



# Annual Review of Corporate Reporting 2019/20

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# 1. Introduction

## Quality of corporate reporting and areas for improvement

The overall quality of reporting by UK companies has remained consistent in recent years. We have seen incremental improvements in certain areas, such as fewer inconsistencies between the disclosure of significant judgements and estimates and related disclosures elsewhere in the annual report and accounts.

We consider that there is still room for improvement in other areas. Disclosures should be sufficient for users of the accounts to understand the effect of significant matters on the companies' performance, cash flows and financial position. This will be particularly relevant when companies have to explain the effects of the Coronavirus (Covid-19) pandemic.

Companies should carefully consider the issues most frequently identified in our reviews (see [section 2.1](#)). This year we have also provided a [Corporate Reporting highlights](#) document, which provides a summary of the most significant findings from our reviews.

## Impact of Covid-19 on financial reporting

The Covid-19 pandemic has created unprecedented challenges for companies reporting their financial results. In addition to understanding the effect on historical performance, users of accounts want to know the likely implications for future results.

The FRC's 2019/20 Review of Corporate Reporting is informed by our review of reports for periods up to 31 October 2019, almost all published before the full impact of the pandemic on businesses and broader society became apparent.

Despite this, the findings from our reviews are relevant to future reporting. The pandemic underlines the importance of companies' not just complying fully with the minimum reporting requirements but also considering whether additional information is required to satisfy the underlying reporting principles and objectives and to meet investor needs. Therefore, we expect companies to consider our findings carefully during their financial reporting process. Companies should also consider the documents produced by CRR and the Financial Reporting Lab ('the Lab') in relation to financial reporting in a Covid-19 environment as part of the [FRC Covid-19 response](#).

Starting with the [Guidance for companies on Corporate Governance and Reporting](#), released in March and updated in May, we have encouraged boards to focus on areas of reporting of most interest to investors, and to provide clarity on the use of key forward-looking judgements, with guidance covering:

- the need for narrative reporting to provide forward-looking information that is specific to the entity and which provides insight into the board's assessment of business viability and the methods and assumptions underlying that assessment;

- going concern and any associated material uncertainties, the basis of any significant judgements and the matters to consider when confirming the preparation of the financial statements on a going concern basis;
- the increased importance of providing information on significant judgements applied in the preparation of the financial statements, sources of estimation uncertainty and other assumptions made; and
- judgement required in determining the appropriate reporting response to events after the reporting date and the extent to which qualitative or quantitative disclosures may be appropriate.

Our selection of issues in the discussion of findings in depth for 2019/20 ([section 3](#)) and our key disclosure expectations for 2020/21 ([section 5.1](#)) reflect these areas of focus.

As part of our 2020/21 work, we have performed an additional thematic review on the [financial reporting effects of Covid-19](#). The report was published in July, and we present the key findings on [page 23](#).

In addition, we note that the International Accounting Standards Board (IASB) introduced a practical expedient into IFRS 16 to deal with Covid-19-related rent concessions. This relieves lessees from the requirement to determine how to account for a lease modification in specific circumstances, as set out on [page 31](#).

## 2020/21 priorities

Our monitoring of annual reports and accounts prepared in the 2020/21 cycle will focus on: disclosures addressing risk, judgement and uncertainty in the face of the ongoing economic and social impact of Covid-19; the potential consequences of geopolitical tensions and the UK's exit from the European Union; and climate-related risks.

Companies should articulate their expectations of the possible impacts of those factors on their specific business. The financial reporting implications of specific circumstances, such as a change in business model affecting operating segments, should also be considered.

# 1. Introduction (continued)

## Overview of our monitoring activities and outcomes

We performed 216 reviews as part of our 2019/20 review cycle, which is broadly consistent with previous years (2018/19: 207 reviews; 2017/18: 220 reviews). Our focus continues to be on larger companies, which have the greatest effect on market confidence, with 67% of our reviews attributed to FTSE 350 companies (2018/19: 65%; 2017/18: 60%).

Approximately half of our cases arose from thematic reviews. We performed thematic reviews on impairment of assets<sup>1</sup> and the effect of two new accounting standards on full year accounts (IFRS 9 and 15), as well as a further 'light touch' thematic review on Brexit disclosures, discussed in last year's report, and the impact of IFRS 16 on interim accounts.<sup>2,3</sup>

We wrote to 96 companies (2018/19: 80; 2017/18: 101) with substantive questions about their reporting, asking for additional information or further explanation. As with previous years, the majority of such cases resulted in companies volunteering or agreeing to make improvements to their future disclosures. We always follow up such undertakings by reviewing companies' subsequent reports. We had to re-open one case (2018/19: two cases, 2017/18: three cases) where companies had not adequately fulfilled the undertakings provided. We expect companies to check that they have fulfilled their undertakings to the regulator when they perform their pre-issuance checks.

We asked 14 companies that restated their accounts as a result of our enquiries to draw the restatements to users' attention in their next accounts as these cases represented more significant non-compliance. The frequency of restatements relating to cash flow statements remains a concern, and we will continue to critically review line items appearing on the face of the cash flow statement and challenge companies in relation to any unusual items.

In cases where we identify particularly significant non-compliance, we issue a press notice to draw this to the attention of the wider market. We issued one such press notice this year (2018/19: none, 2017/18: one) in relation to a FTSE 250 company that restated its revenue and certain amounts on its cash flow statement.

Further details of these cases, our approach to monitoring and developments in 2020/21 can be found in [section 6](#).

<sup>1</sup> [Impairment of Non-financial assets \(October 2019\)](#)

<sup>2</sup> IFRS 9 'Financial Instruments', IFRS 15 'Revenue from Contracts with Customers' and IFRS 16 'Leases'.

<sup>3</sup> Findings of the thematic review of Brexit disclosures were published in the [2018/19 Annual Review](#).

# 1. Introduction (continued)

## Purpose of the report

### Who is this report for?

The primary audiences are preparers and auditors of corporate reports, and investors.

This year, for the first time, we have also produced a short summary, [Corporate Reporting highlights](#), intended for CFOs, Audit Committee chairs and other senior management.

### What is this report for?

The report provides the main findings arising from the FRC's corporate reporting monitoring work, which is conducted by its Corporate Reporting Review team ('CRR').

It sets out our view of the current state of corporate reporting in the UK, what makes for better quality reporting, and where we see shortcomings requiring improvement. We explain our expectations for the next reporting season. The report also shares insights from the Lab's projects, which invited input from investors as well as preparers.

This report provides preparers and auditors with an understanding of what needs to be on, or higher up, their agenda in relation to financial and narrative reporting.

This year, preparers face the additional demands of producing high-quality reports against the backdrop of the effects of the Covid-19 pandemic and its economic consequences. CRR produced a dedicated thematic review on that topic in July.

We have used this report to reinforce or refresh the key messages from that report. There is particular emphasis on consistency across going concern, viability and accounting estimates, and on communicating the full range of potential variances in outcome around a central forecast.

### Case studies and disclosure examples

We include case studies, to illustrate selected key findings and areas for improvement, and provide examples of better disclosure, annotated to explain what makes it better. These have been developed from our observations during the year, but do not represent any particular company's reporting.

## Structure of the report

Following positive feedback for our thematic review reports and results of the post-review survey, discussed on [page 37](#), we have refreshed the layout and style of the Annual Review.

A separate summary document, [Corporate Reporting highlights](#), gives a standalone, 'story-on-a-page' view of key points, for readers who want to understand our key messages but do not require all the underlying detail. This has been designed to highlight our key concerns in areas where we most commonly find breaches of reporting requirements for the financial statements and the strategic report. We also explain how we expect the matters identified to be addressed through improvements in future reporting.

We have not produced a separate Technical Findings report for 2019/20. Information previously split across that and the Annual Review is now in one place. We hope this makes it more accessible and hence more useful.

## Section by section

- Section 2, [Findings: overview](#), summarises the key findings from our monitoring work and the quality of corporate reporting we observed.
- Section 3, [Findings: in greater depth](#), examines the ten most frequently identified areas arising from CRR's monitoring of financial statements and strategic reports. It incorporates further discussion of these topics, highlighting the more significant issues we encountered.
- Section 4, [Findings: thematic reviews](#), presents the key findings from the thematic review projects undertaken in 2020, including our report on the 'Financial reporting effects of Covid-19'. It also provides key messages from the Lab's project on 'Reporting in times of uncertainty', reflecting the reporting needs identified by investors and other users.
- Section 5, [Our expectations for 2020 and future developments](#), looks ahead to the areas of focus for our monitoring of 2020 annual reports and accounts. It also highlights changes in IFRS and other requirements affecting 2020 and future periods.
- Section 6, [CRR monitoring activity](#), describes our monitoring programme and activity in 2019/20. It includes a summary of published references to our enquiries, where these had a significant impact on the companies' reporting.

## 2.1 Quality of corporate reporting

The overall quality of reporting by UK companies has remained consistent in recent years. The table opposite shows the ranking of the ten topics that arose most frequently in our correspondence with companies in the last three years.

The topics have remained similar, but the specific nature of our queries has evolved. For example, we note that during the 2019/20 review cycle, our questions on revenue and financial instruments mainly related to newly-adopted standards and amendments.

We have observed gradual improvements in the quality of reporting in certain areas. Our recent questions reflect the fact that we encourage continuous improvement. For example:

- We identified fewer companies with inconsistencies between the judgements and estimates disclosed in the accounts and related disclosures in other sections of companies' reports.
- We identified fewer pervasive shortcomings in alternative performance measure (APM) disclosures, indicating that our focus on this area in recent years has had some effect.
- The issues raised relating to strategic reports appeared to relate to a lack of detail, rather than outright non-compliance (e.g. entirely overlooking the non-financial reporting statement).

There remains, however, opportunity for further improvement, as evidenced by the fact that a large majority of our reviews result in companies, as a minimum, enhancing their disclosures.

We continue to identify issues from desktop reviews, without having to seek clarification or further explanation from companies. This indicates that companies could have prevented errors by performing more thorough pre-issuance checks. For example, many of the cash flow statement errors described in sections [3.1.7](#) and [6.3](#) were identified through critically analysing the line items appearing on the face of the cash flow statement for compliance with IAS 7 'Statement of Cash Flows'.

In addition, we consider that a number of the disclosure issues we identified may have been avoided if boards 'took a step back' and considered the disclosure objectives of accounting standards and legislation when evaluating the quality of their reports and the needs of investors. We expect such considerations to become more important as more companies publish reports in the highly uncertain environment created by the Covid-19 pandemic. [Section 2.2](#) discusses this aspect further.

### Ten most frequently raised topics

Topic	2019/20	2018/19	2017/18
Judgements and Estimates	1	1	1
Impairment of Assets	2	4	6=
Revenue	3	10	5
Financial Instruments	4	8=	-
Alternative Performance Measures	5	3	2
Strategic Report	6	2	3
Statement of Cash Flows	7=	5	9
Provisions and Contingencies	7=	7	10
Fair Value Measurement	9=	8=	-
Business Combinations	9=	-	-

[Sections 3.1.1 to 3.1.10](#) analyse each of the above topics in further detail.

## 2.2 Stepping back from the detail

### Meeting disclosure objectives

- In trying to meet the detailed reporting requirements of IFRS, companies should not lose sight of the objectives of financial reporting.
- The overall objective of financial statements is to provide financial information that is useful to a wide range of users in making economic decisions (IAS 1 'Presentation of Financial Statements', paragraph 9). Some standards include disclosure objectives for specific areas of accounting.
- The detailed disclosure requirements in standards explain how specific IFRS disclosure objectives may be achieved. However, these may not be enough. For example, loan covenant information, not specifically required by IFRS 7 'Financial Instruments: Disclosures' or IAS 7, may be relevant to disclosure of financial instrument risk and liquidity.
- Conversely, immaterial disclosures may frustrate the overall and/or specific objectives, by obscuring useful information. We expect companies to communicate material information clearly and concisely.
- We encourage disclosures in accordance with the requirements that are entity-specific and granular – sufficiently detailed to distinguish the company from others, and between different parts of the business, wherever such distinctions are decision-useful.

