Financial Reporting Council

CORPORATE REPORTING THEMATIC REVIEW

JUDGEMENTS AND ESTIMATES

NOVEMBER 2017

The Financial Reporting Council (FRC) is responsible for promoting transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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Thematic reviews supplement the FRC's monitoring work conducted by Corporate Reporting Review (CRR). CRR monitors company reports and accounts for compliance with the Companies Act 2006, including applicable accounting standards, and other reporting requirements. The aim of our thematic reviews is to identify and share examples of good practice reporting and highlight areas where improvements can be made.

This report shares our detailed findings from the targeted review of companies' disclosures of significant accounting judgements and sources of estimation uncertainty. Companies can use this to assess and enhance their own disclosures to ensure they provide high quality information to investors in their annual reports and accounts.

CRR's reviews are based solely on company reports and accounts and do not benefit from detailed knowledge of each company's business or an understanding of the underlying transactions entered into. They are, however, conducted by staff who have an understanding of the relevant legal and accounting framework. The FRC provides no assurance that the reports and accounts subject to review are correct in all material respects. The FRC's role is not to verify the information provided but to consider the quality of compliance with reporting requirements.

1 BACKGROUND

In December 2016, the FRC wrote to 20 quoted companies informing them that CRR would review the disclosure of significant accounting judgements and sources of estimation uncertainty in their next annual report and accounts.

CRR's recent annual reports on corporate reporting had consistently highlighted the need for improvement in the reporting of judgements and estimates. Our routine monitoring work identifies many examples of generic disclosures that do not describe the specific judgements a board has made or that fail to explain the extent to which changes in estimates could have a material effect on the following year's accounts.

The objective of the review is to encourage better quality reporting that enables readers to assess the quality of management's decisions and to identify better practices. A press notice[1] was issued on 15 December 2016 to raise awareness of the issues to be covered by this thematic review. This report summarises our findings from those 20 targeted reviews, as well as providing broader observations from our regular reviews.

Our sample comprised three companies from the FTSE 100, 12 from the FTSE 250, four smaller listed entities and one company from the AIM market.

1 http://www.frc.org.uk/getattachment/651205c1-6521-49b4-9590-9cba1d899a53/Judgements-and-Estimates-thematic-review-2017.pdf

2 KEY MESSAGES

We were encouraged to see that most of the companies in our sample responded to advance notification of our review by making some improvements to their disclosures. These improvements were not as significant as we had observed in our other thematic reviews but there were signs that, in general, companies were focusing on the right areas. We found that:

- Many companies in our sample had reconsidered which judgements, assumptions and other areas of estimation uncertainty are genuinely the most difficult, subjective or complex to report.
- A far greater proportion of the companies clearly distinguished judgements from estimates than in their prior year accounts.
- The better quality reports identified a smaller number of judgements and estimates but provided much richer information about the supporting assumptions and sensitivities. Users of these reports would have a clearer picture of which decisions taken by the board had a significant impact on the company's performance. It was particularly helpful when companies explained the reasons for changes in the list of judgements and estimates considered to be key from those disclosed in the previous year.
- The average number of estimates disclosed by the companies reviewed decreased when compared with their previous annual report. However, we still identified a significant number of estimate disclosures that did not appear to have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next year. Information about longer term uncertainties may be useful for users of financial statements. However, these additional disclosures should be clearly identified and explained.
- Most companies in the sample improved the granularity and level of detail of their disclosures. However, it was disappointing that a significant minority still used elements of 'boilerplate' text, which could apply to any company and gave no additional useful information to users of the accounts. In many such cases, the audit committee report or auditors' report provided more granular information regarding the significant judgements made. We would like to see similar depth in the notes to the financial statements.

Of the 20 reports included in the sample, we wrote follow-up letters to five companies where there was a substantive question relating to their disclosures. Correspondence with these companies is ongoing.

The principal findings from the thematic review are set out in section 4. We have included a number of examples of better disclosures that illustrate how companies could address these findings.

3 DISCLOSURE REQUIREMENTS

IAS 1[2] is an overarching standard. It sets out the requirements for all judgements and estimates disclosures, including those that are not in the scope of other, more specific, standards.

