Lab project report:

Accounting policies and integration of related financial information

July 2014

Contents

Project summary 3

Context and introduction 4

Project observations 5

Accounting policy disclosures 5

Placement of accounting policies 10

Ordering of notes to the financial statements 14

Financial review integration 16

Other observations 19

Participants and process 20

Reporting examples

I. New IFRS requirements – UBM 9

II. Impact of new IFRS – Vodafone 9

III. Integrated policy – ITV 11

IV. Integrated policy and estimates – Cairn Energy 12

V. Contents page – AngloAmerican 15

VI. Contents page – Cairn Energy 15

VII. Cash flow statement & commentary – Vodafone 17

VIII. Income statement, OCI & commentary – Schroders 18

Project summary

The FRC is committed to promoting Clear & Concise corporate reporting, and this Lab project is designed to support Clear & Concise reporting. For more information on the FRC's Clear & Concise initiative see the FRC's website.[1]

In recent years, a number of companies have experimented with the presentation, position and content of accounting policy disclosures and financial review information. This Lab project report (Report) considers the views of investors and companies in relation to this experimentation and looks at:

- Accounting policies: which are disclosed, the content of what is disclosed, and their placement;
- Notes to the financial statements: ordering, grouping and combining notes; and
- Financial review: integration with the primary financial statements.

16 companies, many of which have undertaken changes to these areas of reporting, and 19 institutional investors, analysts and representative organisations, have taken part in the project. Further input was received through an online survey which elicited responses from over 200 retail investors. (See the section 'Project process' for more information.) The aim of this Report is to provide insight from investors on each of the above areas and aid companies when considering their future reporting.

Summary of observations

Accounting policies

Investors have some clear messages for companies in relation to improving the prominence of significant accounting policies, and enhancing the quality of their disclosures:

- while investors are generally happy for companies to make judgements on which accounting policies are significant, they are able to articulate attributes of a significant policy (see box);
- likewise, investors are able to articulate qualities of good policy disclosures (see box);
- investors prioritise the need for improvements in the quality of disclosure over placement.

Beyond the significant policies, there are diverse views in relation to the additional accounting policies currently disclosed by many companies;

- nearly half of retail investors surveyed prefer a complete list of policies to be disclosed in the annual report, with a quarter going as far as suggesting that all policies are significant;
- institutional investors are more supportive of only the significant policies being included in the annual report, with additional policy information being made available on the company's website.

Companies might consider the specific needs of their investor base, perhaps seeking feedback. Moving these non-significant policy disclosures to an appendix within the annual report may be a helpful compromise.

Notes to the financial statements

On note order:

- the combining of tax expense and balance sheet notes is viewed as logical by investors;
- the case for combining or grouping other notes, and indeed for significant change in note order, has not been made;
- consistency of note order across companies and time is highly valued; and
- a table of contents can be helpful in navigating through to the desired information, especially where notes are ordered in a relatively different manner.

[1] https://frc.org.uk/Our-Work/Headline-projects/Clear-Concise.aspx

Integration of Financial Review

For integrating financial review and financial statement information; while some see merit in increased analysis of financial statement line items however, most prefer the traditional approach of placing management commentary and financial statement information in separate sections of the annual report.

Attributes of significant policies

The following attributes (alone or together) may indicate a significant accounting policy to be disclosed:

- materiality of transactions classes and amounts, and importance to the nature of the business;
- policies for all distinct revenue streams;
- where there is choice of policy under IFRS, or significant judgement in selecting the policy and
- where there is need for management to apply significant levels of estimation or judgement in applying the policy.

Qualities for the content of policy disclosures

Policies should:

- be written using plain, understandable language;
- describe any judgements made in selecting the policy applied, and the rationale for them;
- describe the company's application of accounting policies (not summarise the IFRS standard), including the estimation/judgements made and their significance to reported amounts; and
- describe new IFRS requirements only if they significantly, or are likely to significantly, impact the financial statements; and present the impact of changes in tabular format.

Context and introduction

The regulatory context

IAS 1 *Presentation of Financial Statements* (IAS 1) requires significant accounting policies, significant judgments made in applying the accounting policies, and assumptions and other major sources of estimation uncertainty, to be disclosed in the notes to the financial statements.

Companies must disclose in their summaries of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements, and the other accounting policies used that are relevant to an understanding of the financial statements. IAS 1 provides guidance on when a policy must be disclosed, such as;

- disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position;
- the nature of the company's operations mean that the users of its financial statements would expect certain policies to be disclosed for that type of entity;
- an accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material;
- a policy is selected from alternatives allowed in IFRSs; and
- a policy is not specifically required by IFRSs but the entity selects and applies in accordance with IAS 8.

IAS 1 also requires notes to be presented in a systematic manner. It indicates the summary of significant accounting policies would normally be disclosed in a single note after the primary financial statements. However, the standard states that entities may apply another systematic order.

Developing current practice

Accounting policy disclosures of companies applying IFRS often fill many pages in the financial statements, as companies usually disclose more than only the significant accounting policies. The majority of companies place their notes in the normal order described in IAS 1 and disclose their accounting policies in a single note (usually note 1).

A number of companies have sought to improve their reports over recent reporting cycles by removing or separating immaterial or less important information, improving the disclosure of important policy information, changing note order to give prominence to some over others, and integrating related financial review and financial statement information.

Additionally, the IASB issued an Exposure Draft proposing amendments to IAS 1 which seeks to clarify the flexibility in presentation intended in the current standard and is undertaking additional consideration of materiality and disclosures more generally (see adjacent box).

This Lab project explores investor' views on these developments.

Related IASB work streams

Proposed amendments to IAS 1 Presentation of Financial Statements

The IASB issued an Exposure Draft (ED) of amendments to IAS 1, indicating that the amendments clarify the intent of the current Standard. The following proposals relate most directly to this Lab project.

Materiality – to clarify that the concept of materiality applies to the specific disclosure requirements set out in individual Standards and that materiality applies to both the primary statements and the notes to the financial statements. The ED also clarifies that disclosing immaterial information can obscure the material information provided.

Notes – to confirm that entities have flexibility to present the notes to the financial statements in a systematic order determined by the entity, including where to place accounting policy disclosure within the notes.

Significant accounting policies – to remove income taxes and foreign currency examples so that they are less likely to be considered significant policies in every case.

Materiality research project

The IASB is also examining materiality more generally. The initial stage of the project is to research how materiality is applied in accounting standards, case law and regulation across jurisdictions. The materiality project will also look at improving guidance in relation to what is meant by significant accounting policies. IASB staff expect to present the findings to the Board later in 2014.

Principles of disclosure

In April 2014 the IASB decided to prioritise work on establishing principles for the notes to the financial statements, including establishing the objective and boundaries of the notes and principles for organising, placing, formatting and linking information.

Project observations

Investors think current accounting policy disclosure includes "boilerplate" text, with repetition of language in accounting standards, and are not specific enough to the company.

Accounting policy disclosures

Which accounting policies should be disclosed?

Investors have some clear messages for companies in relation to improving the prominence of significant accounting policies. However, they differ on how the remainder of the policies currently disclosed should be presented.

Institutional investors consider that policies that are not significant are clutter. Most of these investors would still like access to a fuller set of policies on the company's website, with attention drawn through a link shown in the financial statements. In contrast, almost half of the retail investors surveyed prefer that companies continue to disclose all accounting policies that are currently disclosed. Companies might consider the specific needs of their investor base. Moving these policy disclosures to an appendix within the annual report may be a helpful compromise.

Which accounting policies are significant?

Investors think that companies should use their knowledge and experience to determine which accounting policies are significant for their specific business and transactions. However, they offered the following attributes as indication that a policy is significant:

- *Material transaction classes and amounts*. While not every material balance indicates a significant policy, the policy on revenue is considered to always be significant. Investors are particularly interested in policies that are important or unique to the business' operations.

- *Accounting policy choices.* While the number of explicit choices of accounting policy allowed in IFRS is decreasing, where a choice is allowed, that policy should be considered significant unless it is clearly immaterial.