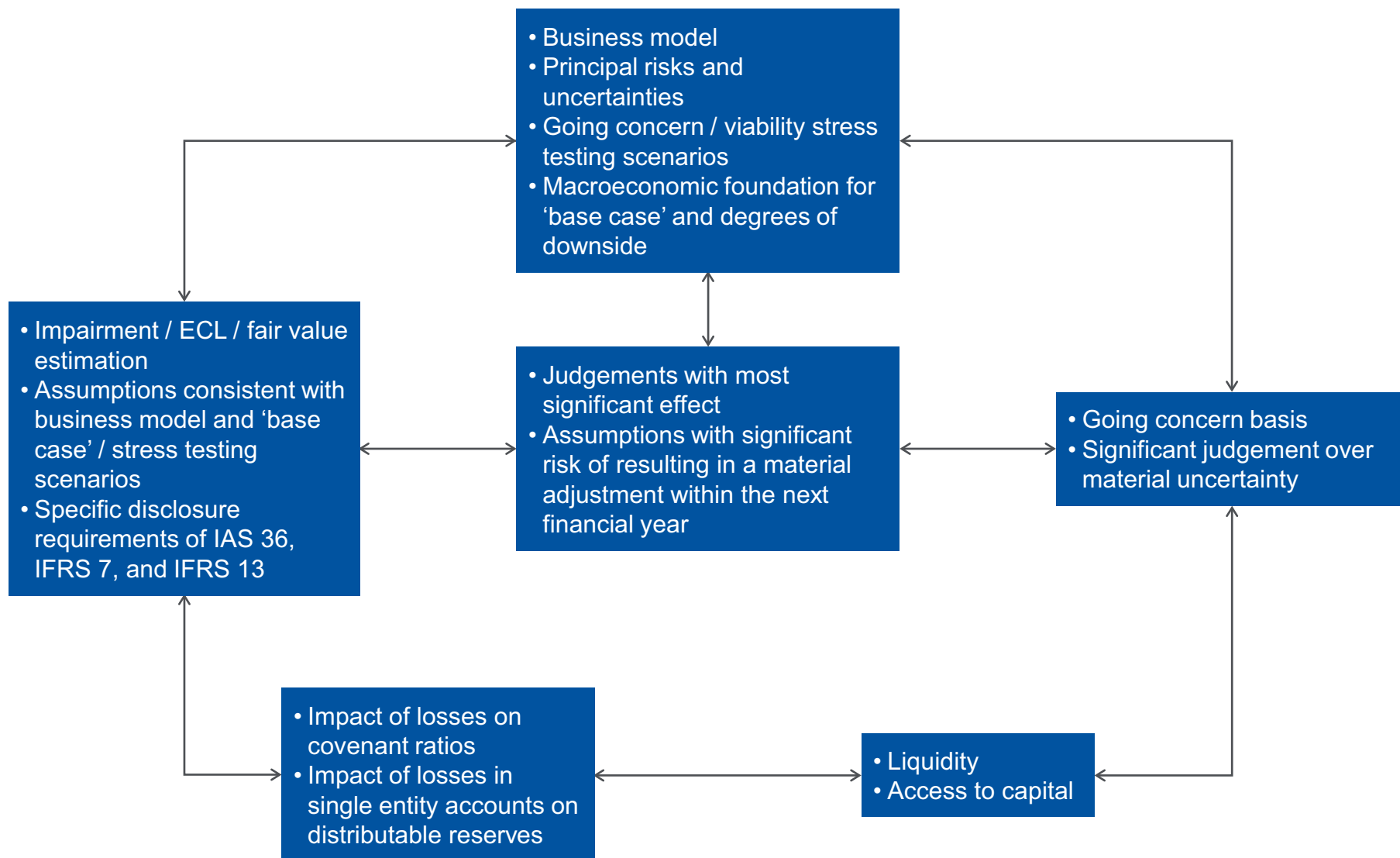
### Questions to consider in balancing detail and usefulness

- Do disclosures enable users to:
  - understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers (IFRS 15.110);
  - evaluate the significance of financial instruments for financial position and performance (IFRS 7.7);
  - evaluate the nature and extent of risks arising from financial instruments (IFRS 7.31);
  - assess the effect that leases have on the financial position, financial performance and cash flows of the lessee (IFRS 16.51); and
  - evaluate the entity's objectives, policies and processes for managing capital (IAS 1.134)?
- Do the disclosures provide additional information that is, for example:
  - relevant to users in understanding the financial position and liquidity of an entity (IAS 7.50); and
  - qualitative and quantitative ... about [a lessee's] leasing activities necessary to meet the disclosure objective (IFRS 16.59)?

### Consistency, coherence and connections

- Disclosures meeting different objectives or specific requirements do not stand in isolation. They are part of presenting a true and fair view in the annual accounts.
- We often question companies where disclosures are apparently inconsistent or contradictory. We encourage the board and senior management to review the annual report and accounts as a whole to ensure that disclosures are consistent and coherent.
- Stepping back to consider the overall picture should promote:
  - consistency between different parts of the annual report and accounts;
  - coherent approaches to going concern, viability, impairment and other key areas of estimation assumptions; and
  - connections between different parts of the annual report, where clear linkage through signposting and cross-reference enhances users' understanding.
- The diagram on the next page highlights some of the areas where we expect consistency.

## 2.2 Stepping back from the detail





# 3. Findings: in greater depth

Section 2.1 includes a table that lists the 10 topics that we raised most frequently in our correspondence with companies.

- Sections 3.1.1 to 3.1.10 provide further detail in relation to each topic.
- These sections also provide bullet point summaries of the more significant or frequent issues identified during our reviews, with examples of how better disclosures meet our expectations.
- During the year, we continued to identify issues in relation to earnings per share (EPS) and illegal dividends to which we would like to draw attention, although they are not in the top 10 most common issues. The case studies in section 3.2 illustrate the matters that we identified and the outcomes of our enquiries.

These summaries, case studies and disclosure examples are not a substitute for considering the detailed requirements of relevant legislation and reporting requirements, but they do provide insights into common areas for improvement. We encourage preparers and reviewers of accounts to familiarise themselves with the issues identified and consider whether they are relevant to their own reports and accounts.

The case studies and examples of better disclosure have been drafted for the purposes of this report, to represent disclosure made by a hypothetical company. However, the points they illustrate reflect real matters arising in the course of our reviews and enquiries.

Topic pages include a chart showing the relative frequency of the key sub-topics, identified by the colour of the commentary tables.



## 3.1.1 Judgements and estimates

Judgements and estimate disclosures have been an area of focus for several years. We have seen some evidence of certain companies providing more tailored disclosures. However, there continue to be companies that do not identify all material judgements and estimates or do not provide enough information to enable users to understand the level of uncertainty in estimates.

We expect companies to critically assess whether their disclosures are sufficient to:

- explain specific accounting decisions that are difficult, subjective or complex; and
- explain key assumptions and illustrate the impact of reasonably possible changes on reported results. An example of doing this well is the extract from a hypothetical company's reporting shown below.

We have identified the following major sources of estimation uncertainty at the end of the year that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

### Impairment of tangible assets

We assess our tangible assets for impairment when circumstances or events indicate that the carrying amounts may not be recoverable. Following the restructuring of our UK operations, we assessed our UK-based properties for impairment, including our North-East distribution centre, which has a carrying amount of £20m.

We compared the carrying amount of these assets with their recoverable amount, which is the higher of fair value less costs to sell and value in use. The assumptions made in estimating the recoverable amount were consistent with those made when assessing the recoverable amount of our UK cash generating unit as a whole, as discussed in note 6. The key assumptions made were: the risk-adjusted pre-tax discount rate, the cash flows to be generated over the five-year period covered by management's strategic plan and the growth rate into perpetuity after this period. We assumed a pre-tax discount rate of 8%, a growth rate of 2% and average EBITDA margin of 10%. As a result, we concluded that the recoverable amounts were greater than the carrying amounts and no impairment was required.

We performed a sensitivity analysis to consider whether reasonably possible changes to our assumptions would have resulted in an impairment charge. An increase in the discount rate to 10% would have resulted in an impairment charge of £3m to our North-East distribution centre. A reduction in EBITDA margin to 7% would have resulted in an impairment charge of £6m to the centre.

Specific assets identified and quantified, not just a generic statement that tangible assets are a source of estimation uncertainty

Information about management's assumptions given

Sensitivity analysis provided



### Lack of quantification of estimation uncertainties

- Estimation uncertainties were disclosed but not quantified (e.g. through sensitivity analyses or by disclosing the range of reasonably possible outcomes).
- Disclosures cross-referred to notes that did not contain the required information.
- Values assigned to key inputs and assumptions were not given.

### Apparent omission of judgements and estimates

- Judgements made in concluding that there were no material going concern uncertainties were not explained.
- No explanation of judgements made in relation to matters where there is no guidance within IFRS (e.g. in contrast to IAS 11, IFRS 15 does not provide guidance on accounting for claims from third parties such as sub-contractors).

### Lack of detailed or precise explanation of critical judgements

- Some companies summarised or paraphrased their accounting policies and procedures, without identifying and explaining specific judgements and estimates.
- Some gave no specific explanation of judgements around the accounting for complex or unusual transactions.

### Other matters

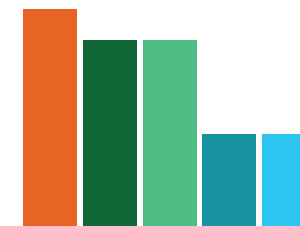
- Companies did not pinpoint specific amounts at risk of material adjustment (e.g. they indicated that the tax balance included uncertain tax positions but did not identify the amounts).

## 3.1.2 Impairment of Assets

The findings in the chart and table below reflect a combination of our routine reviews and our thematic review on impairment of non-financial assets.

The majority of our queries resulted in companies providing undertakings to improve their future disclosures (e.g. by explaining their testing in greater detail or by setting out their assumptions and sensitivity analyses). These outcomes highlight the need for companies to think broadly about their accounts as a tool for communicating useful information. We frequently found that disclosures could have been more transparent and company-specific. For example, where there are impairment testing triggers but the relevant calculations do not identify an impairment loss, it would be helpful to explain that fact and share details of the methodology, key assumptions and headroom.

We will continue to pay close attention to this topic in the light of Covid-19. We expect companies to pay particular attention to the guidance set out in our [thematic review report on impairment of non-financial assets](#) as well as our [thematic review report on the financial reporting effects of Covid-19](#).



### Sensitivity analyses

- Sensitivity analyses did not provide all the information required by paragraphs 134(f) or 135(e) of IAS 36 'Impairment of Assets' (e.g. values assigned to key assumptions and headroom).

### Impairment testing method

- We identified cases where there appeared to be impairment indicators, but it was not apparent whether additional impairment tests had been performed in relation to tangible and intangible assets with finite lives. We noted that in such circumstances, it would be helpful to explain that impairment tests had been performed, and provide details about such tests.
- Disclosures indicated that impairment testing had been performed at a reported segment level (i.e. based on an aggregation of operating segments), in contrast with paragraph 80(b) of IAS 36, which requires that a cash generating unit (CGU) or group of CGUs should not be larger than an operating segment before aggregation.
- Some accounts did not sufficiently explain the reasons for revising the composition of CGUs or the methodology applied (paragraphs 87 and 130(d) of IAS 36).

### Investments in subsidiaries

- We identified cases where parent company net assets exceeded consolidated net assets and/ or market capitalisation. In such cases, we noted that users would find it helpful if companies explained whether they had performed impairment tests and shared details about such tests (e.g. impairment testing methods, assumptions and headroom).

### Key inputs and assumptions

- Required disclosures were not provided for key assumptions (e.g. management's approach to determining values assigned to key assumptions and whether they reflected past experience and their consistency with external sources of information), as required by paragraph 134(d) or 135(d) of IAS 36.
- Companies did not always explain how discount rates were derived, including how current market assessments of the time value of money and of risk were incorporated (paragraph 55(b) of IAS 36).

### IAS 36 disclosures

- Required disclosures were not provided in relation to impairment losses recognised during the year (e.g. the recoverable amount of impaired assets and the events and circumstances that led to impairment).
- Some accounts gave boilerplate information about the nature of CGUs (e.g. some reproduced the IAS 36 definition without explaining company-specific CGUs such as individual branches, stores or operating segments).