The judgements and estimates referred to by IAS 1 affect current and future accounts differently. This is reflected in the different disclosure requirements. Paragraph 122 of IAS 1 requires disclosure of judgements made by management in applying an entity's accounting policies, but does not apply to those relating to estimates. Judgements that depend on management assumptions about the future are matters covered by the more wide-ranging disclosures of sources of estimation uncertainty required by paragraph 125 of IAS 1. To make this distinction clear in our report, we refer to disclosures in the scope of paragraphs 122 and 125 as 'judgements' and 'estimates', respectively.

Judgements

The disclosure requirements of paragraph 122 are limited to the judgements management makes when applying its significant accounting policies and that have the most significant effect on amounts that are recognised in the accounts. The language used makes clear that not all judgements should be disclosed; they must relate to a significant policy and the judgement must have materially affected the reported numbers. In practice, these decisions may be finely balanced and are often considered by the company's senior management, the audit committee and external auditors. The disclosure should be of sufficient detail to help readers understand how policies have been applied and to enable them to compare judgements between different companies' financial statements.

Examples of judgements that do not involve estimation are:

- when substantially all the significant risks and rewards of ownership of assets are transferred;
- whether, in substance, sales of goods are financing arrangements;
- whether or not to consolidate an investee company;
- whether a company is acting as principal or agent; or
- whether the terms of a financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.

2 IAS 1 Presentation of Financial Statements

Estimates

The disclosure requirements for sources of estimation uncertainty similarly apply to a limited set of matters. They relate to assumptions and estimates at the end of the current reporting period that have a ***significant risk*** of resulting in a ***material adjustment*** to the carrying amounts of assets and liabilities ***within the next financial year.***

All three factors apply, which limits the number of items we might expect to see reported. The more estimates that are disclosed, the less specific the disclosures would become. This would run the risk of obscuring the most relevant information with other disclosures[3].

Examples of estimates include:

- the recoverable amount of classes of property, plant and equipment;
- uncertain tax provisions;
- selection of discount rate for pensions;
- provisions subject to the future outcome of litigation in progress; and
- determination of depreciation methodologies.

Details are required of the relevant assets and liabilities and their year end carrying amounts. Information should be disclosed only in respect of relatively few assets and liabilities because the requirements relate only to the most difficult, subjective and complex judgements[4]. Disclosure is not required for assets and liabilities measured at fair value if this is based on quoted prices in an active market for an identical asset or liability[5].

The standard gives examples of disclosure that may help users understand management's judgements about the future[6]:

- what the assumptions and uncertainties are;
- how sensitive the assets and liabilities are to those assumptions – and why;
- the expected resolution of the uncertainty and range of reasonably possible outcomes for the next financial year; and
- explanation of any changes made to past assumptions if the uncertainly is unresolved.

They are not all required to be disclosed but, in most cases, we would expect some additional disclosures to be necessary in order to fully understand the estimates made.

The FRC expects disclosures to focus on those estimates that may genuinely have a material effect on the following year's accounts. This should provide readers with sufficient detail that they can share in management's understanding of the uncertainties underlying those estimates. This may result in disclosure of relatively few items but with a greater depth of information than often seen currently.