- *Judgement and/or estimation*. Accounting policies which require significant levels of estimation and/or judgement in their application are significant. Investors want insight into the sensitivity of balances and earnings amounts stemming from elements of estimation and judgement.

Many investors do not differentiate between accounting policy, judgement and estimate disclosures, in the way that accounting standards distinguish them. Investors often describe estimates when asked which accounting policies they refer to most. This demonstrates the importance to investors of the estimates and judgements made in choosing and applying accounting policies, and supports disclosure that provides a clear understanding of estimates and judgements in the context of the related accounting policy.

A few investors indicate that accounting policies which differ from the norm for a company's sector are significant unless the related transactions and balances are clearly immaterial. Such differences may relate either to choices in policy, or judgements made in how they are applied.

One investor suggests that if an amount is important enough to be discussed in the financial review, the related accounting policy is likely to be significant.

Investor views

"I only want significant / material policies. If there is little choice / room for interpretation, there is no need for disclosure. Remove boilerplate text. Make judgements more meaningful."

Large buy-side investor

Lab comment

Insight from Corporate Reporting Review

Under the Companies Act 2006 (the Act), the FRC's Conduct Committee reviews the annual reports and financial statements of public and large private companies to determine whether they comply with the Act and other reporting requirements. Corporate Reporting Review (CRR) performs this work and based on their recent findings, developed for this Report, the following do's and don'ts in relation to disclosure of significant accounting policies:

DO

- Describe the policies that are significant to the nature or complexity of your business;
- Explain how you apply those policies to your specific business and transactions;
- Identify the nature of the judgements you make;
- Consider disclosing the impact on your accounts if you had made an alternative judgement; and
- Refer to the actual issues faced when disclosing assumptions and other sources of estimation uncertainty.

DON'T

- Include reference to immaterial policies which can obscure key information; and
- Use boilerplate text such as extracts from standards or model accounts.

Quality of accounting policy disclosures

Investors indicate that accounting policy disclosure should be company-specific and enable a reader to understand:

- the relevance of the policy to the company and its business transactions;
- where the company has made a policy choice and why that choice is most appropriate for the business;
- how the company applies its policies;
- the impact of judgement and estimation required in the application; and
- consequences for the reported amounts.

Understanding the judgement and estimation applied by management, including where management's judgement sits within a range of possible or acceptable outcomes, is valuable for investors to enable them to evaluate the reported financial position and results and their sensitivities. Improved disclosure of judgements and sensitivities is desired by investors.

When a policy choice has been made, investors would like the rationale for why the treatment selected is most appropriate for the business, and an explanation of the qualitative impact of the chosen policy. Similar information is required when the company changes its choice of policy.

Investors also value plain language but emphasise that companies need to consider their audience carefully when determining the language to be used, and find a balance that respects knowledgeable readers while being understandable to non-specialists.

Some companies and one investor find even the 'boilerplate' accounting policies to be a useful summary of accounting standards, and in particular a useful summary of IFRS applied by a company in a given year, which is more readily accessible and understandable than the standards themselves.

As a test, companies could ask themselves whether reading the policy alone allows them to clearly understand:

- the trigger for recognising or derecognising transactions and balances;
- the judgements required to determine the relevant trigger has been met; and
- how amounts are measured or valued including the key judgements and estimates required.

Investor views

"Policies need to be written in plain English and explain how the companies apply the policy to enable me to determine if management are conservative or aggressive in application."

Large buy-side investor

"Detailed explanations are most relevant particularly around judgement areas and understanding of revenue recognition in all its forms."

Retail investor

Lab comment

Judgement and estimation

A number of investors told us that there should be a high level of interaction of the reporting of key estimates and judgements across the auditor and audit committee reports, and accounting policy disclosures.

Figure 1: Interaction of key reports and policies

Investor expectation as to how estimates and judgements should be reported:

- Accounting policy disclosure should cover management's application of all key policies, estimates and judgements.

- Audit Committee report should describe how the audit committee responded to and concluded on the key estimates and judgements.

- Auditor report should describe auditor's work around the key estimates and judgements.

If done well, audit committee and auditor reports can link to the accounting policy disclosure, and be more focused on what the audit committee and auditor respectively did in relation to topics that feature in their work.

Project observations

Based on insight gained from investors during the project, the Lab project team developed the adjacent accounting policy on intangible assets by enhancing a listed company's disclosure. This policy could be included in the accounting policies note or integrated into the intangible asset note. Equally, the table could be integrated in the intangibles note and the remainder placed in the accounting policy note.

In testing this enhanced disclosures with investors, most viewed this level of disclosure as a step forward, which should be adopted by companies for all significant policies, but some provided further improvement suggestions, included below. The following is a summary of feedback from investors.

Most investors like:

- The first two paragraphs which provide context to the relevance of the policy to the business;
- Personalising the language using "we";
- Using clear, plain language and presentation; and
- The information contained in the table, in particular UEL disclosures, which are often not disclosed in sufficient detail by companies.

Improvements suggested by a small number of investors include:

- Removal of the context and accounting policy disclosures in the first four paragraphs as these are not providing value for well-informed investors;
- Writing disclosure in third person, as it is viewed as being more business-like;
- Adding disclosure of recognition criteria for internally generated intangible assets and the review process to identify when expected benefits will not be realised resulting in the costs written off; and
- Adding disclosure of the valuation basis of each asset and to which aspects the judgement and estimation relate, rather than characterising each as low, moderate or high.

Example accounting policy disclosure – enhanced policy

Intangible assets

Intangible assets are an important source of value for Made Up plc. Intangible assets are either acquired or generated internally.

In the normal course of business we buy other companies and assets, such as our purchase in the year of the trade and assets of Fake Business. Some of the assets may be intangible, such as customer relationships, brands or licences, and because we have bought these external to the group we must record a value for these assets.

When we buy an individual intangible asset it is initially recorded at cost. When we account for acquisitions of companies and businesses we are required to identify intangible assets and determine their fair values at which the assets are initially recorded.

We also develop some intangible assets internally mainly comprising software, databases and our retail website. The related research costs are expensed when incurred but once a viable project has been identified which satisfies all the required criteria for capitalisation, including the probability of generating future value for the group, the development costs (directly attributable costs such as labour and materials) are capitalised.

We estimate the period over which each asset will generate value to us, which is called the Useful Economic Life (UEL), and amortise (spread the cost in the income statement) the asset over that period on a straight-line basis. Amortisation commences once an asset is ready for use. We reconsider UELs annually. For some assets the UEL requires no estimation, such as the length of a contract, but for others significant estimation is required such as for customer relationships. Our intangible assets and their respective UELs are as follows:

Category	Valuation Judgement/ Estimation Level*	UEL Basis	UEL (years)	Weighted Average UEL (years)
Software licences	Low	Contract length	1 – 3	1.3
Operating licences	Low	Contract length	3 – 5	4.0
Customer relationships	High	Customer retention / churn	5 – 8	7.5
Contracts	High	Contract length	5 – 15	8.9
Brands	High	Brand age, forecasted profitability, growth prospects and market position	15 – 50	39.3

* Low – Limited or no estimation and/or management judgement required to determine valuation as mainly based on independently defined attributes such as cost and contractual length.

Moderate – A reasonable level of estimation and/or management judgement required to determine valuation but the range of outcomes is narrow and different application of judgement is not likely to result in a material difference in valuation.

High – A high level of estimation and/or management judgement required to determine valuation, particularly in relation to estimating future cash flows. Different application of judgement is likely to result in a material difference in valuation.

New IFRS requirements

IFRS require that companies disclose when changes to accounting policies occur either due to change in the standards themselves or due to management choice.

Investors would prefer that disclosure in relation to new IFRS requirements be limited to changes that have, or will potentially have, a material impact on the financial statements. For completeness, they also suggest that the company states it has considered all the upcoming changes and those disclosed are the only ones that materially impact the company.

Investors prefer it when companies split the disclosure to distinguish new requirements:

- required to be implemented during the year;
- not yet required to be adopted; and
- being adopted early during the year.

In particular, investors believe there is value in understanding when management are adopting a new requirement early, and its impact. For example, it may be important to understand whether the manner in which transition or adoption in the period chosen provides a particular advantage over other options.