## 3.1.3 Revenue from Contracts with Customers

The increase in the frequency of our substantive questions in relation to revenue reflects issues identified in companies' first accounts since adopting IFRS 15. In general, most of our questions arose because companies gave generic information about their revenues and related accounting, without being sufficiently precise about how IFRS 15 had been applied to company-specific arrangements.

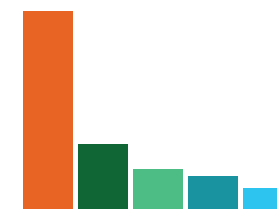
In this context, we draw attention to the overarching objective set out in paragraphs 1 and 110 of IFRS 15, which requires disclosure of sufficient qualitative and quantitative information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers.

### Disclosures about performance obligations

- Some companies did not explain significant judgements made in determining whether multi-element arrangements contained a single performance obligation or a number of performance obligations.
- Explanations were not given for concluding that performance obligations were satisfied over time.
- There was insufficient information about the measure of progress of performance obligations delivered over time.
- There was scope to provide fuller explanations about performance obligations satisfied at a point in time (e.g. it would be helpful to explain why dispatch of goods coincides with the transfer of control).

### Determining transaction price (including the variable consideration constraint)

- Many accounting policies did not explain the nature of variable consideration or how it was estimated or constrained.
- Disclosures of estimation uncertainties indicated a significant risk of a downward adjustment to revenue thus indicating that the variable consideration constraint may not have been appropriately applied.



### Contract assets and contract liabilities

- Some companies disclosed material contract assets and/or liabilities either on the face of the balance sheet or in the notes, but provided no further information about the nature of these balances and the accounting.

### Treatment of contract modifications

- Narrative disclosures within the annual report indicated the existence of contract modifications but the accounting for such events was not clear from the accounting policies.

### Miscellaneous IFRS 15 points

- Insufficient explanation of judgements made in determining that an entity was acting as a principal rather than an agent.

The example on the next page illustrates disclosures that we expect companies to provide when explaining significant judgements that have been made in applying IFRS 15. It also highlights the following issues that we are finding with companies' application of, and disclosures under, IFRS 15:

- Explanations about variable consideration (including the application of the variable consideration constraint).
- Disclosure of judgements and estimates that aid users' understanding of how management has applied IFRS 15 (including sensitivity analyses that do not conflict with the IFRS 15 guidance on applying the variable consideration constraint).

These and other issues are discussed in further detail in '[IFRS 15 thematic review - Review of Disclosures in the First Year of Application](#)' as well as '[IFRS 15 – A follow-up thematic review](#)'.

### 3.1.3 Revenue from Contracts with Customers (continued)

In certain industries contract modifications, often termed variations, are very common. These variations may impact scope or price, or both, and the accounting will depend upon the specific circumstances. For example, the change in location of the bridges will be a contract modification and be accounted for once approved. If the price for the modification is not agreed until a later date the variable consideration requirements will apply. The claim for the inclement weather may represent variable consideration and be estimated under that guidance, or if there was no basis under the contract for such a claim it may represent a contract modification and only be accounted for once approved. If variations are a material issue, as is the case here, we would look to the accounting policies to ensure there was clear explanation of the related accounting.

Variable consideration can come in many different forms and pain-share / gain-share is one example that is common in the construction industry.

We expect the nature of each material type of variable consideration, and how they are estimated and constrained, to be clearly explained within the company's accounting policies.

The company had two long-term and complex construction contracts in progress, the accounting for which involves significant management judgement. Both contracts have a range of potential outcomes, depending on uncertain future events that could result in a material difference in the amount of revenue recognised in future periods.

#### Contract A: UK Infrastructure Division

This project is for the upgrade of rail track between Newtown and Oldtown, including the replacement of signalling systems and the construction of new crossing bridges. At 31 March 2020, the Group had applied for compensation from the customer for a number of variations which arose during the year, following the change in location of two crossing bridges, as well as lost time from inclement weather. The accounting policy for variations is set out in note 1 on page 123. Negotiations with the customer are ongoing and, depending on how these proceed, there is a potential upside or downside risk to the amount of revenue recognised for the contract up to 31 March, of £15m.

#### Contract B: UK Residential Division

This project is for the construction of a new halls of residence for the University of Midtown. This contract includes a gain-share / pain-share arrangement with the customer whereby the Group is entitled to share in a bonus if the overall project is delivered both on time and within budget. Conversely, the Group will share in a penalty if the project is delivered late or over-budget. The accounting policy for gain-share / pain-share arrangements is set out in note 1 on page 123. The Group has recognised its share of the performance bonus in the current year's revenue, on the basis of the following facts and assumptions:

- The project is 72% complete, and management judges it possible to forecast with a sufficient degree of accuracy what the overall contract performance will be.
- The project is on track to be completed on time and under budget.
- It is assumed that there will be no further waves of Covid-19-related disruptions to the Group's supply chain. If there were further disruption impacting any of the suppliers upon which we are dependent there would be a material risk that the project would not be completed on time.

The amount included within current year revenue in respect of the above is £10m. If circumstances surrounding the project's expected timeline or cost levels change to the point where it is no longer likely that the bonus will be received, a reversal in revenue will need to be recorded.

The company refers to the potential reversal of revenue and indicates that the downside risk is equal to the upside risk. This suggests that the variable consideration constraint may not have been appropriately applied.

Under the constraint, variable consideration should only be recognised to the extent it is highly probable that a significant revenue reversal will not occur when the uncertainty surrounding the variable consideration is resolved.

We would likely raise a question with the company on this point.

There is again reference to the possibility of reversal of revenue. Therefore, it appears that management may not have appropriately applied the variable consideration constraint.

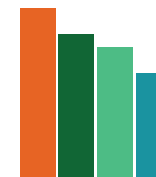
We would likely question whether it was appropriate for this amount to have been recognised in current year revenue.

## 3.1.4 Financial Instruments

The increase in the frequency of our substantive questions in relation to financial instruments reflects issues identified in companies' first accounts since adopting IFRS 9. The most significant issues that we raised with corporates related to classification of financial instruments, liquidity disclosures and supply-chain financing arrangements. In relation to financial institutions, most of our queries related to expected credit loss (ECL) provisions and related disclosures, which highlights the significance of the matter to companies in that sector.

A number of the matters identified are discussed in more detail in the [thematic review report on IFRS 9](#) that we published in 2019.

In addition, we are undertaking a thematic review on cash flows and liquidity disclosures, which is the subject of a separate report and is summarised in [section 4.3](#).



### Reverse factoring

Companies are reminded that supply chain financing arrangements, including reverse factoring transactions, are currently an area of focus for the FRC. In this context, we draw attention to the [2019 report published by the Lab](#), which contains information on supply chain financing and provides guidance on the accounting for, and disclosure of, such transactions.

We note that the IASB's Interpretations Committee recently considered the principles and requirements in IFRS Standards relating to reverse factoring. The committee noted that companies should not gross up the cash flow statement, unless the arrangement involves cash inflow and outflow, when an invoice is settled by the financing transaction.

Non-cash transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about the financing activity. Companies also need to determine whether to derecognise the supplier payable and recognise a liability to the finance provider, and what additional disclosures about exposures to risk from financial instruments, significant judgements and material effects are required.

### Estimation and disclosure of ECL provisions and credit risk

- There was insufficient information about the recoverability of other financial assets (e.g. contract assets and parent company receivables due from subsidiaries) and the methodology used to assess recoverability.
- Companies did not quantify weightings applied to forward-looking economic scenarios or they listed key variables without any quantification.
- The factors considered in determining whether there had been a significant increase in credit risk were not explained (e.g. quantitative and qualitative thresholds triggering a transfer from stage 1 to stage 2).
- The non-linear relationship between economic scenarios and ECL provisions was not adequately explained by some companies' sensitivity analyses (e.g. disclosures illustrated the impact of applying a 100% weighting to the severe downside scenario while no upside sensitivity was given).

### Other financial instrument issues

- Companies did not make it clear whether certain assets and liabilities were accounted for under the requirements of IFRS 9 or another accounting standard (e.g. 'other receivables', deferred contingent consideration and certain balances relating to contracts with customers).
- One company accounted for the repricing of a term loan, including a change in term, by prospectively altering the effective interest rate. However, the application guidance for IFRS 9 (paragraph B5.4.6) explains that such an event requires a recalculation of the carrying amount and the recognition of a modification gain or loss in the income statement.
- There was insufficient detail on the accounting for committed contracts for the purchase of own shares and options over non-controlling interests.

### Supply chain financing and factoring arrangements

- Invoice discounting and reverse factoring arrangements appeared to be in use, but there was no disclosure of their terms, related risks or their effects on the accounts, liquidity and key metrics such as net debt.

### Liquidity risk disclosures

- There was insufficient detail about undrawn credit facilities (e.g. their terms, undrawn amounts and whether they were committed).

## 3.1.5 Alternative Performance Measures (APMs)

Our reviews of APM information considered the [ESMA Guidelines on Alternative Performance Measures](#), which applied to all UK issuers of securities traded on a regulated market in the period under review. As stated in our previous thematic reviews, we consider that the Guidelines are consistent with the Companies Act 2006 and codify best practice in supporting a strategic report that is fair, balanced and comprehensive. We expect UK companies to continue to follow the Guidelines after the end of the transition period on 31 December 2020, and will comment in our letters where we consider that they do not.

We were pleased to note that, due to improvements in the quality of most companies' APM disclosures, we did not raise as many queries as we did in previous years. However, we still identified issues relating to undue prominence and transparency of APMs (e.g. lack of reconciliations and lack of explanations of APM adjustments). Our future reviews will continue to focus on these aspects - especially in circumstances where APMs provide a flattering view of performance or where their presentation appears to obscure IFRS results. Reporting of APMs in preliminary announcements will be one area to which we will pay close attention when reviewing companies' other investor information for consistency with the annual report and accounts, discussed in [section 6.5](#).

Where companies adjust for restructuring programmes that last several years, we will continue to encourage them to provide detailed information throughout their duration (e.g. cumulative cash costs and expected total cash costs and the expected duration of such programmes). The points below summarise the issues that we identified.



### Rationale and consistency of APM adjustments

- Disclosures referred to multi-year restructuring programmes without giving further information (e.g. total cash costs to date, total expected cash costs and the timeframe of such programmes).
- Some companies did not adjust for gains that met their stated criteria for classification as adjusting items.
- Costs excluded from adjusted performance appeared to be part of normal operations.
- Generic explanations were given without explaining individual classes of adjustments.

### Level of prominence given to APMs

- The financial highlights gave more prominence to APMs (e.g. by presenting more APMs than IFRS measures or by placing IFRS measures in footnotes).
- Key statements such as the Chairman's Statement and CEO's Review focussed principally on adjusted measures (e.g. where discussions focused on adjusted EPS but not IFRS loss per share).
- Discussions on adjusted performance were not accompanied by meaningful commentary on IFRS measures.

### Reconciliations not provided for APMs

- Key APMs were not reconciled to the accounts.
- For key financial ratios, some companies did not state the numerator and the denominator or reconcile them to the accounts.
- Reconciliations were provided but they did not reconcile APMs to directly comparable IFRS line items.
- It was unclear how reconciling items related to amounts in the accounts.

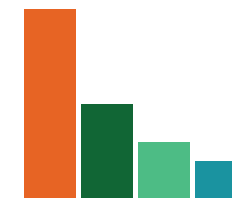
### Other APM points

- APMs were given labels or descriptions that are similar to IFRS measures, which is potentially misleading to users.
- Companies did not explain the rationale for presenting certain APMs (e.g. why APMs provide useful information to users and how the APMs are used internally).
- Some companies did not provide definitions for all APMs.

## 3.1.6 Strategic Reports

Our assessment of strategic reports considered specific reporting requirements of the Companies Act as well as the overarching requirement to produce a strategic report that provides a fair, balanced and comprehensive analysis of the development and performance of the business. The chart and tables below provide insights into areas for improvement.

Companies may also find it helpful to refer to the FRC's 'Guidance on the Strategic Report' as well as CRR's 'Thematic Review: Small Listed and AIM Quoted Companies'. Although the latter report was prepared in the context of smaller listed and AIM-quoted companies, it does provide helpful insights and best practice guidance to companies of all sizes on selected topics (Strategic Reports, APMs, Cash Flow Statements, Pensions, and Judgements and Estimates).