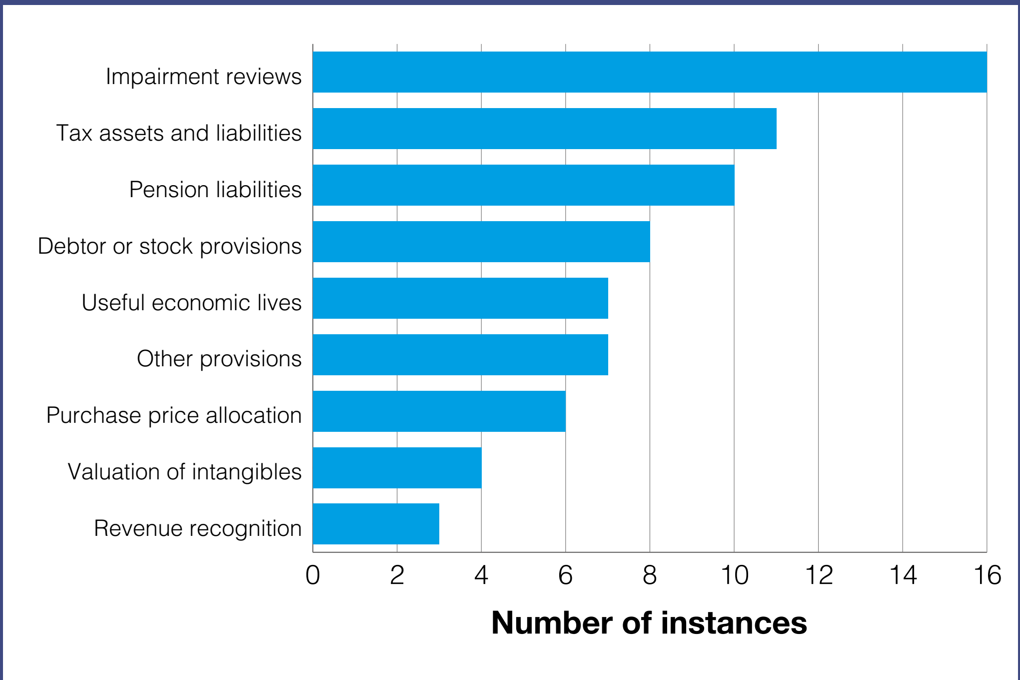
In some cases it may be helpful to disclose additional information, for example where there is a significant risk of adjustment arising in the longer term. Such disclosures should be clearly distinguished from those relating to uncertainties with a significant risk of material adjustment within the next year.

3 IAS 1, paragraph BC84
4 IAS 1, paragraph 127
5 IAS 1, paragraph 128
6 IAS 1, paragraph 129

4 PRINCIPAL FINDINGS

Most common disclosures

The most commonly disclosed estimates in the sample of accounts reviewed were as follows:



As noted later in this section, some of these matters (particularly impairment) were disclosed even when it was not clear whether there was a significant risk of material adjustment within the next year.

The most commonly disclosed judgement related to exceptional or separately disclosed items, followed by assets held for sale and control of other entities. Overall, significantly fewer judgements were disclosed than estimates, and these covered a diverse range of areas.

For the companies reviewed, the number of estimates disclosed ranged from zero to eight, with an average of four. This has decreased from a maximum of 10 and an average of five for the same sample of companies last year. The average number of judgements disclosed ranged from zero to seven, with the average remaining at one. We welcome the removal of disclosures in respect of less material amounts in order to focus on the most difficult, subjective or complex judgements.

4.1 Differentiation between judgements and estimates

The FRC expects judgements and estimates to be separately identified and the relevant disclosures to be provided for each.

A third of companies reviewed did not clearly distinguish judgements from estimates. The importance of differentiating between these is explained in section 3. A further 15% classified judgements involving estimation as judgements rather than estimates, which led to less disclosure around the specific amounts at risk and the sensitivities and range of outcomes of the amounts involved. This is, however, an improvement from the previous year, when over two thirds of the companies reviewed did not clearly distinguish judgements from estimates.

Wording, such as that used in the following example, can help investors differentiate between judgement and estimate disclosures.

> *"The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements."*

Morgan Sindall Group plc, Annual Report 2016

4.2 Judgements

The FRC expects detailed descriptions of the specific, material judgements made by the directors in applying their accounting policies.

A fifth of the companies reviewed disclosed judgements that did not appear to have a material effect on the financial statements. We expect companies to remove unnecessary clutter from their accounts as it obscures the disclosures of judgements that have the most significant effect on the amounts recognised.

A fifth of the companies reviewed used boilerplate text in the disclosure of at least some of their key judgements. These referred to particular items in the accounts but did not give details of the areas of subjectivity or the basis for management's judgement. Examples of unhelpful disclosure included:

- the classification of assets held for sale as a key judgement, without identifying the relevant assets, when no assets had been classified as held for sale in the balance sheet; and
- listing lease classification as a key judgement without indicating for which leases this was particularly difficult, or the cause of the complexity.

The following example of better disclosure provides the background to the judgement, the technical reference and the basis for the conclusion.