Investors favour concise summaries of the new requirements that materially impact the financial statements. A brief summary, with text presented in tabular format may suffice.

When prior period amounts are restated as a result, the financial impact of a change on previous amounts is also best presented in tabular format showing the balances initially reported, each adjustment clearly identified, and the adjusted balance of each line item that has changed.

Many investors would like companies to assess and disclose the impact of new standards soon after the standard is announced. Currently, there is an abundance of 'boilerplate' disclosure indicating the impact is still being assessed. Investors believe companies should be able to complete and disclose initial impact assessments much earlier than current practice, indicating at least at a high level whether change is likely to be significant. Diversity in how companies disclosed the recent changes in pension accounting was highlighted as an illustration.

Companies indicate that time is required to understand, interpret and apply new standards, including developing systems and processes to obtain and review new numbers to ensure they are of a suitable for public disclosure. They stress that the time and resource needed to do this should not be underestimated, particularly for significant changes, on the basis that the change must have some future significance.

Voluntary changes in policy

Investors like clear disclosure of voluntary changes in accounting policy including management's rationale for the change, even if the impact is not material at the time of the change as it may become more important in the future.

Indeed, some investors would like the impact of the change in policy on each of the subsequent five years to be disclosed in each respective annual report. However, this may not be practical for companies if it involves maintaining parallel systems for that period.

Excerpt: new IFRS requirements – UBM annual report 2012 page 82

Investors commented positively on the new IFRS disclosures of UBM and ITV, which are very similar. They valued the tabular presentation and the clear and concise summaries of standards and their potential impact.

New and amended IFRS issued by the IASB but not yet effective for the year ended 31 December 2012

The following new and amended IFRSs may have an impact on the Group's consolidated financial statements:

Accounting standard	Requirements	Impact on financial statements
IFRS 9 'Financial Instruments'	Financial assets will be measured at amortised cost or fair value. Liabilities will be measured in accordance with the existing requirements of IAS 39, but the portion of the change in fair value of a liability arising from changes in the entity's own credit risk will be presented in other comprehensive income, rather than in the income statement. The IASB has not yet issued the revised requirements on hedge accounting and the impairment of financial assets. Effective for annual periods beginning on or after 1 January 2015.	The Group will assess the effect of IFRS 9 after the IASB has issued the complete standard.
IFRS 10 'Consolidated Financial Statements'	Establishes a single control model for deciding whether entities should be consolidated by a parent. Effective retrospectively for annual periods beginning on or after 1 January 2013.	None.
IFRS 11 'Joint Arrangements' (and related amendments to IAS 28 'Investments in Associates')	Distinguishes between joint ventures and joint operations and requires the use of the equity method for interests in joint ventures. Effective retrospectively for annual periods beginning on or after 1 January 2013.	None.
IFRS 12 'Disclosures of Interests in Other Entities'	Requires additional disclosures about an entity's interests in subsidiaries, joint arrangements and associates. Effective for annual periods beginning on or after 1 January 2013.	Additional disclosures will be made in the 2013 financial statements.
IFRS 13 'Fair Value Measurement'	Establishes a single source of guidance for all fair value measurements and requires including additional disclosures about fair value measurements. Effective prospectively for annual periods beginning on or after 1 January 2013.	The Group is currently assessing the impact of IFRS 13 on fair value measurements and disclosures.
IAS 1 'Presentation of Financial Statements' (amended)	Requires separate presentation of other comprehensive items that could be reclassified in future to profit or loss and those which will never be reclassified. Effective for annual periods beginning on or after 1 July 2012.	None.
IAS 19 'Employee Benefits' (amended 2011)	Requires all remeasurements of defined benefit obligations and plan assets to be included in other comprehensive income. Requires expected return on plan assets to be measured using the discount rate applied in measuring the defined benefit obligation. Effective for annual periods beginning on or after 1 January 2013.	None. Reduction in return on plan assets included in profit or loss which, as the Group's schemes are currently in deficit, will result in a net financing expense being recognised, rather than the current net financing income. Please refer to Note 7.2 for quantification of this change.

The following amendments to IFRS are not expected to have a significant impact on the Group's consolidated financial statements:

- IAS 27 'Separate Financial Statements' (amended)
- IAS 28 'Investments in Associates and Joint Ventures' (amended)
- IAS 32 'Financial Instruments: Presentation' (amendment)
- Annual improvements 2009–2011

Excerpt: impact of new IFRS – Vodafone annual report 2013 page 99

Investors commented positively on the following Vodafone disclosure as providing good disclosure of the impact of new IFRS on key financial information.

For periods commencing on or after 1 April 2013, the Group's financial reporting will be presented in accordance with the new standards above. Except for IFRS 11 and the amendments to IAS 19, these pronouncements are not expected to have a material impact on the consolidated results, financial position or cash flows of the Group. The impact of restating key financial information for the impact of IFRS 11 and the amendments to IAS 19 for the year to 31 March 2013 is described below:

Consolidated income statement and statement of comprehensive income for the years ended:

	2013			2012		
	As reported £m	Adjustments £m	New basis £m	As reported £m	Adjustments £m	New basis £m
Revenue	44,445	(6,404)	38,041	46,417	(7,596)	38,821
Gross profit	13,940	(2,466)	11,474	14,871	(3,251)	11,620
Share of results of equity accounted associates and joint ventures	6,477	520	6,997	4,963	1,033	5,996
Operating profit	4,728	(508)	4,220	11,187	(702)	10,485
Profit before tax	3,255	(372)	2,883	9,549	(561)	8,988
Profit for the financial year	673	(16)	657	7,003	(9)	6,994
Other comprehensive income	76	16	92	(4,653)	9	(4,644)
Total comprehensive income	749	–	749	2,350	–	2,350

Consolidated statement of financial position at:

	2013			2012		
	As reported £m	Adjustments £m	New basis £m	As reported £m	Adjustments £m	New basis £m
Non-current assets	119,411	(2,736)	116,675	119,551	(3,132)	116,419
Current assets	23,287	(1,672)	21,615	20,025	(994)	19,031
Total assets	**142,698**	**(4,408)**	**138,290**	**139,576**	**(4,126)**	**135,450**
Total equity	72,488	–	72,488	78,202	–	78,202
Non-current liabilities	38,986	(1,519)	37,467	37,349	(1,724)	35,625
Current liabilities	31,224	(2,889)	28,335	24,025	(2,402)	21,623
Total equity and liabilities	**142,698**	**(4,408)**	**138,290**	**139,576**	**(4,126)**	**135,450**

Consolidated statement of cash flows for the year ended:

	2013			2012		
	As reported £m	Adjustments £m	New basis £m	As reported £m	Adjustments £m	New basis £m
Net cash flow from operating activities	10,694	(1,870)	8,824	12,755	(2,458)	10,297
Net cash flow from investing activities	(7,398)	1,652	(5,746)	3,843	2,738	6,581
Net cash flow from financing activities	(2,956)	213	(2,743)	(15,369)	(300)	(15,669)
Net cash flow	**340**	**(5)**	**335**	**1,229**	**(20)**	**1,209**

Placement of accounting policies

A number of companies have experimented with the placement of their accounting policies, including integrating them into the relevant financial statement note, or placing some of the disclosed policies in an appendix to the financial statements to indicate management's view that they are of less importance than other information.

Where are accounting policies best placed?

Three different views are held by investors:

- Preference for placement of accounting policies in one note, as is the current norm;
- Preference for integrating accounting policies into each note or section; and
- No preference.

A number of investors holding each of the views above, prefer that all companies place the policies in the same position – i.e. they prefer standardisation of placement across companies, whether integrated in the notes or not. This enables them to more quickly access information when needed.

Placement in one note

Investors who view that the significant policies are best placed together in one list, point to the following advantages:

- When they refer to accounting policies they often refer to more than one policy at the same time, which is aided by policies being placed together;
- It has been the norm for many years which investors are used to. Similarly, the majority of investors with this view prefer the disclosures to be in note 1, rather than an appendix or elsewhere, as they are able to locate them quickly and easily; and
- Having the policies placed together helps companies to see the length of the disclosure and may aid them in identifying non-significant policies.