### Comprehensiveness of strategic report

- The financial review focussed on the income statement, with limited or no information on significant changes in the balance sheet and cash flow statement.
- Companies' financial reviews did not discuss matters that were significant in their context (e.g. some did not discuss significant tax matters or they only made brief references to debt covenants or maturing debt facilities even though more detailed comments would have been helpful).

### Non-financial Information Statement

- Several companies provided a table with cross-references to where non-financial information was located, but in certain cases the stated pages did not appear to contain the precise information required by the legislation (e.g. information on anti-corruption and anti-bribery matters).

### Whether the strategic report gave a fair review

- There were cases where the financial review highlighted improvements in adjusted profit without highlighting the IFRS loss.
- In certain instances comparisons of year-on-year performance were not performed on a like-for-like basis, thereby obscuring the performance of pre-existing businesses (e.g. where stripping out the impact of a recent acquisition showed that revenue and profits of pre-existing businesses were lower than in the previous year).

### Principal risks and uncertainties

- Omission of risks that appear to merit inclusion (e.g. impact of climate change).

### Reporting on stakeholders and Section 172 disclosures

In July 2020, the Lab [launched a project](#) on reporting on stakeholders and Section 172 ('S172'). The initial stage of the project explored how companies approached S172 statements for the first time, and the perspective of investors and other stakeholders on the statements. These discussions highlighted that the statements:

- are typically focused on process, particularly on engagement with stakeholder groups, but do not provide sufficient information on outcomes of such engagement, including feedback received and impact on decision making;
- do not clearly show the link between stakeholders and related risks and their impact on the business model and the long-term success of the company;
- do not provide examples of difficult decisions; and
- often provide narrative which is not sufficiently supported by quantitative information and metrics.

To help improve reporting of s172 statements, the Lab has [published a set of tips](#) for companies to consider as they prepare their next S172 statement. These tips cover what useful content to include, how to present it, and how to facilitate the process of preparing the statement. The Lab will continue its project on reporting on stakeholders into 2021 and will look to identify examples of best practice in this area.

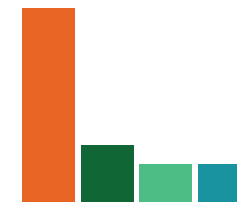


## 3.1.7 Cash Flow Statements

Our reviews continued to highlight significant concerns regarding the preparation of certain companies' cash flow statements.

As explained in [section 6.3](#), a number of companies agreed to restate their cash flow statements as a result of our queries, and we are concerned by this continuing trend. In the majority of cases, the cash flow misclassifications overstated operating cash flows. We are also concerned that most of the errors were basic in nature and could have been spotted by carefully considering the appropriateness of various line items appearing on the face of the cash flow statement.

We strongly encourage companies to consider the guidance and case study provided in our [2019 Annual Review of Corporate Reporting](#) (pages 12 to 14). We consider that the guidance, together with the summary of required references in [section 6.3](#) of this report and the points below provide an indication of the issues that companies should look out for when performing their pre-issuance reviews.



### Reported cash flows

- Companies with reverse factoring arrangements did not explain how the related cash flows were presented and the overall impact of these arrangements on the cash flow statement.
- Non-cash amounts were presented as cash flows (e.g. assets purchased under finance leases and non-cash finance charges).
- Proceeds from new borrowings and repayments of borrowings were offset rather than reported on a gross basis.
- There were basic errors in the indirect cash flow statement (e.g. share-based payment charges were deducted from profit before tax instead of being added back).
- There were material unexplained inconsistencies in reported cash flows and disclosures provided in other sections of accounts, such as the Strategic Report.

### Other cash flow matters

- The financial review did not discuss significant cash flow matters (e.g. significant changes in operating cash flow and movements in restricted cash).
- Some reconciliations of liabilities from financing activities did not meet the IAS 7 requirements (e.g. because they were presented on an aggregate basis for an entity's net debt, including cash and cash equivalents and derivative assets, which are not liabilities from financing activities).
- Some companies did not meet all IAS 7 disclosure requirements (e.g. they did not disclose dividends received from associates and joint ventures or net cash paid on acquisitions).

### Accounting policies

- We raised queries where accounting policies stated that cash equivalents included amounts with an original maturity of greater than three months, in contrast to the guidance in IAS 7, which explains that an investment normally qualifies as a cash equivalent when it has a short maturity of, say, three months or less from the date of acquisition.

### Classification of cash flows

- Certain costs were charged to the income statement (e.g. acquisition-related costs and consideration for post-acquisition services) but the related cash flows were classified as cash flows from investing activities, rather than as operating activities.
- Cash flows from acquisition of non-controlling interests were classified as investing activities, rather than as financing activities.
- Derivative-related cash flows were classified as cash flows from financing activities, even though the derivatives related to operational hedges and hedges of net investments in foreign operations.

## 3.1.8 Provisions and Contingencies

As with last year, we questioned companies where the nature and timing of obligating events was unclear or where there appeared to be disclosure omissions. The majority of our disclosure-related queries related to failure to provide sufficient information to enable users to understand the nature of provisions, related uncertainties and potential timing.



### Disclosures about provisions and contingencies

- Disclosures were not sufficiently detailed (e.g. where disclosures stated that provisions were for third-party claims without further explanation or commenting on timing).
- A number of companies did not give details of legal provisions on the basis that they were commercially sensitive. However, they did not provide the high-level information required by IAS 37 in such circumstances.
- Provisions of different classes were aggregated (e.g. onerous contract provisions were aggregated with provisions for legal, commercial and regulatory claims).

### Measurement of provisions

- It was unclear in some cases why the discount rates applied to measure certain long-term provisions appeared to be higher than risk-free rates.

### Recognition criteria for provisions

- It was not always clear how restructuring provisions met the recognition criteria set out in IAS 37 'Provisions, Contingent Assets and Contingent Liabilities', which states that a provision shall be recognised when there is a present obligation, the outflow of resources embodying economic benefits is probable and a reliable estimate can be made.
- Provisions were not recognised for claims covered by insurance, which is not consistent with the IAS 37 requirement to recognise liabilities and related insurance reimbursements on a gross basis.
- Insufficient information was provided to support the conclusion that recovery of insurance reimbursement assets was virtually certain.
- Insufficient information about the recognition of certain provisions (e.g. a remediation provision was recognised for the first time by a company that had been operating for a number of years, but the obligating event giving rise to the provision was not explained).
- There were questions on whether onerous contract provisions had been omitted.

In addition to the above points, we draw attention to the following changes to IFRSs that will impact companies' future reporting of provisions and contingencies:

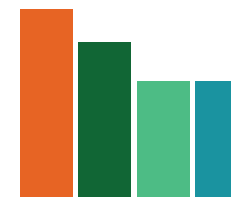
- IFRIC 23 'Uncertainty over Income Tax Treatments' is effective for annual periods beginning on or after 1 January 2019. It clarifies the recognition and measurement of tax items when there are uncertainties over income tax treatments. It also sets out the methods to be applied in determining amounts to be recognised (most likely amount or expected value) and whether tax treatments should be considered collectively.
- In May 2020, the IASB issued amendments to IAS 37, which explains the costs to be considered when assessing whether a contract is onerous. The amendments are effective for annual periods beginning on or after 1 January 2022, with earlier application permitted.

## 3.1.9 Fair Value Measurement

The number of queries in this area reflect the fact that fair value principles in IFRS 13 'Fair Value Measurement' are applied in several aspects of corporate reporting and disclosure (e.g. derivative and non-derivative financial instruments, investment properties, business combinations and recoverable amounts based on fair value less costs of disposal (FVLCD)).

In reviewing fair value matters, we checked compliance with specific IFRS 13 disclosure requirements and considered whether the qualitative and quantitative information provided was sufficient for an overall understanding of the valuation techniques used and the unobservable inputs and assumptions. We also assessed the adequacy of disclosures around significant judgements and the sensitivity of valuations to reasonably possible alternative assumptions.

Our findings are summarised below. In addition, as explained in [section 3.1.10](#), we identified a number of fair value measurement issues in the context of business combinations (e.g. insufficient explanations about the valuation of accrued income recognised on acquisition, as well as cases where there were significant reversals of contingent consideration and provisions in the post-acquisition period).



### Sensitivity analyses

- Some companies did not provide IFRS 13 disclosures. For example:
  - paragraph 93(h)(i) requires a narrative description of the sensitivity of fair value measurements; and
  - for financial assets and financial liabilities, paragraph 93(h)(ii) requires a sensitivity analysis illustrating the effect of reasonably possible alternative assumptions.
- Some companies stated that the valuation of non-financial assets measured at fair value (e.g. investment properties) was a significant source of estimation uncertainty. We noted that it would have been helpful to provide sensitivity analyses in relation to such non-financial assets.

### Description of valuation techniques

- In certain cases, the choice of valuation technique clearly required judgement, but some companies did not adequately explain the fact.
- Some companies stated that independent valuers had provided valuations but did not explain the methods, inputs and assumptions applied.
- Many companies disclosed fair values for 'other financial assets' and 'other financial liabilities' but did not explain what the amounts represented or how the fair values were determined.
- Fair value estimation required company-specific adjustments to established valuation techniques, but this was not explained in sufficient detail.

### Quantification of unobservable inputs

- Some companies did not quantify unobservable inputs and assumptions for measurements categorised within Level 3 of the fair value hierarchy.
- We identified inconsistencies between valuation inputs and assumptions (e.g. discount rates) and information provided in other sections of the accounts.

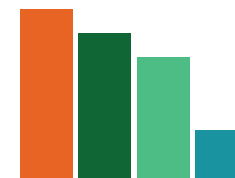
### Other IFRS 13 points

- We challenged a parent company that stated that the recoverable amount of its investment in a subsidiary represented FVLCD, but the value significantly exceeded the company's market capitalisation.
- Fair value hierarchy disclosures did not include all recurring and non recurring fair value measurements.
- Some companies did not provide a reconciliation of opening and closing balances categorised as Level 3.

## 3.1.10 Business Combinations

Our review of business combinations considered the detailed recognition and disclosure requirements set out in IFRS 3 'Business Combinations', alongside the requirement, in paragraph 59, to disclose information that enables users to evaluate the nature and financial effect of business combinations.

In general, our questions related to the sufficiency of explanations (e.g. explanations about valuation methods in relation to acquired assets and liabilities and contingent consideration). We also raised questions when disclosures omitted other information that appeared to be critical to achieving high-level disclosure objectives of the standard.



### Assets and liabilities recognised on acquisition

- Some companies could have provided additional information to enable a better understanding of the valuation of assets acquired (e.g. discount rates applied and commodity price assumptions).
- We challenged companies where they did not explain the methodology and assumptions applied in estimating the fair value of deferred income recognised on acquisitions.
- We sought further explanations where information provided in accounts made it unclear why certain provisions were recognised in the acquisition accounting as part of the acquiree's balance sheet.
- Where there was a subsequent reversal of a provision recognised in a business combination, we questioned whether the initial fair value had been appropriately determined.
- We challenged companies where their business combinations did not result in recognition of intangible assets such as brands or customer lists.

### Accounting for specific business combinations

- Certain accounts did not explain material gains on bargain purchases.
- We challenged a company where disclosures gave insufficient information about the accounting applied to a group reorganisation.
- We challenged companies where narrative information indicated that asset acquisitions had been treated as business combinations.
- We asked companies to provide information and explain significant judgements in relation to the accounting applied to put and call options over non-controlling interests.

### Acquisition consideration and related costs

- Companies did not explain their policies in relation to the valuation of contingent consideration or explain the valuation techniques applied.
- Some accounting policies stated that the cost of an acquisition includes directly attributable expenses, which is not consistent with IFRS 3.
- We sought further information where the accounting for deferred consideration was not well-explained. For example, we asked for clarification of whether any deferred consideration fell within the definition of contingent consideration in IFRS 3.

An obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met.

### Other IFRS 3 matters

- Where there was a subsequent reversal of contingent consideration, we asked a company to demonstrate that the initial fair value had been appropriately determined.
- We challenged a company that did not provide IFRS 3 disclosures in relation to a large acquisition that changed the nature and scope of its operations (e.g. revenue and profit of the acquiree since the acquisition date and the additional revenue and profit that would have been contributed by the acquiree if the acquisition had occurred at the start of the reporting period).

