

12th April 2017

Dear Investor

Ahead of the annual reporting season

I am writing ahead of the 2017 shareholder meeting season to highlight some recent changes and developments in reporting which I hope will be helpful.

Overall aim of the annual report

The purpose of the annual report is to communicate relevant information to investors, and the annual report as a whole should be fair, balanced and understandable. The FRC encourages clear and concise reportingⁱ, which includes avoiding boilerplate disclosures and ensuring that the report and accounts only contain material information.

We encourage investors to engage with companies to provide a steer on what information they believe is relevant and to challenge where reporting falls short of expectations.

When we wrote to companiesⁱⁱ ahead of the annual report preparation season, we reminded them that investors call for annual reports to be more user-friendly and information to be communicated more clearly. We hope that many of the suggestions we made to them will have improved the quality and usefulness of the disclosures that you see. Some areas of focus are outlined below.

Strategic report

Business model reporting

A Financial Reporting Lab reportⁱⁱⁱ, published in October, identified room for improvement in the clarity with which many companies explain how they make money and what differentiates them from their peers.

Alternative performance measures (APMs)

We continue to monitor how alternative performance measures (or 'non-GAAP' measures) are used to report performance.

This year will be the first in which the European Securities and Markets Authority (ESMA) 'Guidelines on Alternative Performance Measures' apply to annual reports. You should expect to see disclosures that give a clear and complete understanding of the APMs presented, how they are calculated and why they are useful and, where relevant, reconciliation to amounts presented in the financial statements.

We issued FAQs^{iv} on this topic in May 2016 and in November published a thematic study on the use of APMs in interim reports^v issued since the guidelines became effective.

Risk reporting and viability statements

Amendments to 'The UK Corporate Governance Code' (the Code) in 2014 introduced reporting of a longer-term view of a company's prospects in a viability statement. Our initial assessment of statements suggests that there is little variation in disclosures between business sectors. This year, we have encouraged companies to provide clear disclosure of why the period of assessment selected is appropriate for the particular circumstances of the company, what qualifications and assumptions were made, and how the underlying analysis was performed.

Brexit

In light of the referendum vote in favour of the UK leaving the EU, companies will need to consider the consequential risks and uncertainties in the political and economic environment and the impacts of those risks and uncertainties on their business. We highlighted matters that Boards should consider in relation to the potential impact of the referendum result in our press release of 12 July, 'Reminders for half-yearly and annual financial reports following the EU referendum'^{vi}.

As the economic and political effects are developed and become more certain in the medium and longer term, we would expect Boards to provide increasingly company specific disclosures with, ultimately, quantification of the effects.

Governance reporting

The FRC's Corporate Governance Code operates on a comply or explain basis. Where companies elect not to comply with key provisions of the Code, they should provide specific, explanations. As a reminder, this means setting out the background, providing a clear rationale for the action being taken and describing any mitigating activities. We encourage investors to challenge companies where they do not believe that explanations given are sufficiently persuasive.

Audit committee report

In 2015, the FRC issued its 'Audit Quality Practice Aid for Audit Committees'^{vii} to assist Audit Committees in evaluating and reporting on audit quality in their assessment of the effectiveness of the external audit process. You should expect to see this reporting in the context of the company's business model and strategy, the business risks it faces, and its perception of the reasonable expectations of the company's investors and other stakeholders.

Financial statement disclosures

Tax

The FRC's thematic study of tax reporting^{viii} identified areas for improved disclosure. We reminded companies that they should articulate how they account for material tax uncertainties by explaining the bases for recognition and measurement. We expect more companies to disclose the amount of their tax provisions than in previous years.

Dividends

In 2015 the FRC's Financial Reporting Lab produced a report^{ix} on best practice in dividend disclosures. We have already noted examples of improved disclosure, and expect to see more over the coming reporting period. You may wish to challenge companies that provide insufficient information in this area.

