate governance, to raise matters on areas outside the FRC's current statutory enforcement remit for a small sample of companies. We wrote to the companies concerned to draw their attention to areas of potential improvement in their reporting of governance and stakeholder engagement. We assessed the effectiveness of this work and were pleased to see that all those companies that had published a further annual report since receiving our letter had made improvements to the governance reporting. We will continue this approach in 2021/22.

1.6 Statement of Intent on Environmental, Social and Governance challenges

In July 2021 we published the FRC Statement of Intent on Environmental, Social and Governance challenges (ESG), which sets out areas where ESG reporting fails to meet the demands of stakeholders, suggestions to address some of these challenges, and the FRC's planned activities in this area. As set out in our climate thematic review of last year, investors increasingly require reporting that goes beyond the statutory minimum requirements. We are concerned that a checklist approach to individual requirements is not providing sufficient, coherent information on climate change across the annual report and accounts as a whole to meet the overall disclosure objectives of those requirements. In particular, we expect companies to provide sufficient information so that users can understand the relationship between uncertainties and scenarios discussed in narrative reporting and the assumptions applied and sensitivities considered in the financial statements.

In the FRC's view, we need better:

- Production – to ensure that better internal information leads to better decisions and better insight for stakeholders;
- Audit and Assurance – so that the reported information is robust and reliable;
- Distribution – so that information is made accessible to interested parties;
- Consumption – to ensure the information leads to better decision making by stakeholders;
- Supervision – so that information and activity is appropriately monitored and requirements are enforced; and
- Regulation – as coordinated and coherent regulation leads to efficiency.

As we work towards a more effective system of production, audit and assurance, distribution, consumption, supervision and regulation, the FRC will work within its remit and with other standard setters, regulators, market participants and other stakeholders to build a system that is forward-looking and fit for purpose.

2. Year-end developments

2.1 IFRS developments

As in previous years, companies will be expected to apply amendments to IFRSs that became applicable this year and disclose the expected impact of revisions that have been issued but are not yet applicable, if material.

The following amendments have been endorsed by the UK Endorsement Board and should be considered by entities in the forthcoming reporting season:

- Covid-19 related rent concessions beyond 30 June 2021
- Interest Rate Benchmark Reform – Phase 2
- Extension of the Temporary Exemption from Applying IFRS 9 (amendments to IFRS 4 for insurers)

An outline of the effect of each of these can be found in our Annual Review of Corporate Reporting.

2.2 UK GAAP developments

A number of minor amendments to UK GAAP become effective for accounting periods beginning on or after 1 January 2021, including:

- Amendments due to the UK exit from the European Union;
- Interest rate benchmark reform (Phase 2);
- Covid-19-related rent concessions beyond 30 June 2021; and
- Going concern assessments in interim accounts.

Further details can be found in the Annual Review of Corporate Reporting.

2.3 Taskforce for Climate-related Financial Disclosures (TCFD)

For accounting periods beginning on or after 1 January 2021, commercial companies with a premium listing on the main market of the London Stock Exchange must include a statement in their annual financial report explaining the extent of their compliance with the TCFD's recommendations and recommended disclosures on a comply-or-explain basis. Consultations are also underway to extend TCFD-type disclosures to other Public Interest Entities, including large private companies and some financial services companies. Further details can be found in the Annual Review of Corporate Reporting.

Our thematic review of climate reporting found that many large companies have already started to implement the TCFD recommendations. It is important to ensure that the information presented does not appear to be an 'add-on' containing boilerplate messages. We found that reporting under the TCFD recommendations was improved where it was better integrated with the company's strategy with the use of cross-referencing.

3. Keep in touch

Contact us

We would welcome feedback on the scope and format of this new publication.

Contact us at enquiries@frc.org.uk

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