"The Group determined based on the criteria in IFRIC 4 'Determining whether an Arrangement Contains a Lease' that the supply contract with PraxAir does not contain a lease. This contract, concluded in 2010, with subsequent amendments in 2015, included the construction of an air separation plant by PraxAir to be owned and operated by PraxAir and the supply of oxygen and other industrial gases produced by PraxAir to EVRAZ Nizhny Tagil Metallurgical Plant for a period of 25 years on a take or pay basis. In 2015, the air separation plant was put into operation and the Group started to purchase gases from PraxAir. Management believes that this arrangement does not convey a right to the Group to use the asset as the Group does not have an ability to operate the asset or to direct other parties to operate the asset; it does not control physical access to the asset; and it is expected that more than an insignificant amount of the asset's output will be sold to the parties unrelated to the Group."

EVRAZ plc, Annual Report & Accounts 2016

Where a company has no judgements that are significant enough to require disclosure, it is helpful to state this explicitly:

"In the course of preparing the financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimations… that have had a significant effect on the amounts recognised in the financial statements."

RPS Group plc, Report and Accounts 2016

4.3 Estimates – risk of material change to next year's accounts

The FRC expects estimate disclosures to focus on those with a significant risk of a material change to the carrying value of assets and liabilities within the next year.

Disappointingly, just over two-thirds of the companies reviewed disclosed estimates which, although they may have related to material amounts, did not appear to have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities at all. A common example was the disclosure of estimates around goodwill impairments, when the related note stated that the directors did not believe that any reasonably possible change in the key assumptions on which the recoverable amount was based would cause the carrying amount to exceed its recoverable amount.

In other cases, balances such as income taxes were disclosed as key sources of estimation uncertainty although the related notes stated that the outcome of these uncertainties were expected to be resolved after more than one year. Where this is the case, material adjustments may still arise as a result of a reappraisal of the asset or liability within the next year, in which case companies should explain this.

It is often helpful to provide additional disclosures where, for example, a company believes that there is a significant risk of a material adjustment, but only in the longer-term. This is often the case for provisions for asset retirement obligations. In this situation, we would expect the disclosures to be clearly differentiated from those relating to estimates with a genuine risk of a material effect in the following year. The following example is of a company helpfully explaining that it has provided disclosures in addition to those specifically required by IAS 1.

"The Group does not have any key assumptions concerning the future, or other key sources of estimation uncertainty in the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Notwithstanding this, as a significant portion of the Group's activities are undertaken through long-term construction contracts, the Group is required to make estimates in accounting for revenue and margin. These estimates may depend upon the outcome of future events and may need to be revised as circumstances change. Further detail is provided in the accounting policies on page 117."

Morgan Sindall Group plc, Annual Report 2016

Sources of estimation uncertainty may vary from year to year. We expect companies to reassess whether disclosures made in a previous year remain relevant, to avoid accumulating clutter in accounts. The following example illustrates the outcome of such an exercise:

"During the year, Management reassessed the critical estimates and critical judgements and resolved that the following were no longer considered critical.

Provisions

…Management has considered each element that makes up the total provision balance as at the year end and decided that assumptions used to estimate these elements of provisions were not sensitive enough to change the provision balance materially hence provisions are no longer considered a critical estimate…

Providing for doubtful debts

The level of provision for doubtful debts has decreased significantly from previous years and hence is no longer a critical estimate as the range of possible outcomes resulting from various assumptions applied by management are now not considered material. This was previously considered a critical estimate due to the higher than normal trade receivables balances in our French segment at 31 December 2014."

Computacenter plc, Annual Report and Accounts 2016

4.4 Estimates – clear, specific descriptions

The FRC expects estimate disclosures to be clear and specific, pinpointing the precise sources of uncertainty and avoiding the use of boilerplate language.

A third of our sample used boilerplate language when disclosing estimates. The most commonly identified examples of this related to taxation, useful economic lives and debtor and stock provisions. In many cases, the disclosures could apply to any company and gave no additional useful information to users of the accounts. It was not always clear why the areas of estimation uncertainty disclosed were considered to be significantly difficult, subjective or complex, as required by IAS 1[7]. One company listed the valuation of intangibles assets as an estimate, then went on to describe the process for valuing acquisition intangibles in general terms without identifying the key sources of uncertainty.

In many cases where boilerplate language was used, the audit committee report or auditors' report provided much richer information regarding the particular assumptions made. We would welcome a similar depth of disclosure in the notes to the financial statements. It is not, however, necessary to duplicate information between individual notes to the accounts and a dedicated note regarding judgements and estimates; cross-referencing was used effectively by many of the companies reviewed.