## 3.2 Other issues: miscalculation of EPS and unlawful distributions

During the year, we continued to identify issues in relation to miscalculated EPS and unlawful distributions. Although these are outside the top 10 in terms of frequency, we consider that they warrant attention owing to their significance.

- EPS is a common measure of performance used by investors and analysts.
  - Most of the EPS issues arose as a result of a corporate restructuring that had not been correctly reflected in the EPS calculation.
  - The following case study illustrates one such situation.
- Unlawful distributions may involve a breach of company or common law requirements regarding distributions, which may have implications for directors' personal liability as well as for shareholders in receipt of the dividend.
  - The most common issue in this area is a failure to file interim accounts prior to the payment of dividend, when a distribution by a public company is not supported by distributable profits determined by reference to the company's last audited accounts. This is illustrated in the case study on [page 22](#).
  - We have also identified cases where the company had not correctly assessed the status of certain reserves or based its determination of available profits on consolidated accounts without ensuring that subsidiaries' profits had been distributed to the parent company to enable dividend payments to shareholders.

### Case study: EPS

#### Background

- A company disposed of a profitable division during the reporting period.
- Owing to restructuring costs in other divisions, it reported a loss from continuing operations.
- Shortly after the period end, and before issuing its financial statements, the company executed a 5-for-1 share split to increase market liquidity.
- Its total issued share capital included shares held in treasury to meet the obligations of employee and executive share scheme options.
- The company disclosed overall basic earnings per share, a basic loss per share from continuing operations, lower diluted earnings per share and a smaller diluted loss per share from continuing operations, based on the number of shares in issue at the start and end of the reporting period.

#### Enquiry

- We asked the company to explain the basis on which it had applied the requirements of IAS 33 'Earnings per Share', given that:
  - owing to the loss from continuing operations, we would have expected the share scheme's potential ordinary shares to be non-dilutive<sup>4</sup>; and
  - the calculations did not appear to reflect the share split<sup>5</sup>.

#### Outcome

- The company restated comparative figures in its subsequent financial statements.

#### Key principles

- A transaction after the year-end which does not provide evidence of conditions at the end of the reporting period is generally a non-adjusting event, requiring no change to the amounts disclosed in the financial statements.
- The share capital transactions specified in paragraph 64 of IAS 33 are an important exception.
- Potential ordinary shares are not dilutive for earnings per share unless also dilutive for earnings from continuing operations per share.

<sup>4</sup> IAS 33, paragraph 41

<sup>5</sup> IAS 33, paragraph 64

## 3.2 Other issues: miscalculation of EPS and unlawful distributions

### Case study: Unlawful distributions

#### Background

- A public company made dividend payments and completed a number of share buybacks during the year under review.
- The amount of retained earnings shown at the end of previous financial year was less than the combined amount of the distributions.
- Section 836(2)(a) of the Companies Act 2006 requires a public company to file interim accounts prior to the payment of dividend when a distribution is not supported by distributable profits determined by reference to the company's last audited accounts.

#### Enquiry

- We observed that the company did not appear to have filed individual interim accounts prior to the payment of the dividends and asked how the company believed that its distributions were lawful.

#### Outcome

- The company confirmed that it had not filed individual interim accounts and that certain distributions had been undertaken contrary to the provisions of the Companies Act 2006.
- The company sought legal advice following our correspondence to determine appropriate steps to remedy the situation.

#### Key principles

- In each of our last three annual reviews we have drawn attention to potential breaches of the Companies Act requirements for distributions in circumstances where the latest annual accounts do not support the planned distribution.
- These breaches are indicative of possible weaknesses in the broader control environment.
- We are surprised and concerned that distributions by large public companies continue to be made in contravention of the applicable requirements of the Companies Act 2006.
- We are aware that many companies' distributable reserves are under pressure due to the economic effects of Covid-19. As a result, many companies have made the decision to halt or delay dividend payments and a number have also halted share buy-back programs.
- However, we want to remind companies that are planning to make distributions of their continuing obligations under the Act, particularly those contained in section 836(2)(a). We also expect boards of directors and company secretaries to put in place adequate processes and internal controls to ensure that:
  - sufficient distributable reserves are available to cover planned distributions as part of a robust distributions approval process;
  - sufficient distributable reserves are available when distributions are made, taking account of events since their declaration;
  - individual interim accounts are filed prior to payment of a dividend when a distribution is not supported by distributable profits in the company's last audited accounts;
  - these controls include share buy-backs and other transactions classed as distributions, e.g. employee benefit trust transactions; and
  - the treatment and impact of items such as merger reserves and credits taken directly to equity are carefully considered.

# 4.1 Financial reporting effects of Covid-19

[Read the report](#)

In July, the FRC published its first review of company reporting since the onset of the Covid-19 pandemic.

The sample of 17 interim and annual reports and accounts with a March year end (across a range of industries) found most companies provided sufficient information to enable a user to understand the impact Covid-19 has had on their performance, position and future prospects. However, there were a number of areas where disclosures should be improved.

## Key findings

Notable areas in which improvement is needed include:

1. Going concern disclosures in both interim and annual financial statements should clearly explain the key assumptions and judgements taken in determining whether a company is able to operate as a going concern. In particular, any significant judgements taken in determining whether or not there is a material uncertainty in respect of going concern must be clearly documented.
2. Assumptions used in determining whether the company is a going concern should be compatible with assumptions used in other areas of the financial statements.
3. We expect sensitivity analysis or details of a range of possible outcomes to be provided for areas subject to significant estimation uncertainty. The number of disclosures in this area is likely to increase as a result of Covid-19.
4. We discourage the arbitrary splitting of items such as impairment charges between Covid-19 and non-Covid-19 financial statement captions as such allocations are likely to be highly subjective and therefore unreliable. We also expect companies to apply consistently existing accounting policies for exceptional and other similar items to Covid-19 related income and expenditure.
5. Although IAS 34 'Interim Financial Reporting' has only limited disclosure requirements, interim financial statements would benefit from more detailed disclosures explaining the way in which Covid-19 has impacted a company's reported performance and future prospects.



Some of our observations concern disclosures which are not explicitly required by either accounting standards or the relevant law. Additional information in these areas would have been helpful to the user.

In the current environment, we would also encourage companies to consider the need for disclosures not explicitly prescribed by IFRS to enable users of accounts to understand the impact of events and conditions on a company's position and financial performance, as required by paragraph 31 of IAS 1.



Overall, the best disclosures were those that were specific to the company and which provided additional information that clearly explained how Covid-19 had impacted the company's reported position and performance and how it may affect future prospects.

We encourage preparers to consider carefully the findings of this review when preparing their forthcoming interim and annual reports. Companies should aim to ensure that not only mandatory disclosure requirements have been met but that sufficient explanations have been included within the financial statements to enable a user to understand how Covid-19 has affected both the amounts presented and the company's future prospects.

## 4.2 Financial Reporting Lab: Reporting in times of uncertainty

In response to the Covid-19 pandemic, and several investor discussions, the Lab issued an [infographic](#) in March and two reports (and related summaries) in June relating to reporting in times of uncertainty. Updates to these reports including current disclosure practices were [released in October](#).

- 'Covid-19 – Going concern, risk and viability' highlights the impact of the uncertainties arising from the Covid-19 crisis on three key areas of disclosure.
- 'Covid-19 – Resources, action and the future' provides more detailed guidance and examples to help companies answer the questions raised by investors' information needs.

The Lab also undertook a survey focused on the types of information investors would like to see from companies in the current environment. Findings from the survey were [summarised in an infographic](#), appended to the 'Resources, action and the future' report.

### Covid-19 – Going concern, risk and viability

[View the summary in Sway](#)

#### Going concern

Disclosure around going concern helps to provide context in uncertain times. Helpful disclosures:

- clarify the going concern position and detail the factors that support that assessment, such as the cash position, support from others (including government schemes), current business activity, etc;
- provide detail of the actions (both current and potential future) and their status;
- provide detail, specific to the business, of the elements of uncertainty and how they affect the company; and
- connect to broader reporting within the report, such as risk and viability disclosures.

#### Risk reporting

A different approach to short-term risks is needed than that for reporting longer-term risks, and the level of information needed increases. Companies should:

- be consistent in reporting, and where there are differences between the annual report and other information published by the company, these should be explained;
- focus on the most relevant issues such as liquidity, solvency and operational matters;
- clarify timing of issues;
- provide information on impacts, changes to risks and their mitigation, and changes to risk appetite; and
- consider splitting risks by geographies, operations or segments.

#### Viability statement

Good viability disclosures provide detail about the prospects of a company and its viability. Due to Covid-19, companies should consider providing information on:

- specific short and medium-term Covid-19-related factors considered, e.g. government support, employee and supplier-related issues;
- viability across the group, and within the ultimate parent;
- how the board is monitoring and controlling the situation;
- business model resilience and actions; and
- how Covid-19 has been reflected in scenarios and stress testing of both prospects and viability.



## 4.2 Financial Reporting Lab: Reporting in times of uncertainty (continued)

### Covid-19 – Resources, action and the future

[View the summary in Sway](#)

#### Summary of key findings

In these times of uncertainty, companies should:

- focus on what really matters and on the big picture;
- avoid information gaps being filled by others;
- use other channels for communication, e.g. website, video; and
- ensure consistency between the annual report and ad-hoc reporting.

#### Resources

What cash and liquid resources does the company have now?

- Amount and nature of cash and liquid resources, and sources of cash (operation-based and finance-based) Location and context of cash
- Barriers to accessing cash

What cash and liquid resources could the company get access to in the short term?

- Debt terms and maturity
- Availability of short-term financing
- Intended use of funding

#### Actions

Disclosures on short-term management actions to sustain, extend, and support the company's ability to remain viable, related to:

- expenses and cash outflows;
- dividends;
- capital expenditure (including in relation to curtailed and hibernated activities);
- suppliers (including information on supply chain and payments); and
- government support and other concessions.

#### The future

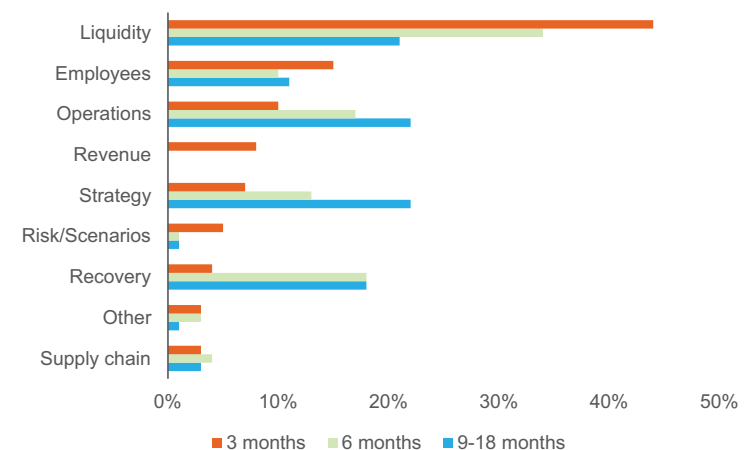
Disclosures on how decisions made now will affect the future of the company, and on management's views on the future of the business itself, including what different scenarios might mean for the company:

- The company's purpose and whether it needs to change
- How the company takes account of and supports its stakeholders and its drivers of value
- Base case, upside and downside scenarios and assumptions
- Longer-term trends and impacts, including how the business model may need to adapt, and changes to the company's aims and prospects

### Survey of investors' information needs

The Lab's survey in April and May 2020 found that investors, when asked to rank the importance of areas of reporting, expected companies to have focused on cash and liquidity in the very short term (next three months), but more on strategy and operations in the longer term, as shown on the right.

At that time, the most commonly reported horizon over which investors were considering investment was one month. Investors wanted companies to provide information on a quarterly basis and the preferred format was through the company website.