The main perceived disadvantages are:

- Having to move between notes and the accounting policies as they are not located together (particularly challenging when using a digital version); and
- A tendency to repeat some policy in the notes to give context to the judgements and estimates made, and the numbers presented.

Many investors who prefer presentation in one note find cross-referencing between policies and notes helpful.

Integrating into each note or section

Investors that prefer accounting policies integrated into each note or section of the financial statements, identify the following advantages:

- The policy provides necessary context to the numbers, and this is most effective if presented together;
- It reduces duplication within the notes; and
- It improves the readability of notes.

The main perceived disadvantages are:

- Some policies are over-arching and do not relate to a single note, resulting in some policies remaining in the equivalent of note 1;
- It may result in policies which are not significant being retained; and
- It is likely to be more time consuming to locate each policy as they are spread through the notes and the notes are more likely to be ordered differently across companies.

No preference

The third view held by investors was that they have no preference where in the notes the policy information is disclosed. This view tends to be held by investors that use search functions to interrogate digital versions of financial statements to locate information they require, rather than reading through the whole financial statements.

Investor views:

"I think that it is quite helpful to integrate the policy with the note. It gives you the policy and then you can see the numbers underneath it."

Investor association

"I don't care where a policy is presented, content is key."

Large buy-side investor

Company views:

"As only a small portion of shareholders request a paper copy, we integrated policies into the relevant note to provide online users greater clarity and insight into the numbers presented in each note, remove duplication and assist digital readers by having relevant information together rather than searching the pdf multiple times for linked information."

FTSE100 company

Excerpt: integrated policy – ITV annual reports 2009 and 2012

ITV have undertaken a process of integrating their accounting policies into the relevant note. Below is an example showing how ITV have integrated the policies into the profit before tax note, together with segmental reporting. The revenue policy has also been integrated. Some investors commented positively on the enhanced level of disclosure on revenue stream recognition criteria and thought this improved presentation. The 'In this section' and 'Keeping it simple' boxes elicit mixed responses, with those investors that like them, feeling this adds an easy to digest explanation of the content, whereas others feel the text within the boxes does not add to their understanding.

Before the change - 2009 pages 71, 72, 78

1.2) Revenue recognition

Revenue is stated exclusive of VAT and consists of sales of goods and services to third parties. Revenue from the sale of goods is recognised when the Group has transferred the significant risks and rewards of ownership and control of the goods sold and the amount of revenue can be measured reliably. Key classes of revenue are recognised on the following bases:

Advertising and sponsorship	on transmission
Programme production	on delivery
Programme rights	when contracted and available for exploitation
Participation revenues	as the service is provided

Revenue on barter transactions is recognised only when the goods or services being exchanged are of a dissimilar nature. Participation revenues relate to interactive and 'red button' services.

1.3) Segmental analysis

In accordance with IFRS 8, operating segments are reported in a manner that is consistent with the internal reporting provided to the Board of Directors, the chief operating decision maker.

2 Operating segmental information

The Board of Directors considers the business primarily from a product perspective. The reportable segments are therefore Broadcasting & Online, ITV Studios and Other. All of the segments reported meet the quantitative thresholds required by IFRS 8, which the Group first adopted in 2007.

Management has determined the reportable segments based on the reports reviewed by the Board of Directors. The Broadcasting & Online segment now includes the results of the previously disclosed Online segment which is now managed as part of the Broadcasting business. The comparatives have been restated in this note to reflect this significant change in the nature of the Group's operations. The Global Content segment has changed its name to ITV Studios to reflect the rebranding of this business during the year.

Broadcasting & Online is responsible for commissioning and scheduling programmes on the ITV channels, marketing and programme publicity and online rights exploitation. It derives its revenue primarily from the sale of advertising airtime and sponsorship. Other sources of revenue are from online advertising, premium rate services and the digital terrestrial multiplex, SDN. The Broadcasting & Online segment also includes the Group's investment in STV Group plc.

ITV Studios (formerly Global Content) derives its revenue primarily from ITV Studios UK (a commercial programme production company), international production centres in America, Germany, Sweden and Australia and the businesses in ITV Studios Global Entertainment. A proportion of revenue is generated internally via programme sales to the Broadcasting & Online segment. ITV Studios Global Entertainment sells programming, exploits merchandising and licensing worldwide, and is a distributor of DVD entertainment in the UK.

Other comprises the Group's 100% interest in Carlton Screen Advertising ("CSA"), which sells cinema screen advertising in the UK, and was put into creditors voluntary liquidation in the year and its 50% interest in Screenvision US and Europe, which operate cinema screen advertising businesses in continental Europe and the United States and were held for sale at the reporting date.

The segment information provided for the reportable segments for the years ended 31 December 2009 and 31 December 2008 is as follows:

	Broadcasting & Online		ITV Studios		Other		Consolidated	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Total segment revenue	1,543	1,683	597	622	1	40	2,141	2,345
Intersegment revenue	–	–	(262)	(316)	–	–	(262)	(316)
Revenue from external customers	1,543	1,683	335	306	1	40	1,879	2,029
EBITA before exceptional items	111	120	91	90	–	1	202	211
Share of (loss)/profit from joint ventures and associated undertakings	(4)	(4)	–	–	(3)	(11)	(7)	(15)

After the change - 2012 page 107

In this section . . .

This section focuses on the results and performance of the Group. On the following pages you will find disclosures explaining the Group's results for the year, segmental information, exceptional items, taxation and earnings per share.

2.1 Profit before tax

Keeping it simple . . .

This section analyses the Group's profit before tax by reference to the activities performed by the Group and an analysis of key operating costs.

Earnings before interest, tax, amortisation (EBITA) and before exceptional items remains the Group's key profit indicator. This reflects the way the business is managed and how the Directors assess the performance of the Group.

Accounting policies

Revenue recognition

Revenue is stated exclusive of VAT and comprises the sale of products and services to third parties. Selecting the appropriate timing and amount of revenue recognised requires judgement. The key area of judgement in respect of recognising revenue is the timing of recognition. Revenue from the sale of products is recognised when the Group has transferred both the significant risks and rewards of ownership and control of the products sold and the amount of revenue can be measured reliably. Revenue recognition criteria for the Group's key classes of revenue are recognised on the following bases:

Class of revenue	Recognition criteria
Advertising	on transmission or display
Sponsorship	on transmission of the sponsored programme or series
Programme production	on delivery of episode and acceptance by the customer
Programme rights	when contracted and available for exploitation
Participation revenues (interactive & 'red button' services)	as the service is provided
Digital revenue: Archive and Video on Demand – one-off and top-up content	on delivery of content (one-off) or over the contract period in a manner that reflects the flow of content delivered (top-up)
Digital revenue: Catch-up	on receipt of third party reports showing revenue share calculation (showing subscribers and hours downloaded)

Segmental information

Operating segments, which have not been aggregated, are reported in a manner that is consistent with the internal reporting provided to the Board of Directors, regarded as the chief operating decision maker.

The Board of Directors considers the business primarily from a product or activity perspective. The reportable segments for the years ended 31 December 2012 and 31 December 2011 are therefore 'Broadcast & Online' and 'ITV Studios', the results of which are outlined in the following tables:

	Broadcast & Online 2012 £m	ITV Studios 2012 £m	Consolidated 2012 £m
Total segment revenue	1,834	712	2,546
Intersegment revenue	–	(350)	(350)
Revenue from external customers	1,834	362	2,196
EBITA before exceptional items	413	107	520
Share of losses of joint ventures and associated undertakings	(1)	–	(1)

	Broadcast & Online 2011 £m	ITV Studios 2011 £m	Consolidated 2011 £m
Total segment revenue	1,820	612	2,432
Intersegment revenue	–	(292)	(292)
Revenue from external customers	1,820	320	2,140
EBITA before exceptional items	379	83	462
Share of losses of joint ventures and associated undertakings	(2)	–	(2)

Intersegment revenue, which is carried out on arms' length terms, is generated from the supply of ITV Studios

Excerpt: integrated policy and estimates – Cairn Energy annual report 2012 pages 104-105

This excerpt illustrates the integration of significant judgemental areas and key estimates and assumptions into groupings of notes and the integration of accounting policies into notes.