The following better examples disclose the specific assumptions and other sources of estimation uncertainty.

"At 31 December 2016, the programme with the next largest capitalised development balance is the Dassault 5X which has a net book value of £52.7 million. This aircraft is yet to enter service and a two year delay was announced by the aircraft manufacturer at the start of 2016. The most critical estimates are considered to be the date of entry into service and the size of the future fleet, both of which are based on public forecasts, from independent industry experts."

Meggitt plc, Annual Report and Accounts 2016

"The Group's defined benefit obligation is discounted at a rate set by reference to market yields at the end of the reporting period on high quality corporate bonds. Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived. The most significant criteria considered for the selection of bonds include the issue size of the corporate bonds, quality of the bonds and the identification of outliers which are excluded. The assumptions selected and associated sensitivity analysis are disclosed in Note 24 on pages 145 to 148."

Spirax-Sarco Engineering plc, Annual Report 2016

7 IAS 1, paragraph 127

"In determining an estimate of NRV, management has made judgements in respect of the durability and general high quality of the Group's products, which provide a certain degree of protection against adverse market conditions, and competitor product development and pricing activity.

The significant downturn in the industry has reduced transaction volumes meaning that some items of inventory may not have been sold near the balance sheet date, increasing the level of judgement required. Some market transactions reflect the actions of distressed sellers and are not applicable to the market as a whole."

Hunting plc, 2016 Annual Report and Accounts

Overall, we were disappointed with the granularity of disclosures in respect of uncertainties relating to tax assets and liabilities. We had hoped for a greater improvement following publication of 'Corporate Reporting Thematic Review of Tax Disclosures'[8], in October 2016, which identified opportunities for companies to improve the usefulness of their disclosure of judgements and estimates in this area.

An example of more specific disclosure in this area was as follows:

"The UK's dividend taxation regime prior to July 2009 is the subject of long-running litigation between HMRC and other taxpayers in relation to the tax charge on dividends received from EU-based companies. The outcome of this dispute is likely to be relevant to the Group in respect of certain dividends received by UK Group companies before that date. Pending resolution in the courts, a tax creditor of £12.6m (2015: £12.6m) continues to be held for the potential tax liabilities arising if the final decision is made by the courts in HMRC's favour.

Within the tax charge is a credit of £3.1m (2015: £nil) relating to recognition of the net benefit of unused tax losses arising from the acquisition of Spectraseis AG in 2015. The ultimate utilisation of these losses is now considered probable as a result of the post-acquisition restructuring of the business."

Spectris plc, Annual Report and Accounts 2016

8 http://www.frc.org.uk/getattachment/d15d079f-bbd1-46ba-979c-cbc776f8042b/Corporate-Reporting-Thematic-Review-Tax-Disclosures-Oct-2016.pdf

4.5 Estimates – quantification

The FRC expects disclosure of the specific amounts at risk of material adjustment, rather than just the value of the financial statement line item within which these are contained.

If the estimation uncertainty identified relates to a particular amount within a balance then users of the accounts need more than just a total amount in order to understand the effect on the balance sheet. For example:

- Significant uncertainty may attach to just one particular provision within the total provisions balance.
- Uncertain tax positions are just one component of a tax balance.

However, only 40% of the companies reviewed consistently quantified the specific amounts at risk of material misstatement within the next financial year.

We identified the following good example of disclosing the specific amounts at risk:

"During the year, Management held a number of 'difficult' contracts under review that were considered to be performing below expectation. The number of contracts under review fluctuated during the year between eight and 12. Each contract was subject to a detailed review to consider the reasons behind the lower than anticipated performance and the potential accounting impacts related effect on revenue recognition estimates.

For a limited number of these 'difficult' contracts, where there was no immediate operational or commercial remedy for the performance, a range of possible outcomes for the estimate of the total contract costs and total contract revenues was considered to determine the best estimate of stage of completion.

The gross revenue recognised in the year from these contracts under review was approximately £10.4 million. The range of potential scenarios considered by management in respect of these specific contracts included a reduction in revenue, and margins, recognised in 2016 of £4.1 million, in the year. Also, based on Management's best estimate, the total cost to complete on these contracts were £26.6 million."