## 4.3 Thematic Reviews

### IFRS 15 'Revenue from contracts with customers': a follow-up thematic review

This year's thematic review focused on whether companies provided sufficient information in relation to the following areas:

Timing of revenue recognition	Contract balances
Variable consideration	Significant judgements
Revenue disaggregation	Costs to obtain or fulfil a contract

The principal findings of the thematic review are set out below:

- Some companies are still not clearly communicating when each of their performance obligations are satisfied and thus when revenue is recognised.
- Where revenue is recognised over time, often the specific method used to measure progress was not explained.
- Disclosures about the nature of variable consideration, and how it is estimated and constrained, were sparse, if provided at all. We also found a few instances where companies' disclosures about the related risks were poorly articulated and potentially misleading.
- We are concerned that some companies overlooked the accounting requirements under IFRS 15 for costs to obtain or fulfil a contract when these appear relevant to their activities. Only a small proportion of companies included a policy for these costs and even fewer provided quantitative information.
- In general, companies provided helpful disaggregated revenue disclosures, but in some instances the categories selected did not fully reflect the risks to which the nature, amount and timing of revenue was most sensitive.
- Information about significant judgements relating to revenue was variable. Some descriptions lacked clarity about specific judgements made. Quantitative disclosure, such as sensitivity analyses or the range of potential outcomes, was often not provided for judgements involving estimation uncertainty.
- There is scope to improve disclosures about material contract balances, particularly how they arise and vary year-on-year. Better disclosures clearly explained the relationship between the fulfilment of performance obligations and the timing of cash flows.

### IFRS 16 'Leases': disclosures in the first year of application

We carried out a thematic review on the disclosure of the impact of IFRS 16 by companies operating in industries where the standard has had a significant effect. We concentrated on ongoing disclosures required by IFRS 16, as well as disclosures relating to lease balances required by other standards, such as IAS 1 and IFRS 7.

In general, most companies in our sample explained the impact of adopting the new standard well, clearly addressing the requirements of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' and IFRS 16. We also identified a number of examples of good practice, which are set out in our thematic review report.

There was scope for improvement in most companies we reviewed. The most common areas for improvement were:

Judgements	A number of companies could better explain significant judgements and their impact. In particular there was scope to describe company-specific judgements about the lease term or the scope of IFRS 16.
Accounting policies	Better examples provided policies specific to companies' circumstances. However, we identified a number of companies whose accounting policies relied on boilerplate language, or did not address apparently material items.
Disclosures	Most companies provided the information required by paragraph 53 of IFRS 16, but did not use a tabular format or provide cross references as required, making it hard for a reader to find all the information. In some cases, companies should have better explained their exposure to future cash outflows, e.g. relating to unrecognised lease extension options or variable lease payments.

In addition to considering the broader areas for improvement in our report, we encourage companies to consider whether enhancements are required to IFRS 16 disclosures as a result of Covid-19. These may include amending accounting policies in relation to any lease modifications, in the light of the IASB's emergency amendments to IFRS 16, as well as clearly communicating any significant changes in judgements companies may make, e.g. relating to lease term, as a consequence of Covid-19. Companies may also need to enhance or introduce estimation uncertainty disclosures in relation to impairment testing of right of use assets.

## 4.3 Thematic Reviews (continued)

### Cash flows and liquidity disclosures

Cash flow statements and related disclosures have been an area of focus for CRR in recent years. The objective of the thematic review was, therefore, to explore in more detail issues identified in CRR's routine work as well as to consider some of the themes from the Lab's project: [Disclosures on the sources and uses of cash](#).

We summarise below the key findings emerging from the review. The full report on our findings is to be published in November.

#### Cash flow statement

The majority of companies in our sample complied with IAS 7 in respect of the presentation requirements for the cash flow statement. In line with our findings from routine reviews, we continued to challenge a number of companies where we identified:

- material inconsistencies between items in the cash flow statement and the notes;
- missing or incorrectly classified cash flows; or
- inconsistencies between financing cash flows and the reconciliation of financing liabilities in the notes.

We also identified several areas for improvement in the disclosure of accounting policies for the cash flow statement, in particular, relating to key judgements and the treatment of significant and large one-off transactions.

#### Liquidity, going concern and viability

Several companies which published their accounts before the UK nationwide lockdown in March contained only boilerplate disclosures, particularly in respect of liquidity risk. There was a marked improvement in going concern, viability and liquidity disclosures after this date, primarily as a result of the impact of Covid-19, most notably in smaller listed companies, which is consistent with the findings of our thematic review on the financial reporting effects of Covid-19 published in July 2020.

The majority of these companies disclosed key liquidity information such as availability of cash, undrawn borrowing facilities and compliance with covenants. We did, however, identify that some companies could improve their disclosure of covenant testing, and assumptions and judgements around going concern and viability.

### Quality of reporting in relation to climate change

CRR contributed to a wider FRC thematic review of how companies and auditors assess and report on the impact of climate change. We reviewed the narrative reporting and financial statement disclosures of 24 companies, weighted towards sectors and industries which are perceived to face greater risks relating to climate change.

CRR's thematic work on climate has been carried out alongside a consideration of climate-related issues across the FRC.

- Audit Quality Review (AQR) has considered firmwide policies and procedures at audit firms and assessed a sample of audits for the level and adequacy of the auditor's response to the effects of climate change on the audited entity.
- The Professional Oversight team has assessed the responses of relevant professional bodies and Crown Dependencies' audit regulators to climate-related issues relevant to their respective remits.
- The Corporate Governance and Stewardship Team (CG&S) has evaluated reporting by 60 companies against the UK Corporate Governance Code to assess how boards are taking account of climate-related issues. CG&S has also assessed the evolving approaches investors are taking to reporting on climate-related issues.
- The Lab has re-tested the views of investors regarding best practice climate-related reporting and their views on audit.

The full thematic report, covering governance, corporate reporting, audit, professional oversight and investors' views will be published later this year.

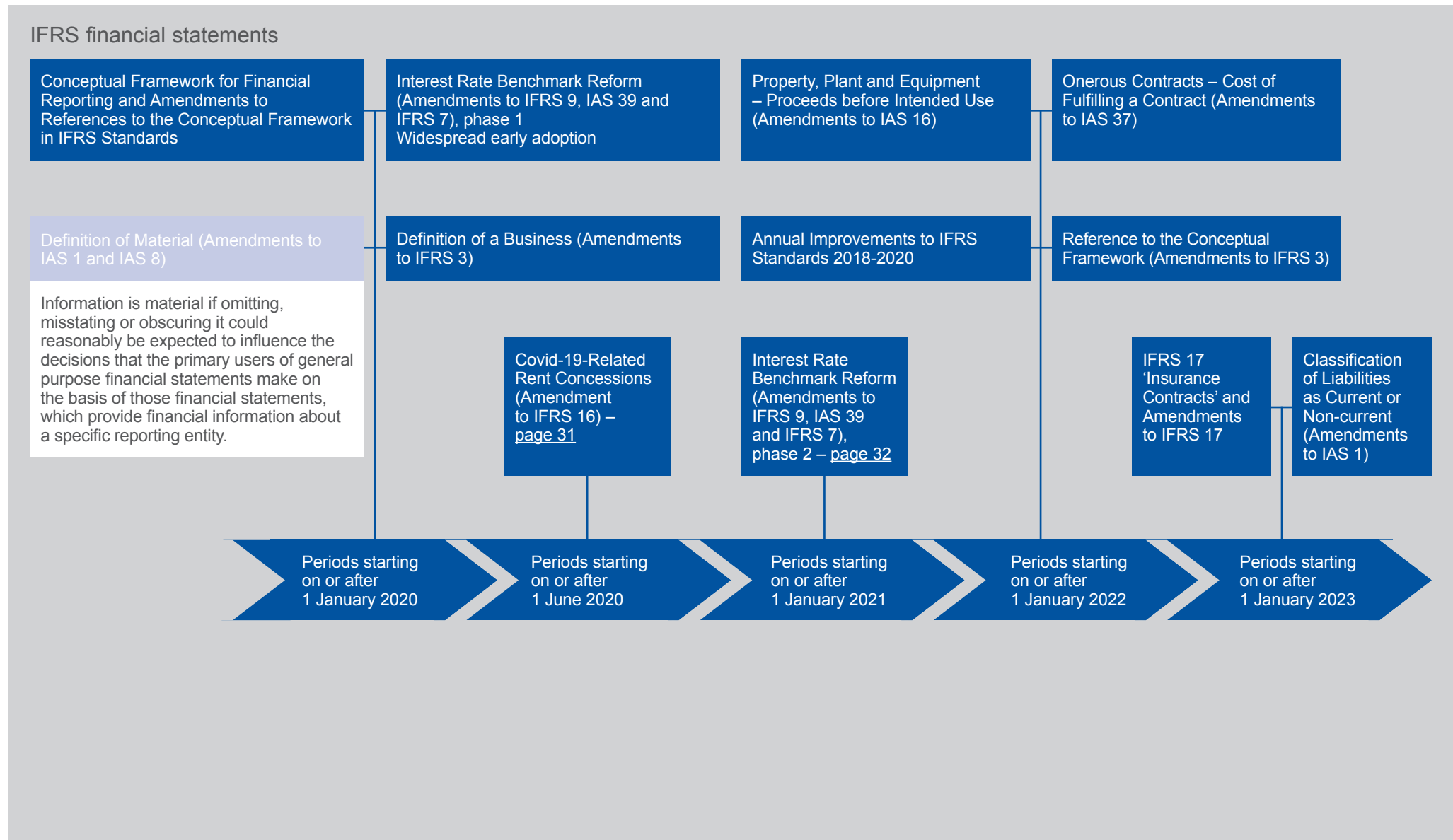
## 5.1 Key disclosure expectations for 2020/21

Our expectations for disclosure in 2020/21 reporting reflect the impact of Covid-19 on users' needs and priorities. We expect to see ...

- ... disclosure of forward-looking information that is specific to the entity and which provides insights into the board's assessment of the business's prospects and the methods and assumptions underlying that assessment.
- ... a clear explanation of any material changes in the business model. We will also assess whether a changed business model is appropriately reflected in the financial statement disclosures of, for example, operating segments, or the allocation and impairment testing of goodwill.
- ... going concern disclosures that explain the basis of any significant judgements, including whether there are any associated material uncertainties, and the matters considered when confirming the preparation of the financial statements on a going concern basis.
- ... consistency between the business model, going concern disclosures, the viability statement and financial statement assumptions and estimates, notably for impairment testing at group and parent company level.
- ... disclosures about significant judgements applied in the preparation of the financial statements, sources of estimation uncertainty and other assumptions made, that enable users to understand management's exercise of judgement and views about the future.
- ... appropriate disclosure of information relevant to understanding the company's financial risk management, particularly the potential impact of debt covenants on liquidity and the use of factoring and reverse factoring in working capital financing.
- ... 'adjusted for Covid-19' alternative performance measures only in exceptional circumstances. Allocation of items such as impairment charges between Covid-19 and non-Covid-19 are likely to be highly subjective and therefore generally unreliable.