The investors who like this excerpt valued the linkage of the policies, judgements and estimates with the note and the clear presentation format with relevant headings to quickly locate information.

Assets and Investments: Section 4 – Other Assets and Liabilities

This section details our other non-current assets and liabilities, most notably the Group's other intangible assets, including goodwill, and the Company's investments in subsidiaries.

Significant accounting judgements in this section:
Impairment testing of Goodwill
For the purpose of testing goodwill for impairment, where the goodwill has arisen on a business combination, the remaining deferred tax liabilities that relate to the acquisition accounting are treated as part of the relevant cash generating unit.

Key estimates and assumptions in this section:
Impairment testing of Goodwill
The goodwill arising from the corporate acquisitions during the year is tested for impairment by comparing the recoverable amount against the carrying value of the underlying oil and gas assets in the North Sea operating segment. The recoverable amount represents fair value less costs to sell.

Where no recent third party transactions exist on which a market-based fair value can be established, Cairn has used discounted cash flow modelling techniques to determine the fair value of its exploration/appraisal assets. The use of these models requires estimates of long term oil price, discount rates, recoverable hydrocarbon reserves and the costs of development wells and production facilities. Key assumptions used in the discounted cash flow calculations include a long term oil price of $90 per boe, a discount rate of 10% and inflation on oil prices and costs of 2.5%.

The discounted cash flow projections used to determine the fair value of intangible exploration assets with no discovered resource are risk-weighted for future exploration and appraisal success. Given the inherent risk associated with exploration activities, these valuations are highly subjective.

Key estimates and assumptions used in the measurement of deferred tax liabilities, which are included in the cash generating unit, will also impact on the goodwill impairment test. See section 5.5.

Impairment testing of Investments in Subsidiaries
The Company's investments in subsidiaries have been tested for impairment by comparison against the underlying value of the subsidiaries' exploration/appraisal assets based on fair value calculated using the same assumptions as noted for the testing of goodwill impairment above.

4.1 Intangible Assets – Other

Accounting policies
Goodwill
In testing for impairment, goodwill arising on business combinations is allocated from the date of acquisition to the group of cash-generating units representing the lowest level at which it will be monitored. Cairn's policy is to monitor goodwill at operating segment level before combining segments for reporting.

The recoverable amount of a cash-generating unit, or group of cash generating units, is determined by taking the higher of fair value less costs to sell or its value-in-use, using estimated cash flow projections over the licence period of the exploration assets risk-weighted for future exploration success. The key assumptions are sensitive to market fluctuations and the success of future exploration drilling programmes. The most likely factor which will result in a material change to the recoverable amount of the cash-generating unit is the results of future exploration drilling, which will determine the licence area's future economic potential.

Assets and Investments: Section 4 – Other Assets and Liabilities Continued

4.1 Intangible Assets – Other Continued

Group	Goodwill $m	Software Costs $m	Total $m
Cost			
At 1 January 2011	67.2	8.9	**76.1**
Exchange differences arising	–	(0.1)	**(0.1)**
Additions	–	1.8	**1.8**
At 1 January 2012	67.2	10.6	**77.8**
Exchange differences arising	11.6	0.6	**12.2**
Additions	473.9	4.5	**478.4**
At 31 December 2012	**552.7**	**15.7**	**568.4**
Amortisation and impairment			
At 1 January 2011	4.4	6.8	**11.2**
Exchange differences arising	–	(0.1)	**(0.1)**
Charge for the year	–	2.7	**2.7**
Impairment	62.8	–	**62.8**
At 1 January 2012	67.2	9.4	**76.6**
Exchange differences arising	–	0.5	**0.5**
Charge for the year	–	2.0	**2.0**
At 31 December 2012	**67.2**	**11.9**	**79.1**
Net book value at 31 December 2012	**485.5**	**3.8**	**489.3**
Net book value at 31 December 2011	–	1.2	1.2
Net book value at 1 January 2011	62.8	2.1	64.9

Goodwill additions in 2012 relate to the corporate acquisitions during the year. Details of these can be found in section 2.1.

For impairment testing, this goodwill has been allocated to the North Sea operating segment. No impairment of goodwill was identified at 31 December 2012. At that date, the recoverable amount of North Sea assets is not materially different from its carrying value.

The key assumptions in determining the recoverable amount of the North Sea assets are the values attributed to firm exploration prospects and the Skarfjell discovery currently under appraisal and the underlying oil price and discount rate estimates used in the discounted cash flow calculations.

The fair value attributed to exploration prospects and assets under appraisal is estimated using discounted cash flows, risk-weighted for future exploration and appraisal success. Until completion of exploration and appraisal work programmes these valuations remain highly subjective. A change in the assessment of technical risk could result in the carrying value equalling or exceeding the recoverable value.

The goodwill impairment test is also sensitive to changes in commodity price and discount rate. Any reasonable change in assumptions to increase the discount rate applied or reduce the oil price assumption would result in an impairment of goodwill.

Goodwill relating to the Greenland operating segment was fully impaired in 2011. As the 2010 and 2011 drilling campaign offshore Greenland did not result in the discovery of commercial hydrocarbon reserves, the fair value of Greenland assets no longer supported the carrying value of the $62.8m of goodwill allocated to the operating segment. Consequently, the remaining goodwill was fully impaired.

Ordering of notes to the financial statements

When companies have integrated their accounting policies into relevant notes, they have generally had to re-order and group some notes. This is because certain policies relate to more than one note to the financial statements.

Other companies which have not integrated accounting policies into notes, have re-ordered the notes as they felt this allowed them to better tell the story of the company's financial position and results, and / or to highlight the more important information, in management's view, by presenting it first. Less important is presented later or in a separate section or appendix.

How are the notes to the financial statements best ordered?

Again, there are three investor views:

- Preference for the 'normal order';
- Preference for company-specific ordering; and
- No preference.

Some investors in each category would like all companies to be consistent, to ease locating information across different companies. This does create a contradiction with regard to company-specific ordering.

Preference for the 'normal order'

The 'normal order' of following the order that line items appear in the primary statements, described in IAS 1, is preferred by some investors for the following reasons:

- It has been the most common presentation for many years and the case for change has not been proven; and
- Investors like consistency of presentation across companies and time, to aid comparison and locating information.

There is also a preference by a few investors for 'complete' standardisation, whereby every company is required to have the same note order e.g. note 16 for every company could be share based payments, and companies that do not have any such transactions would disclose 'not applicable'. This presentation style seems to be favoured by a small proportion of time-pressured analysts that look at numerous sets of financial statements.

Preference for company specific ordering

Grouping notes into relevant sections, and / or presenting notes in order of importance to the company are presentation styles favoured by investors that like to read management's story in the annual report. These investors value management structuring the financial statements to present the information in a way to best tell the story of the company's performance for the year and financial position at the end of the year.

Where companies do change the structure of their financial statements, as a navigation tool, a contents page is considered necessary by investors. If a company is to make major changes in presentation, investors prefer they are all made in one-step, rather than over a number of years.

No preference

Similar to the above, some participants have no preference as to presentation format as they are comfortable to search for information they require.

Combining notes

The majority of investors support combining tax expense and tax balance sheet notes to have all the tax information together, but there is little support for combining other notes, as it is not seen as enhancing reporting.

Investor views:

"The easiest accounts are where I know everything is going to be in the same place every year. I'm sort of inclined to take it to an extreme stance that it's the same place for every company"

Large buy-side investor

"I prefer the note ordering that works best for that company, and I also like the idea of healthy competition in effective communication in financial statements."

Large sell-side investor

Excerpt: contents page - AngloAmerican 2013 annual report page 151

Below illustrates notes grouped into topics with the demotion of notes believed less important to an additional disclosures section at the back of the notes. This is a common approach by companies that have restructured their financial statements. Investors find a contents page helpful in locating information and some value understanding which disclosures management believe to be more important than others.