Computacenter plc, Annual Report and Accounts 2016

4.6 Estimates – quantification of assumptions

The FRC expects the assumptions underlying estimates to be quantified when investors need this information to fully understand their effect.

There may be situations where assumptions need to be quantified in order for investors to be able to understand the positions taken by management. This is particularly relevant in industries where certain matters are likely to be significant sources of estimation uncertainty for all industry participants and where investors will want to make intercompany comparisons.

For example, five of the companies reviewed were engaged in extractive or related industries. Of these, only one disclosed the commodity price assumptions underlying their estimates. We would generally expect such assumptions to be relevant to investors in these industries.

This is an example[9] of detailed disclosures given by one company:

> *"The key assumptions used by management in the value-in-use calculations with respect to the cash-generating units to which the goodwill was allocated are presented in the table below.*

	Commodity	Average price of commodity per tonne in 2017
Steel North America		
Large diameter pipes	*steel products*	*$978*
Oil Country Tubular Goods	*steel products*	*$887*
Seamless pipes	*steel products*	*$1,111*
Flat rolled products	*steel products*	*$592*
Long products	*steel products*	*$572*
EVRAZ Vanady-Tula	*vanadium products*	*$10,990*
EVRAZ Vametco Holdings	*ferrovanadium products*	*$16,247*
EVRAZ Nikom, a.s.	*ferrovanadium products*	*$12,568*

9 Columns not relevant to the example have been omitted from the table.

…The price assumptions for the products sold by the Group were estimated based on industry research using analysts' views published by Bank of America Merill Lynch, Citigroup, Credit Suisse, Deutsche Bank, JP Morgan, Morgan Stanley, RBC, Renaissance Capital, UBS and VTB during the period from August to December 2016. The Group expects that the nominal prices will fluctuate with a compound annual growth rate of (6.6)% - 9.9% in 2017 – 2021, 2.5% in 2022 and thereafter. Reasonably possible changes in sales prices could lead to an additional impairment at EVRAZ Sukha Balka, EVRAZ Stratcor Inc., EVRAZ Inc. NA and EVRAZ Inc. NA Canada cash-generating units. If the prices assumed for 2017 and 2018 in the impairment test were 10% lower, this would lead to an additional impairment of $37 million."

EVRAZ plc, Annual Report & Accounts 2016

We found few examples of quantification of other numerical assumptions used, except where this is required by other standards. A few companies quantified discount rates:

"The discount rate used to calculate these provisions is based on UK gilt yields to approximate a risk free rate and as at 31 December 2016 was 0.48 % (2015: 1.90 %)."

HSS Hire Group plc, Annual Report 2016

A small number of companies, whilst not quantifying assumptions, gave a qualitative description of their basis:

"For 2017, cash flows are based on the approved Board budget. For 2018 to 2021, management has made revenue projections using Spears and Associates 'Drilling and Production Outlook' reports as a default basis, selecting the most appropriate geographic market and driver (rig count, footage drilled or E&P spend) for each CGU. Management has then applied judgemental changes to revenue growth expectations, if appropriate, to reflect circumstances specific to the CGU."

Hunting plc, 2016 Annual Report and Accounts

There is clear scope for companies to consider whether they could enhance investors understanding of the assumptions underlying estimates by providing additional, quantified information.

4.7 Estimates – sensitivities and range of outcomes

The FRC expects more companies to disclose the sensitivity of carrying amounts to assumptions and estimates, and/or the range of reasonably possible outcomes within the next financial year.

90% of the companies reviewed provided sensitivity or range of outcome disclosures for at least some of the estimates disclosed. However, these tended to only be in areas where this disclosure is required by another accounting standard, such as for impairment and pensions. Although tax assets and liabilities were the second most common source of estimation uncertainty, it was disappointing to note that only two of the companies reviewed provided any sensitivity or range of outcome information in this area. None of the companies reviewed provided sensitivity disclosures for useful economic lives, despite this being a commonly cited source of estimation uncertainty.

Good disclosures explain where management's view sits within a range of outcomes, which is valuable for investors and enables them to evaluate the possible effects of estimates on future accounts.