Low interest rates

We reminded companies that they should consider the impact of low interest rates on the amounts reported in their financial statements. In particular, careful consideration should be given to the valuation of long term assets and liabilities, for example the effects of adjusted discount rates on pension scheme liabilities and suppressed returns on pension scheme assets. Companies may need to provide sensitivity analysis to highlight the potential impacts.

Accounting policies, significant accounting judgements and estimates

It is important that companies explain significant judgements and accounting policy choices, particularly where there is diversity of treatment, in pension reporting, for example.

There continues to be room for improvement in the disclosure of accounting policies, particularly in relation to revenue recognition. You should be able to see a clear link between the sources of income described in the business model and revenue recognition policies.

You should also expect companies to identify the precise nature of the judgements they make rather than merely repeat the accounting standards. This will help you assess the quality of management's policy decisions.

Clear descriptions of sources of estimation uncertainty should explain the extent to which the values of assets and liabilities have the potential to change materially in the next year. We have reminded companies to consider whether quantitative disclosures, such as sensitivities or ranges of outcomes, are required so that users can fully understand the potential effect of estimates.

Developments in IFRS

The International Accounting Standards Board has published three major standards that will become effective in the next few years: IFRS 15 *Revenue from Contracts with Customers* (effective for periods beginning 1 January 2018), IFRS 9 *Financial Instruments* (effective 1 January 2018), and IFRS 16 *Leases* (effective 1 January 2019). Given that comparative periods for IFRS 15 and IFRS 9 will be commencing from 1 January 2017, we expect that most companies that apply IFRS will have made substantial progress in their implementation of these standards. You should expect to see companies provide information on this progress and disclose the likely impacts of each of the new standards once they can be reasonably estimated.

Investor feedback

Finally, we would welcome any general or specific comments you may have on the quality of corporate reporting. We would be happy to highlight examples of best practice to encourage broader adoption. For serious concerns, the FRC also has a formal complaints mechanism via our Corporate Reporting Review team: <https://www.frc.org.uk/About-the-FRC/Making-a-complaint-to-the-Financial-Reporting-Coun.aspx>

I hope that you find this letter useful and look forward to your feedback.

Yours sincerely

A handwritten signature in black ink that reads "Stephen Haddrill". The signature is fluid and cursive, with a long horizontal stroke at the end.

Stephen Haddrill
Chief Executive

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ⁱ Further information on the FRC's Clear & Concise initiative is available at <https://www.frc.org.uk/Our-Work/Headline-projects/Clear-Concise.aspx>

Corporate Reporting Review Annual Report 2015 – including Clear & Concise case study (pages 15-17). <https://www.frc.org.uk/Our-Work/Publications/Corporate-ReportingReview/Corporate-Reporting-Review-Annual-Report-2015.pdf>

ⁱⁱ The FRC issues advice to preparers of listed companies <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/October/The-FRC-issues-advice-to-preparers-of-listed-compa.aspx>

ⁱⁱⁱ Financial Reporting Lab report on Business model disclosures <https://frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-Business-model-disclosure.pdf>

^{iv} FAQs on ESMA APM Guidelines <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/May/FAQs-on-the-application-of-the-European-Securities.aspx>

^v FRC Thematic review of the use of APMs in interim reports <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/November/Improved-reporting-of-alternative-performance-meas.aspx>

^{vi} Reminders for half-yearly and annual financial reports following the EU referendum <https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/July/Reminders-for-half-yearly-and-annual-financial-rep.aspx>

^{vii} Audit Quality Practice Aid for Audit Committees <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/May/FRC-provides-aid-to-Audit-Committees-in-evaluating.aspx>

^{viii} FRC's thematic review of tax reporting <https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/October/FRC-thematic-review-welcomes-improved-transparency.aspx>

^{ix} Financial Reporting Lab report on best practice in dividend disclosures <https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-Project-Report-Disclosure-of-dividends-%E2%80%93-poli.pdf>

Financial Reporting Lab implementation study: Disclosure of dividends – policy and practice <https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-Implementation-Study-Disclosure-of-dividends-%E2%80%93-poli.pdf>