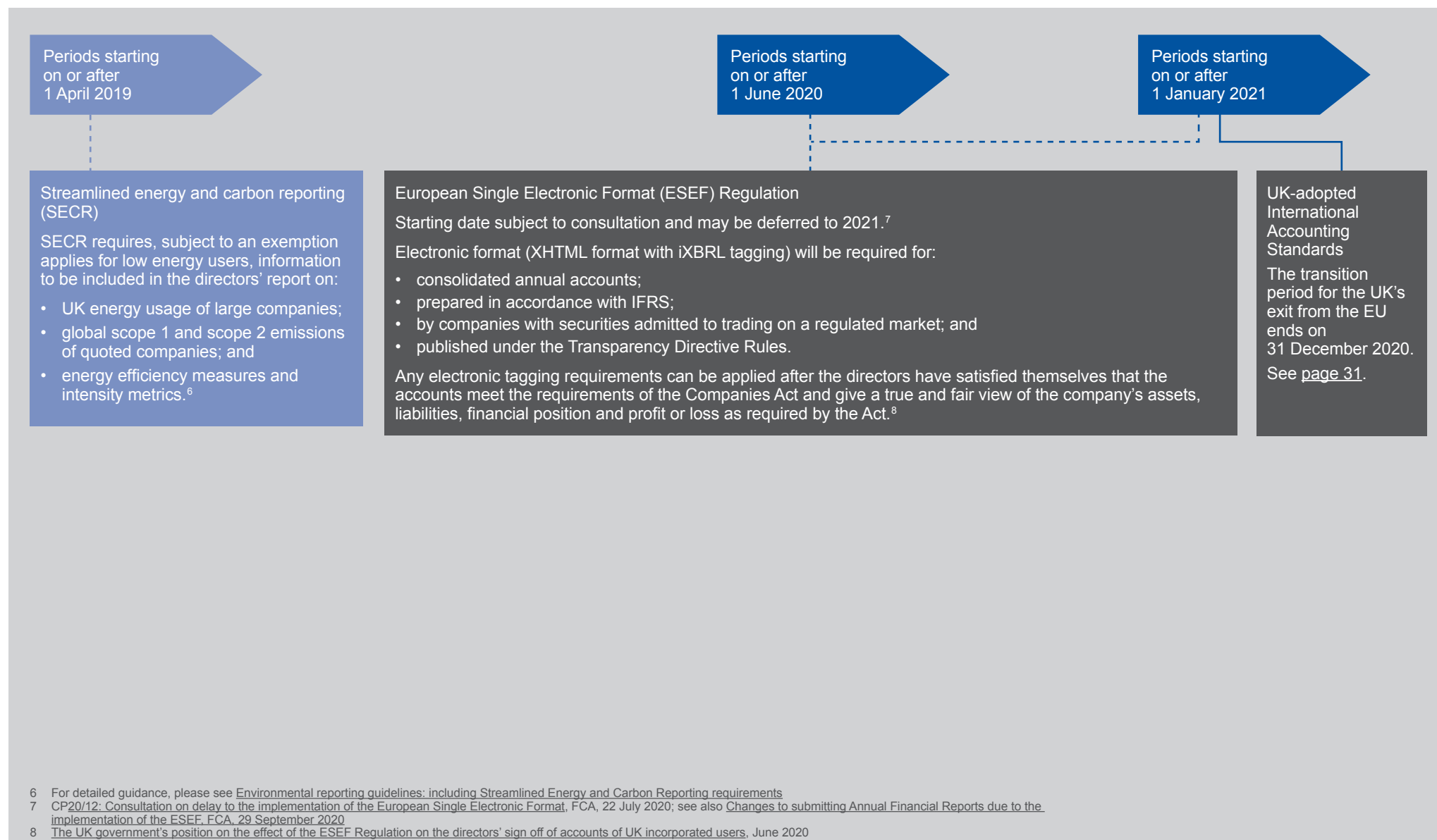
## 5.2.1 Developments in corporate reporting: IFRS

There are a number of changes in IFRS standards coming into effect in 2020-21. Companies should assess the relevance of these to their specific business and any systems or process changes needed to implement the new requirements.



## 5.2.2 Developments in corporate reporting: other key changes

Changes to environmental reporting, submission of accounts with machine-readable 'tagging' and the adoption of International Accounting Standards by the UK after the end of the transition period also need to be considered.



## 5.3 Developments in corporate reporting

### UK endorsement of IFRS

At the end of the Transition Period, SI 2019/685 brings the International Accounting Standards (IAS) already endorsed in the EU into UK law as 'UK-adopted international accounting standards'.<sup>9</sup> New or amended IAS will be endorsed under a power given to the Secretary of State, expected to be delegated to a newly-formed independent body, the UK Endorsement Board.

During the establishment of the UK Endorsement Board, BEIS and FRC have put in place mechanisms to oversee the work of the Endorsement Board staff when developing advice for consideration by the Secretary of State. These include:

- assessment of new IASB standards and amendments against the endorsement criteria in the Regulations;
- outreach to UK stakeholders to gather evidence; and
- making the draft Endorsement Criteria Assessment available for public comment.

The input received, together with the views of the FRC's Corporate Reporting Council, will be used to finalise the Endorsement Criteria Assessment. It will then be submitted to the Secretary of State for formal adoption. The FRC will also publish a Feedback Statement summarising the main comments received and explain how they were incorporated into the final advice.

The transition from EU-adopted IAS to UK-adopted IAS will affect all UK companies that apply EU-adopted IAS in their consolidated or individual accounts.

- Entities with financial years beginning on or before 31 December 2020, but ending on or after that date, continue to apply EU-adopted IAS as at 31 December 2020 and, in addition, have the option to early adopt any UK-adopted IAS.<sup>10</sup>
- Entities with financial years beginning after 31 December 2020 apply UK-adopted IAS.
- Entities with financial years ending before 31 December 2020 but the end of the period for filing the accounts falls after that date continue to apply EU-adopted IAS as at 31 December 2020 and, in addition, have the option to early adopt any UK-adopted IAS.<sup>10</sup>

Further information about UK endorsement and working with the UK Endorsement Board is available on the FRC website.

### Amendment to IFRS 16 – Covid-19-Related Rent Concessions

IFRS 16 Leases contains accounting requirements for lease modifications, including rent concessions. A lessee must determine whether to treat the modification as a separate lease or to adjust the existing lease liability and right of use asset.

In May 2020, following an accelerated due process, the IASB published an amendment providing a practical expedient for preparers accounting for Covid-19-related rent concessions. This amendment is applicable to annual reporting periods beginning on or after 1 June 2020, but may also be adopted early.

The expedient permits a company to elect not to assess whether a rent concession is a lease modification, where the following conditions are met:

- a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- b) any reduction in lease payments affects only payments originally due on or before 30 June 2021; and
- c) there is no substantive change to other terms and conditions of the lease.

Where companies use this expedient, they should disclose this in the notes to their financial statements together with the amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the expedient has been applied.

The amendment received EU endorsement on 9 October 2020, for application, at the latest, as from 1 June 2020 for financial years starting on or after 1 January 2020. This allows for early adoption for periods starting between 1 January and 1 June 2020.

<sup>9</sup> [The International Accounting Standards and European Public Limited-Liability Company \(Amendment etc.\) \(EU Exit\) Regulations 2019 No. 2019/685](#)

<sup>10</sup> [Regulation 1\(5\)-\(8\), as inserted by The International Accounting Standards, Statutory Auditors and Third Country Auditors \(Amendment\) \(EU Exit\) Regulations 2020 No. 2020/335](#)

## 5.3 Developments in corporate reporting (continued)

### Interest Rate Benchmark Reform, phase 2

Phase 2 affects not just those entities that choose to apply hedge accounting, addressed in Phase 1, but any with a LIBOR-referenced contract.

Phase 2 amendments to account for the effects of interest rate benchmark reform provide:

- a practical expedient for modifications required by the reform, applying an updated effective interest rate without having to assess whether the financial asset or liability should be derecognised;
- specific relief so that changes to hedge designations and hedge documentation required by the reform would not result in discontinuation of hedge accounting, provided other qualifying criteria continue to be met;
- an amendment for separately identifiable risk components to cover an initial period when a particular market for financial instruments referenced to an alternative benchmark rate might not yet be sufficiently developed; and
- additional disclosure requirements, with the objective of enabling users to understand
  - the nature and extent of risks arising from interest rate benchmark reform to which a company is exposed, and how it manages those risks; and
  - a company's progress in completing the transition from interest rate benchmarks to alternative benchmark rates, and how it is managing the transition.

These amendments become urgent owing to the timing for the withdrawal of LIBOR, due in 2021. It is therefore anticipated that early adoption is likely to be widespread, subject to the completion of the endorsement process in the EU.

### Definition of Material (Amendments to IAS 1 and IAS 8)

These changes align the definition with language in the Conceptual Framework for Financial Reporting and other standards and were intended to address concerns that the previous definition of material might encourage entities to disclose immaterial information.

The definition now includes the concept that obscuring, as well as omitting or misstating, information is relevant to considering its materiality. Material information should not be obscured by clutter in the financial statements and notes.

### UK GAAP – Amendments to FRS 102, FRS 104 and FRS 105

Effective for accounting periods beginning on or after 1 January 2020:

#### 1. Interest rate benchmark reform

- Affecting specific hedge accounting requirements, to provide relief that will avoid unnecessary discontinuation of hedge accounting during the period of uncertainty as interest rate benchmarks are being reformed.

#### 2. Multi-employer defined benefit plans

- Specifying the presentation of a transition from defined contribution to defined benefit treatment of a multi-employer plan, when the company obtains enough information to apply defined benefit accounting.

#### 3. Covid-19-related rent concessions

- Explicit requirements for accounting for temporary rent concessions for operating leases occurring as a direct consequence of the Covid-19 pandemic, and within a limited timeframe. They shall be recognised over the period the concession is intended to compensate, reflecting the economic substance of the concessions and their temporary nature.

Effective for accounting periods beginning on or after 1 January 2021:

#### 4. Going concern assessments in interim accounts

- Clarifying the requirement to assess the going concern basis of accounting, and requiring the disclosure of any related material uncertainties, when preparing interim financial statements in accordance with FRS 104.

### UK GAAP – Exposure draft

#### 1. *FRED 74 Draft amendments to FRS 102 – Interest rate benchmark reform (Phase 2)*

- Providing relief to minimise discontinuities in the accounting for financial instruments and leases, and avoid unnecessary discontinuation of hedge accounting as agreements are modified in order to transition to alternative benchmark rates as interest rate benchmarks are being reformed.

These amendments are expected to be effective for accounting periods beginning on or after 1 January 2021, with early application permitted. At the time of writing, the FRC is considering the comments from respondents.



## 6.1 How we perform our reviews

### Scope of CRR's work

CRR is responsible for reviewing parts of the annual and interim reports of quoted and large private UK companies in accordance with the [Conduct Committee's Operating Procedures](#).

CRR's statutory function is assessing compliance with legal requirements and relevant accounting standards in:

- the strategic report, including the Section 172 statement and non-financial information statement
- the directors' report; and
- the annual accounts (financial statements).

CRR focuses on the quality of reporting, often suggesting ways in which a company could improve communication with investors. This is consistent with its philosophy of continuous improvement.

We recognise that others with more detailed understanding of a company's business – auditors and Audit Committees – may also have recommendations for future improvement. We encourage companies to consider these.

#### Review

- We select companies based on a risk assessment across the main market and AIM, with rotation for the FTSE 350
- We perform desktop reviews of published information.
- In most cases, CRR review all areas of the annual report that are within scope for the selected companies.
- Full or targeted reviews are performed in response to complaints indicating a potential breach. There were 19 such cases in 2019/20 (2018/19: 28)
- Thematic reviews focus on areas of particular stakeholder interest, looking at just a single aspect of a selected sample of annual reports. [Pages 23-27](#) provide summaries of the 2020/21 thematic reviews.

#### Correspondence

- If there is a question as to whether there is, or may be, a breach of the relevant reporting requirements, CRR will write to the company to obtain sufficient information to determine whether there is in fact a breach or opportunity for improvement.
- Otherwise, we may highlight areas for improvement without asking for a substantive response.

#### Engagement

- Most companies with whom we engage want to do the 'right thing' and engage with CRR on a voluntary basis with a view to improving their corporate reporting.
- We rarely invoke our statutory power, under the Companies Act 2006, to require companies, their officers or their auditors to provide any information and explanations required to carry out CRR's function.
- We used the power to obtain information once last year, at the company's own request (2018/19: no use of statutory powers).
- We have not formed a Review Group for any case in 2019/20.

#### Outcome

- Our enquiries may lead to the company volunteering or agreeing to correct numerical errors, restate comparative figures in subsequent accounts or improve narrative disclosures.
- For details of the more significant outcomes in the period, see [section 6.3](#).
- We always follow up to ensure companies fulfil undertakings to make specific improvements in subsequent reports.

#### 2020 thematic review topics

Financial reporting effects of Covid-19  
IFRS 15 'Revenue from Contracts with Customers': a follow-up review  
IFRS 16 'Leases': first year of implementation  
Cash flow and liquidity disclosures  
Quality of reporting in relation to climate change

For developments in our scale, transparency and scope of reviews, please see 'Transforming the FRC' on [page 38](#).

## 6.2 Review activities for the year

### Number of reviews for the year

We performed 216 reviews in 2019/20. Our focus continued to be on larger companies, with 67% of our reviews being FTSE 350 companies. These statistics are broadly similar to previous years. In 2018/19, we performed 207 reviews (2017/18: 220 reviews), of which 65% related to FTSE 350 companies (2017/18: 60%).