Independent auditor's report to the members of Anglo American plc 152

Principal statements
Consolidated income statement 154
Consolidated statement of comprehensive income 154
Consolidated balance sheet 155
Consolidated cash flow statement 156
Consolidated statement of changes in equity 157

Notes to the financial statements
1 Critical accounting judgements and key sources of estimation uncertainty 158
2 Changes in accounting policies and disclosures 159

Notes to the Consolidated income statement
3 Segmental information 161
4 Operating profit/(loss) from subsidiaries and joint operations 165
5 Operating profit and underlying earnings by segment 166
6 Special items and remeasurements 166
7 Net finance costs 169
8 Income tax expense 169
9 Earnings per share 171
10 Dividends 172

Notes to the Consolidated balance sheet
11 Intangible assets 172
12 Property, plant and equipment 173
13 Investments in associates and joint ventures 174
14 Financial asset investments 175
15 Inventories 175
16 Trade and other receivables 175
17 Trade and other payables 176
18 Financial instruments 176
19 Derivatives 178
20 Provisions for liabilities and charges 179
21 Deferred tax 180
22 Assets and liabilities held for sale 181

Cash flow statement, net debt and related notes
23 Capital expenditure 182
24 Net debt 182
25 Borrowings 184
26 Commitments 186

Employee remuneration
27 Employee numbers and costs 187
28 Retirement benefits 188
29 Share-based payments 191

Group structure and transactions
30 Business combinations and formation of joint ventures 193
31 Disposals of subsidiaries 195
32 Non-controlling interests 196

Additional disclosures
33 Called-up share capital and consolidated equity analysis 197
34 Auditor's remuneration 198
35 Contingent liabilities 199
36 Related party transactions 200
37 Events occurring after end of year 200
38 Group companies 201
39 Financial risk management 203
40 Accounting policies 205
41 Accounting policy changes – restatements 210

Financial statements of the parent company 212

Summary by business operation 215

Key financial data 216

Reconciliation of reported earnings 217

Exchange rates and commodity prices 218

Excerpt: contents page – Cairn Energy 2012 annual report page 85

Below is a different grouping of notes into topics which highlights to investors how management views the business, and in particular how they view asset and liability disclosures as more important than income statement disclosures. Some investors like this presentation as they agreed it reflects the business, while others prefer that income statement disclosures come first as they view them as always more important.

Financial Statements
86 Group Income Statement
87 Statements of Comprehensive Income
88 Balance Sheets
89 Statements of Cash Flows
90 Statements of Changes in Equity

Notes to the Financial Statements
92 **Section 1 Basis of Preparation**
92 1.1 Significant Accounting Policies

Assets and Investments

94 **Section 2 Oil and Gas Assets**
94 2.1 Corporate Acquisitions
96 2.2 Intangible Exploration/Appraisal Assets
98 2.3 Property, Plant & Equipment – Developing/Producing Assets
98 2.4 Capital Commitments

99 **Section 3 Financial Assets, Working Capital and Provisions**
99 3.1 Available-for-sale Financial Assets
100 3.2 Net Funds
100 3.3 Income Tax Assets
100 3.4 Trade and Other Receivables
101 3.5 Trade and Other Payables
101 3.6 Provisions
102 3.7 Financial Instruments

104 **Section 4 Other Assets and Liabilities**
104 4.1 Intangible Assets – Other
106 4.2 Investments in Subsidiaries

107 **Section 5 Results for the Year**
107 5.1 Segmental Analysis
110 5.2 Operating Loss
110 5.3 Finance Income
110 5.4 Finance Costs
111 5.5 Taxation on Loss
114 5.6 Discontinued Operations
117 5.7 Earnings per Ordinary Share

118 **Section 6 Capital Structure and Other Disclosures**
118 **Capital Structure**
118 6.1 Issued Capital and Reserves
119 6.2 Capital Management

120 **Other Disclosures**
120 6.3 Staff Costs
121 6.4 Share-based Payments
123 6.5 Directors' Emoluments
123 6.6 Related Party Transactions
123 6.7 Guarantees

124 **Section 7 Events after the Balance Sheet Date**
124 7.1 Farm-in Agreement with FAR Limited

Appendices to the Notes to the Financial Statements
125 Appendix 1 – Principal Subsidiary Undertakings
126 Appendix 2 – Financial Risk Management: Objectives and Policies
128 Appendix 3 – Share-based Payments
129 Appendix 4 – Auditor's Remuneration

Financial review integration

The financial review consists of management's commentary on the financial performance, position and prospects of the company.

Some companies link the financial review by cross referencing from it to the financial statements, some more extensively than others. Both Schroders and Vodafone have experimented with integrating their financial review with the primary financial statements.

Does it matter where the financial review is placed?

A view prevails for investors that management commentary, including that in the financial review, is not appropriate to be included in the financial statements section of the annual report.

Investors note that the financial statements are prepared in accordance with IFRS and are audited, resulting in the financial statements being considered a "robust" set of information. In contrast, investors observe that the financial review provides management's view of the business and its performance over the year, as such investors prefer a clear separation of this information from audited financial statements.

Investors prefer the financial review to be placed in the front section of the annual report, separate from the audited financial statements.

When the financial review is placed in the front section of the annual report, providing links to the financial statements and other parts of the annual report is considered an effective way of limiting duplication. However, some investors that read the information more comprehensively, consider that too much cross referencing detracts from the experience due to continuously having to move between different parts of the annual report.

A small proportion of investors prefer the financial review to be placed alongside the primary statements. This is seen as aiding management's telling of its story of the company's performance for the year. Also, by integrating the financial review, duplication of information is reduced (i.e. key line items from primary statements do not need to be repeated in the financial review) and it is easier to read as the commentary is beside the statements.

One of the companies elicited feedback from their investors which indicates the integration of commentary with the primary statements helps retail shareholders to better gain insight into their performance and position. Institutional investors normally would not gain additional insight as the information is consistent with analyst presentations and the preliminary announcement.

However, the companies themselves and some investors note that an integrated format can lead to unnecessary commentary on smaller items shown on the face of the primary statements and would also be very challenging for complex businesses, for example those with multiple segments, to provide in a meaningful manner.

Some investors expressed no preference in placement as they are only concerned with the content.

While there is little support for placing the financial review with the primary statements amongst the investors in this project, there was a view that the additional information and explanations provided on material IFRS balances or movements in balances over the period within the examples presented, is helpful.

This observation is consistent with the Lab's previous work on net debt reconciliations, and the value of explaining for example, changes in debt over the reporting period.

Investor views:

"Management commentary should not pollute the financial statements"

Investor association

Company views:

"We found that integrating the financial review with the financial statements helped retail shareholders to better gain insight into our performance and position"

FTSE company

Excerpt: cash flow statement & commentary - Vodafone 2014 annual report pages 102-103

Vodafone have provided commentary on key statements alongside numerical disclosures in their financial review. The commentary is presented on a separate page to indicate it is unaudited. Some investors commented positively on the commentary, particularly on cash flows and the cash flow reconciliation, as being useful information which is not normally received.

Commentary on the consolidated statement of cash flows

The consolidated statement of cash flows shows the cash flows from operating, investing and financing activities for the year. Closing net debt has reduced to £13.7 billion from £25.4 billion. The reduction has primarily been achieved as the result of cash retained from the sale of our interest in Verizon Wireless after the return of value to shareholders.

Our liquidity and working capital may be affected by a material decrease in cash flow due to a number of factors as outlined in "Principal risk factors and uncertainties" on pages 196 to 200. We do not use non-consolidated special purpose entities as a source of liquidity or for other financing purposes.

Purchase of interests in subsidiaries, net of cash acquired
During the year we acquired Kabel Deutschland for net cash consideration of £4.3 billion. Further details on the assets and liabilities acquired are outlined in note 28 "Acquisitions and disposals".

Purchase of intangible assets
Cash payments for the purchase of intangible assets comprise £1.4 billion for purchases of computer software and £0.9 billion for acquired spectrum.

Purchase of investments
The Group purchases short-term investments as part of its treasury strategy. See note 13 "Other investments".

Disposal of interests in associates and joint ventures
During the year, we disposed of our US Group whose principal asset was its 45% interest in Verizon Wireless for consideration which included net cash proceeds of £34.9 billion. There were no significant disposals in the prior year.