Better examples of disclosure of sensitivity analyses or range of outcomes were as follows:

"Based on the Group's recent experience of revisions to previous tax estimates as more information has become available, and assuming no significant changes in legislation, it currently expects the outcome across all open items to range from a potential increase of £4.0 million in the provision to a potential reduction of £10.0 million."

Meggitt plc, Annual Report and Accounts 2016

"The following summarises the sensitivity from the assumptions made by the Company in respect to the unobservable inputs used in the fair value measurement of the Group's subsidiary preferred shares liability, as well as that in respect to the enterprise value of the underlying subsidiary in general:"

Input	*Sensitivity range*	*Subsidiary preferred shares liability increase/(decrease)*	
As of 31 December:		*2016 $'000*	*2015 $'000*
Enterprise Value	*-2%*	*(1,746)*	*(1,232)*
	+2%	*1,746*	*1,232*
Volatility	*-10%*	*(377)*	*1,783*
	+10%	*(776)*	*(2,353)*
Time to Liquidity	*-6 months*	*416*	*1,253*
	+6 months	*(762)*	*(1,221)*
Risk-Free Rate	*-0.18% / -0.12%*	*416*	*1,253*
	+0.13% / +0.12%	*(762)*	*(1,221)*
DLOM	*-5.0%*	*42*	*42*
	+5.0%	*(26)*	*(26)*

Allied Minds plc, Annual Report and Accounts 2016

"In the last five years, annual reductions and increases in costs estimates have both been experienced. If cost estimates were to change by 15%, the largest observed overall annual movement seen in this period, the provision recognised would need to change by approximately £18.0 million."

Meggitt plc, Annual Report and Accounts 2016

It was particularly helpful that the latter company also disclosed the reasons for the ranges of sensitivities chosen.

Where it is impracticable to disclose the extent of the possible effects of an assumption or other source of estimation uncertainty, the company should disclose that it is reasonably possible that outcomes within the next financial year that are different from the assumption could require a material adjustment to the carrying amount of the asset or liability affected[10]. This disclosure was given by three companies reviewed. One example was as follows:

"Whilst the Board considers the methodologies and assumptions adopted in the valuation are supportable, reasonable and robust, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investment existed and the differences could be significant."

Allied Minds plc, Annual Report and Accounts 2016

4.8 Estimates – changes to past assumptions

The FRC expects that, where past assumptions have changed, these changes should be explained if the past uncertainty remains unresolved.

Where a change in past assumptions amounts to a significant change in accounting estimate, IAS 8[11] requires disclosure of the nature and amount of the change. Of the companies reviewed, two disclosed a significant change in accounting estimate and a further three disclosed a more minor change in assumptions. Only one provided all the necessary IAS 8 disclosures.

For seven of the companies reviewed it was not possible to determine whether or not past assumptions had changed.

An example of a company providing the disclosure required by IAS 1 for changes in assumption is:

"Cash flows were derived assuming future Group growth rates in the short to medium term (up to four years) of 6% for HSS Core and an average of 4% for the remaining CGUs (2015: between 5 and 12%). The directors believe that it is prudent to lower the growth rate assumptions from prior year because of the transitional effects on trading that have occurred as a result of the commencement and ramp-up of the new operating model, as more fully explained in note 4. HSS Core's growth rate at 6% is higher than the other CGUs because the change in operating model in 2016 negatively impacted HSS Core to a greater degree, which however, is reflected by a higher relative growth rate of HSS Core in 2017 – 2020 as HSS Core enjoys the benefit of leveraging the new operating model to drive growth off a lower base."

HSS Hire Group plc, Annual Report 2016

10 IAS 1, paragraph 131
11 IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, paragraph 39

5 NEXT STEPS

Whilst the review identified improvements in disclosures in many areas, there is clear scope for further improvement. We will continue to challenge companies during our routine reviews when we do not see:

- clear differentiation of estimates from judgements;
- detailed disclosures of the judgements that have the most significant effect on amounts recognised;
- distinction made between estimates that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next year, and other estimates such as those that may affect carrying amounts in the longer-term;
- company-specific disclosures that pinpoint the areas of estimation uncertainty and provide useful additional information, avoiding the use of boilerplate;
- quantification of the specific amounts of estimates at risk of material adjustment within the next year;
- quantification of assumptions underlying estimates, where necessary; and
- sensitivity analysis or disclosure of the range of reasonably possible outcomes.

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