	FTSE 100	FTSE 250	Other	Total
Full scope reviews*	19	52	40	111
Thematic reviews	38	35	32	105
	<b>57</b>	<b>87</b>	<b>72</b>	<b>216</b>

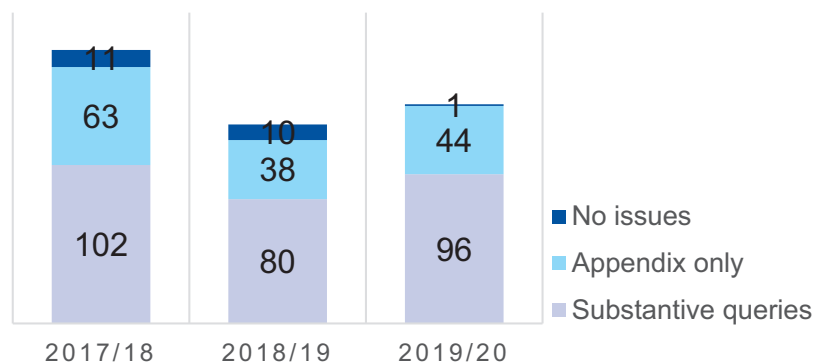
\*Includes 19 complaints (see below)

### Complaints

We continue to welcome well informed complaints to supplement our risk-based selection of reports and accounts for review. In the year to 31 March 2020 we received 29 complaints (2018/19: 28; 2017/18:11). Of these, 19 resulted in an approach being made to the company that was the subject of the complaint. Further [information on how we address complaints and referrals](#) is available on our website.

### Queries raised with companies

We wrote to 96 companies raising substantive queries on which a response was sought (2018/19: 80; 2017/18: 101), which represents a “write-rate” of 44% (2018/19: 39%; 2017/18: 46%).



A 'no issues' letter informs the company that we have performed a review and identified no issues of sufficient significance to draw to the company's attention.

'Appendix only' letters convey less significant matters where the company may not have complied with the relevant legal, accounting or reporting requirements or where there is opportunity for enhancing the general quality of reporting, but no substantive queries have been raised.

### Response times

Companies are asked to respond to our initial letters within 28 days, so that potential matters are addressed promptly. Reasonable requests for extensions are granted. Where possible, we aim to respond to companies' letters within 28 days, although the response time may be higher on more complex cases.

Companies' average response time: 32 days (2018/19: 32 days)

FRC average response time: 25 days (2018/19: 31 days)

### Cases completed

We aim to close our correspondence with companies in time for agreed improvements to be reflected in their next reports and accounts, ensuring that better quality information is in the public domain at the earliest opportunity.

- 97% of 2019/20 reviews were completed by the date of this publication (2018/19: 96%; 2017/18: 92%).
- 94% of these completed cases (2018/19: 93%; 2017/18: 85%) were completed before the next set of reports and accounts were due for publication.

### Working with other regulators

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

We also liaise with the Prudential Regulation Authority on matters of mutual interest regarding financial institutions and may share information, e.g. on complaints that affect both corporate and prudential reporting.

## 6.3 Publication of CRR interaction

### Press Notices

- At the conclusion of our most significant cases, we may issue a press notice in order to bring the matter to the attention of a wider audience.
- This is usually restricted to those cases where there is a significant material change, such as to a primary statement or the content of the strategic report.
- During the year, we issued one press notice (2018/19: none; 2017/18: one), in respect of our review of the annual report and accounts for the year to 30 June 2018 of Galliford Try plc.<sup>11</sup> This highlighted the company's disclosures in its December 2019 interim accounts that:
  - it should not have recognised an £80m claim recoverable from the customer on the Aberdeen Western Peripheral Route contract at 30 June 2018;
  - it should not have recognised claims recoverable from third parties at 30 June 2018; and
  - the derecognition of these claims on adoption of IFRS 15 should have been treated as the correction of an error.
- Galliford Try plc had previously restated its cash flow statement to present loans and advances to joint ventures as investing rather than operating activities, as a result of CRR's enquiries, which we referred to last year.

### References

- This year 14 companies (2018/19: 11; 2017/18: 15) were required to refer to the corrective action taken following CRR review.
- The 14 required references this year are outlined below.

### Cash flow statements

- Errors relating to cash flow statements were again the most common reason for required references.
- SIG plc had reported payments of purchase consideration conditional on the continuing employment of the vendors in the business as investing cash flows, restating the cash flow statement to show them as operating cash flows.
- Cineworld Group plc's comparative cash flow statement was restated due to a number of errors (e.g. a \$202m unpaid liability was treated as a cash outflow, \$50.6m of acquisition-related expenses were classified as investing cash flows rather than as operating cashflows and \$88.4m paid on the settlement of a derivative was omitted from the cash flow statement).

- Anglo American Woodsmith Limited, formerly Sirius Minerals plc, restated its comparative cash flow statement to reclassify \$9.1m of movements in certain restricted cash balances, which were included in financing activities rather than in investing activities.
- Angling Direct plc restated its cashflow statement to reclassify payments for the purchase of businesses from operating activities to investing activities and to exclude from the cash flow statement new finance leases that were non-cash transactions.
- Manolete Partners PLC had presented cash outflows on its investment in legal cases and the purchase of property for resale, relating to a case settlement, within investing activities. However, the cash inflow upon settlement of cases was presented within operating activities, consistent with presenting the settlement consideration as revenue in the income statement. Both types of cash outflow should have been presented within operating activities because they arose in respect of the company's principal revenue-producing activities and resulted from transactions that enter into the determination of profit or loss. The company restated its cash flow statement accordingly.

### Earnings per share (EPS)

- Manolete Partners PLC sub-divided and then consolidated its existing £1 shares, converted 'A' shares into ordinary shares and issued bonus shares during the year to 31 March 2019. However, the company did not adjust the number of shares used in the determination of EPS at 31 March 2018 to reflect these changes. The company disclosed restated basic and diluted EPS for 2019 and 2018 in its March 2020 annual report, applying the effect of the share reorganisation retrospectively in accordance with IAS 33.
- Another company failed to reflect the impact of a post-year-end share consolidation on its EPS calculations and based the earnings on an incorrect measure.

### Interim dividends

- Following our review, British American Tobacco p.l.c. revised its accounting policy for the accrual of interim dividends. Previously these had been incorrectly recognised when declared but not yet paid.

<sup>11</sup> Findings of the FRC in respect of the report and accounts of Galliford Try plc, 12 March 2020

## 6.3 Publication of CRR interaction (continued)

### Purchase of own shares

- Whitbread PLC restated its balance sheet to recognise a liability for the purchase of own shares, with a corresponding adjustment in equity, as an irrevocable commitment existed at the year end.

### Consolidation

- In its 2019 accounts, Dignity Plc disclosed that, after CRR's review of its 2017 annual report and accounts, it had changed its treatment to consolidate funeral trusts holding assets relating to pre-need funerals. Management has concluded that greater weight should be placed on the company's ability to appoint and remove trustees of the trusts, and that the company does have control of the trusts, as defined by IFRS 10 'Consolidated Financial Statements'.

### Impairment of assets

- Vesuvius plc identified, following our correspondence, that their goodwill impairment tests had been incorrectly performed at the reporting segment level in prior years. Having reperformed the tests at the level of operating segments, the largest grouping of cash generating units permitted by IAS 36, the company restated the opening balance sheet for the comparative period to recognise impairment of goodwill and tangible assets.
- Bilby Plc had recognised the full amount of the impairment of the cost of investment in a subsidiary directly in its merger reserve. The company should have debited the full amount to profit and loss, with a reserves transfer from the merger reserve limited to the amount relating to that investment.

### Classification of assets

- CVS Group plc restated its parent company balance sheet to reclassify amounts receivable from group undertakings as non-current to reflect the period over which they are expected to be repaid, as required by IAS 1.<sup>12</sup>
- Renishaw plc revised its accounting policy for cash and cash equivalents as a result of our review, to ensure that only deposits which are short term, highly liquid and subject to insignificant changes in value were included. The change in accounting policy resulted in a prior year reclassification of certain deposits from cash and cash equivalents to other assets. The company also restated the cash flow statement to show amounts that did not meet the revised accounting policy definition of cash and cash equivalents as a cash outflow from investing activities.

### Revenue recognition

- Alpha Financial Markets Consulting plc concluded that accounting for rechargeable expenses on an agency (or net) basis within revenue was not in accordance with the requirements of IFRS 15. As a result, the company restated its prior year revenue and cost of sales figures to show income from rechargeable expenses on a gross basis.

<sup>12</sup> IAS 1 'Presentation of Financial Statements', paragraph 66

## 6.4 Post-review survey

CRR aims for continuous improvement not only in corporate reporting but also in its own practices. In accordance with the Regulators' Code (2014), we seek to provide simple and straightforward ways to engage with those we regulate and hear their views

From April 2019, CRR has collected anonymous feedback from company directors and key staff on their experience of an enquiry through an online survey. The requested feedback covers a majority of the reviews completed in 2019/20 that led to substantive questions being raised. The anonymised responses indicated that we have received views representing a wide range of companies and roles.

We ask the Chairman, CFO, Audit Committee Chair, and anyone else with primary responsibility for responding to our letters three questions:

Did you consider the matters raised to be clear and understandable?

Yes: 98%

Were the matters raised in our review relevant to your company?

Yes: 95%

Were the outcomes of our review proportionate?

Yes: 95%

Results are from responses received to 31 March 2020.

We also ask for respondent's views about the usefulness of our annual publications. The responses show that our main publications – the Annual Review, thematic reviews, and FRC year-end advice letter – are well received, with over 80% rating them as 'very' or 'somewhat' useful.

We invite comments on the survey questions and consider them carefully alongside the standard responses. Where respondents chose to identify themselves, we engaged with them to better understand their views and identified potential improvements to our processes and approach:

- We continue to focus on the timing of correspondence, aiming to write to companies well before the next balance sheet date so as to allow sufficient time for incorporating changes in the next accounts.
- Where certain companies have not previously received an enquiry from us, we now offer them an opportunity for an informal discussion to help them to understand the scope of our enquiry and how we expect them to approach our questions.

## 6.5 Transforming the FRC

During the year, with the finalisation of the CMA audit market study in April 2019 and Sir Donald Brydon's report issued in December 2019, the transition to the new ARGA envisaged by Sir John Kingman has become a wider transformation programme for the FRC as a whole.

Where possible, the FRC has been acting to implement the recommendations of the Kingman report that are relevant to corporate reporting, in advance of primary legislation. The table below summarises progress in these areas. Some recommendations, such as giving the FRC powers to direct a company to change its disclosures in the annual report and accounts, or to obtain expert reports on matters under enquiry, will depend on enabling legislation.

	The Review recommends ...	Action to implement
24	... that the regulator should consider expanding the volume of CRR activity on a risk-based basis.	The CRR team is growing, to take on more cases. It now comprises 25 Case Officers and Directors, up from 17 in April 2019. We are using additional business intelligence input to enhance our risk-based selection approach.
26	... that CRR findings are reported publicly by the regulator. The regulator should publish full correspondence following all CRR reviews, and the findings should be published in a set timeframe.	As part of its 2020/21 review cycle, with the companies' consent, CRR will start publishing case summaries setting out our principal findings from a review and the outcome of engagement with companies. Pending a change in law to address confidentiality constraints, we will contact each company to explain the extent to which we intend to publish information about the review, to share our proposed text and to obtain consent to its publication.
29	... that the stronger corporate reporting review process described earlier should be extended to cover the entire annual report, including corporate governance reporting. This should be done on a risk-based basis.	In its 2020/21 review cycle, CRR will, for a sample of companies, raise matters on areas outside its current statutory enforcement powers. Where appropriate, we are drawing companies' attention to areas of potential improvement in areas such as their reporting of governance and stakeholder engagement. The effectiveness of this pilot scheme will inform the drafting of potential future legislation.
30	... considering whether there is a case for strengthening qualitative regulation around a wider range of investor information ... to ensure that disciplines to drive up the quality of companies' disclosures in the UK are at least as demanding as best practice internationally.	For a risk-based sample of 2020/21 cases, CRR is reviewing preliminary announcements of full-year results and the related presentation of information to investors and analysts, to identify any material inconsistency with disclosures in the annual report and accounts. The findings of this work will inform the next steps to be taken in collaboration with the FCA.

"Given the significant number of recommendations for change before the Government, we have taken action to implement as many as possible with existing powers and influence."

"We have now implemented 20 of the 83 recommendations in the Kingman Review. We are progressing as much as we can whilst waiting for the legislation to establish the ARGA on a statutory footing."

Sir Jon Thomson, Chief Executive,  
[FRC Annual Report 2020](#)



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