Disposal of investments
In the prior year we received the remaining consideration of £1.5 billion from the disposal of our interests in SoftBank Mobile Corp.

Dividends received from joint ventures and associates
Dividends received from associates reduced by 11.6% to £4.9 billion. Dividends received primarily comprise tax dividends and income dividends from Verizon Wireless of £4.8 billion in both the current and prior financial years.

Movements in borrowings
Funds retained from the sale of our interest in Verizon Wireless, after the return of value to shareholders, has enabled us to reduce the overall amount of the Group's borrowings.

Purchase of treasury shares
Cash payments of £1.0 billion relate to the completion of a £1.5 billion share buyback programme that commenced following the receipt of a US$3.8 billion (£2.4 billion) income dividend from VZW in December 2012. Further details are provided on page 101.

B and C share payments
B share payments formed part of the return of value to shareholders following the disposal of the Group's interest in Verizon Wireless. Further details are provided on page 101.

Equity dividends paid
Equity dividends paid during the year increased by 5.6%. A special dividend was paid during the year to 31 March 2012 following the receipt of an income dividend from VZW. Further details on the Group's dividends are provided on page 101.

Other transactions with non-controlling shareholders in subsidiaries
During the year we acquired the non-controlling interests in Vodafone India Limited and commenced the legal process of acquiring the remaining shares in Kabel Deutschland.

Cash flow reconciliation
A reconciliation of cash generated by operations to free cash flow and net debt, two non-GAAP measures used by management, is shown below. Cash generated by operations increased by 5.7% to £12.1 billion, primarily driven by working capital improvements, partially offset by a reduction in EBITDA. Free cash flow decreased by 24% to £4.2 billion, the largest contributing factor being a £0.9 billion increase in tax payments principally arising from the early settlement of certain taxes payable in the United States due to the disposal of our US Group.

	2014 £m	Restated 2013 £m	%
EBITDA	11,084	11,466	(3.3)
Working capital	1,381	177	
Other	(318)	(149)	
Cash generated by operations	**12,147**	**11,494**	**5.7**
Cash capital expenditure	(5,857)	(5,217)	
Capital expenditure	(6,313)	(5,292)	
Working capital movement in respect of capital expenditure	456	75	
Disposal of property, plant and equipment	79	105	
Operating free cash flow	**6,369**	**6,382**	**(0.2)**
Taxation	(3,449)	(2,570)	
Dividends received from associates and investments	2,842	3,132	
Dividends paid to non-controlling shareholders in subsidiaries	(264)	(379)	
Interest received and paid	(1,315)	(1,064)	
Free cash flow	**4,183**	**5,501**	**(24.0)**
Tax settlement	(100)	(100)	
Licence and spectrum payments	(862)	(2,499)	
Acquisitions and disposals	27,372	(1,723)	
Equity dividends paid	(5,076)	(4,806)	
Special return	(14,291)	–	
Purchase of treasury shares	(1,033)	(1,568)	
Foreign exchange	2,423	(716)	
Income dividend from VZW	2,065	2,409	
Other	(3,027)	1,149	
Net debt decrease/(increase)	**11,654**	**(2,353)**	
Opening net debt	(25,354)	(23,001)	
Closing net debt	**(13,700)**	**(25,354)**	

Net debt
Net debt reduced by £11.7 billion to £13.7 billion, primarily as a result of cash we have retained from the sale of our interest Verizon Wireless after the return of value to shareholders, partially offset by cash payments for the acquisition of Kabel Deutschland and also as a result of the other cash movements discussed above.

Excerpt: income statement, OCI & commentary - Schroders 2013 annual report p88-89

Schroder's have integrated commentary with the primary statements. The financial review is presented in a blue shaded box to identify it as unaudited. Similar to Vodafone, investors value the additional disclosures in relation to IFRS numbers.

Financial performance

The Group's income and expenses are presented in the consolidated income statement and the consolidated statement of comprehensive income. Exceptional items of income and expenditure are presented separately. This provides transparency of recurring revenue and expenditure to aid understanding of the financial performance of the Group.

More detailed commentary on the performance of the Group's three segments can be found on pages 96 and 97.

2013	Q1	Q2	Q3	Q4	Total
Net revenue £m	323.0	322.1	366.0	396.5	1,407.6
Profit before tax £m*	115.0	113.0	121.6	158.2	507.8
Net new business £bn	5.6	(1.1)	1.0	2.4	7.9
AUM £bn	236.5	235.7	256.7	262.9	n/a

2012	Q1	Q2	Q3	Q4	Total
Net revenue £m	282.7	261.3	276.5	314.4	1,134.9
Profit before tax £m	95.5	81.9	88.6	94.0	360.0
Net new business £bn	1.6	1.1	2.6	4.1	9.4
AUM £bn	199.6	194.6	202.8	212.0	n/a

* Excludes exceptional items

Net revenue and assets under management

Net revenue increased by 24.0 per cent to £1,407.6 million. Each quarter outperformed the same period of the previous year, reflecting higher levels of AUM and performance fees.

AUM increased to £262.9 billion (2012: £212.0 billion), with net inflows of £7.9 billion as investors favoured equities and multi-asset products, combined with positive investment performance as 68 per cent. of funds outperformed their benchmark or peer group over three years.** Acquisitions contributed to this growth with the purchase of STW increasing AUM by £7.1 billion on 2 April and Cazenove Capital increasing AUM by £20.1 billion on 2 July.

Net revenue included £80.6 million (2012: £28.5 million) of performance fees, equal to 5.7 per cent. (2012: 2.5 per cent.) of net revenue. The amount of performance fees varies from year to year dependent on the performance of certain funds. In 2013, we saw performance fees primarily from a range of Institutional mandates, Cazenove Capital and European equity funds.

Net revenue margin on average AUM increased to 57 bps (2012: 56 bps) with higher performance fees contributing 2 bps. The net revenue margin excluding performance fees reduced 1 bp to 54 bps mainly as a result of lower-margin mandates from acquisitions and within net new business.

Operating expenses

Operating expenses before exceptional items increased to £919.7 million (2012: £791.2 million) due to increased headcount as a result of acquisitions and continued investment in people and infrastructure. The cost to net revenue ratio of 65 per cent. (2012: 70 per cent.) was in line with our long-term KPI of between 65 and 70 per cent.

Headcount increased by 517, of which 366 related to Cazenove Capital and STW. In addition, we continued to recruit in Asset Management, particularly within Investment and IT.

Compensation costs excluding exceptional items increased to £652.5 million (2012: £545.7 million). Compensation costs were set by reference to a ratio of total compensation costs to operating revenue of 46 per cent. (2012: 49 per cent.), equal to a profit share ratio of 39 per cent. (2012: 42 per cent.) which is in line with our long-term KPI. Variable compensation is not only dependent on revenue but also on the effective management of other costs.

Non-compensation costs increased by £21.7 million to £267.2 million, principally due to costs within acquired businesses and continued investment in organic growth.

Profit before tax

Profit before tax and exceptional items increased by 41.1 per cent. to £507.8 million (2012: £360.0 million). After exceptional items of £60.3 million, the Group's profit before tax is £447.5 million. Exceptional items are significant items of income and expenditure that have been presented separately by virtue of their nature to enable a better understanding of the Group's financial performance. Those items are set out in note 1(c) and principally relate to the Cazenove Capital and STW acquisitions and a provision in Wealth Management related to a US Department of Justice programme in Switzerland, explained on page 97.

Taxation

The effective tax rate decreased from 21.3 per cent. to 20.3 per cent. due principally to changes in the UK tax rate and the geographic mix of business. It was virtually unchanged at 21.2 per cent. after exceptional items, as some of those items are not tax deductable. Profit after tax was £404.8 million (2012: £283.2 million) and £352.7 million after exceptional items.

Earnings per share and dividends

Earnings per share before exceptional items was up 43.2 per cent. at 149.9 pence as a result of higher profit before tax partially offset by a higher tax charge despite the lower effective tax rate. The diluted earnings per share includes the potential impact of employee share awards scheduled to vest within the next five years. The KPI of earnings per share after exceptional items was 130.6 pence (2012: 104.7 pence). The IFRS dividend, comprising the 2012 final dividend and the 2013 interim dividend, is up 7 pence at 46 pence per share.

Total comprehensive income

Total comprehensive income was £321.9 million (2012: £259.7 million).

Net losses arising from retranslating non-sterling subsidiaries were £18.6 million (2012: £21.8 million). These losses are driven by sterling strengthening principally against Japanese, Australian and Indonesian currencies.

Actuarial losses of £9.8 million (2012: gain of £10.4 million) arose from changes in assumptions partially offset by differences between expected and actual returns in defined benefit pension schemes.

The net movement in the fair value reserve in the year was a reduction of £1.3 million (2012: £9.5 million). Of that amount, £7.3 million (2012: £25.5 million) was mainly due to the transfer to the income statement of accumulated mark to market gains on realisation, partly offset by £6.0 million of net unrealised gains (2012: £16.0 million).

Financial report

Consolidated income statement

for the year ended 31 December 2013

		2013			2012
	Notes	Before exceptional items £m	Exceptional items[3] £m	Total £m	£m
Revenue	2	1,809.1	–	1,809.1	1,425.4
Cost of sales	3	(431.1)	–	(431.1)	(329.7)
Net gains on financial instruments and other income	4	29.6	–	29.6	39.2
Net revenue[1]		**1,407.6**	**–**	**1,407.6**	**1,134.9**
Operating expenses	5	(919.7)	(58.1)	(977.8)	(791.2)
Operating profit		**487.9**	**(58.1)**	**429.8**	**343.7**
Net finance income	6	11.7	–	11.7	11.8
Share of profit of associates and joint ventures	12	8.2	(2.2)	6.0	4.5
Profit before tax		**507.8**	**(60.3)**	**447.5**	**360.0**
Tax	7(a)	(103.0)	8.2	(94.8)	(76.8)
Profit after tax		**404.8**	**(52.1)**	**352.7**	**283.2**
Earnings per share					
Basic	8	**149.9p**	**(19.3p)**	**130.6p**	104.7p
Diluted	8	**144.6p**	**(18.6p)**	**126.0p**	101.3p
Dividends per share[2]	9			**46.0p**	**39.0p**

[1] Non-GAAP measure of performance.
[2] Interim and final dividends declared during the year.
[3] Please refer to note 1(c) for a definition and further details of exceptional items.

Consolidated statement of comprehensive income

for the year ended 31 December 2013

	Notes	2013 £m	2012 £m
Profit for the year		352.7	283.2
Items to be reclassified to the income statement on fulfilment of specific conditions:			
Net exchange differences on translation of foreign operations after hedging		(18.6)	(21.8)
Net fair value movement arising from available-for-sale financial assets	4	6.0	16.0
Net fair value movement arising from available-for-sale financial assets held by associates	12	(0.9)	1.5
		(13.5)	**(4.3)**
Reclassification to the income statement:			
Transfer to income statement on derecognition or impairment of available-for-sale financial assets	4	(7.3)	(25.5)
		(7.3)	**(25.5)**
Items not to be reclassified to the income statement:			
Actuarial (losses)/gains on defined benefit pension schemes	26	(9.8)	10.4
Tax on items taken directly to other comprehensive income	7(b)	(0.2)	(4.1)
		(10.0)	**6.3**
Other comprehensive losses for the year net of tax		**(30.8)**	**(23.5)**
Total comprehensive income for the year net of tax		**321.9**	**259.7**

Other observations

Contents page

Most annual reports include a contents page or a navigation tool of some sort to assist readers to locate sections of interest to them. Many companies now also include a contents page in the financial statements section to further assist readers.

Investors, both those that read the accounts in digital and paper formats, commented positively on the usefulness of a contents page. It is particularly seen as a necessity when the presentation of information is changed from the previous year.

Plain language

The investor participants in this project had a predominant view that the annual report should be written in plain language, with technical terms minimised.

Where technical or industry-specific terms are used, investors find a glossary useful, although it needs to be updated annually to ensure it contains all such terms used in the annual report and excludes terms no longer used.

Investors also desire standardisation of definitions of industry-specific terms, and calculation of industry specific KPIs across companies to improve the clarity of reporting and facilitate comparison of companies within a sector.

Whilst investors value plain language, they are careful to note that it is possible to take it too far and 'dumb down' the language. Companies need to consider their audience and find a balance in language that respects knowledgeable readers and is understandable by non-specialists.

Medium for reading annual reports

It is interesting to note that investors in this project were split evenly between those that prefer to access reports in digital format, on paper or a mixture of both. As both mediums are used extensively, companies should continue to consider how to best present user friendly reports in both formats.

Some investors express the view that further development in electronic tools may overcome the questions of where to place disclosures, as digital tools could allow users to structure reports in their own preferred format, allowing customised experiences for each reader.

The Lab has commenced a series of projects on corporate reporting in a digital world, exploring current investor preferences and how companies may make the most of the digital opportunity.

Participants and process

A key requirement to ensuring a successful Lab project is getting support from the company and investment communities. Participants join Lab projects by responding to a public call for participants or they are approached by the Lab / other project participants. An iterative approach is taken with additional participants sought during the project to obtain input from the various types of investors and ensure a range of company examples and input.

The participants do not represent a statistical sample and results cannot be extrapolated to the entire population. The differing views of participants should be considered by companies in the context of their own circumstances and audience for reporting.

References made in this Report to views of 'companies' and 'investors', refer to the individuals from companies and investment community organisations that participated in this project. The term 'investors' is used as shorthand to refer to the investment community participants in this project, which include a broad range of individuals in their capacity as investors or their role in analyst organisations that work in the interest of investors.

Involvement of companies

The following companies volunteered to participate in this project by agreeing for the Lab to ask investors to comment on relevant parts of their latest annual reports or planned changes to their annual reports, and by joining group discussions together with the investment community to assist in obtaining views on each area:

- Anglo American
- BP
- BT
- Cairn Energy
- Cobham
- Diageo
- GSK
- HSBC
- ITV
- Legal & General
- Royal Dutch Shell
- Schroders
- Standard Chartered Bank
- UBM
- Vodafone
- William Hill

Involvement of investors

There has also been a considerable amount of support for this project from the investment community. The Lab held mainly face to face interviews with individuals from the following organisations:

Buy-Side

- Alliance Trust
- GO Investment Partners
- Henderson Global Investors
- Hermes Equity Ownership Services
- Invesco Asset Management
- Allianz Global Investors
- Royal London Asset Management
- Standard Life Investments
- USS Investment Management

Sell-Side

- Deutsche Bank
- JP Morgan

Credit Rating Agencies

- Fitch Ratings
- Moody's
- Standard & Poor's

Investor Associations

- Association of British Insurers
- CFA Institute
- CFA Society of the UK
- Investment Management Association
- National Association of Pension Funds (NAPF)

In addition, the Lab conducted online surveys of members of the following retail investor associations:

- ShareSoc
- UK Shareholders' Association

Project process

Two round-table meetings were held with company and investor participants in December 2013. At these meetings, participants discussed some of the example disclosures made by companies (including company motives and process) and discussed their views on each of the areas in this Lab report. This helped the Lab project team to refine their set of questions for investors.

Investors were then sent the questions together with reporting examples in advance of being interviewed in relation to their views on the examples and each topic area in general.

A qualitative online survey was developed to obtain retail investor views. In total, 208 respondents completed the survey. The Lab also obtained input through a survey of NAPF members, which provided input to their observations as an investor association.

Survey results were combined with interview results to reflect investor views in this report. The report distinguishes results when retail shareholder views and views of institutional investors and analysts differ.

Lab project reports

The Lab's project reports provide practical suggestions on reporting from our work with the corporate and investment communities.

Each of the following reports suggests reporting that is focused on meeting the needs of the investment community for consideration by companies.

Governance:

A single figure for remuneration

Reporting of Audit Committees

Reporting of pay and performance

Financial Reporting:

Debt terms and maturity tables

Net debt reconciliations

Operating and investing cash flows

Presentation of market risk disclosures

The reports are available at: https://frc.org.uk/Lab

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