



The Financial Reporting Lab marks its first year

Chartered Accountants' Hall, Moorgate Place, London

22 November 2012

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Agenda

08:00 **Guests arrive**

Breakfast and refreshments

08:30 **Welcome**

Michael Izza, Chief Executive Officer, ICAEW

08:40 **Panel discussion - initial projects**

Chaired by: Stephen Haddrill

- Nick Anderson
- Graham Morrison
- Russell Picot
- Jeannette Andrews
- Victoria Whyte

09:15 **Participant round table discussions – future directions**

Chaired by: Sue Harding

10:00 **Event concludes**

What is the Lab?

The Financial Reporting Lab was set up by the Financial Reporting Council in October 2011 to improve the effectiveness of corporate reporting in the UK.

The Lab provides a safe environment for listed companies and the investment community to explore innovative reporting solutions that better meet their needs.

Lab project reports summarise observations on practices that investors find useful to their analysis and encourage companies to consider adopting the practices if appropriate in the context of their own reporting.

Find out more about the Lab at: <http://www.frc.org.uk/Our-Work/Codes-Standards/Financial-Reporting-Lab.aspx>

Do you have suggestions to share?

The Lab encourages all parties with an interest in corporate reporting to provide comments on its project reports and ideas for new projects. To provide comments, please send us an email at:

FinancialReportingLab@frc.org.uk

Speakers

Michael Izza

Chief Executive Officer, ICAEW
Member, Lab Steering Group

Stephen Haddrill

Chief Executive, FRC
Chair, Lab Steering Group

Nick Anderson

Investment Manager, Global
Equities Team, Henderson Global
Investors Limited
Member, FRC Accounting Council
Lab project participation: Debt
and cash flows, Remuneration

Jeannette Andrews

Analyst, Responsible Investment,
USS Investment Management
Lab project participation:
Remuneration

Graham Morrison

Head of External Reporting,
Vodafone
Lab project participation:
Debt and cash flows

Russell Picot

Group Chief Accounting Officer,
HSBC
Co-chair, Enhanced Disclosure
Task Force

Lab project participation:
Presentation of market risk
disclosures

Victoria Whyte

Company Secretary,
GlaxoSmithKline
Lab project participation:
Remuneration

Sue Harding

Director, Financial Reporting Lab,
FRC

Sue is director of the Lab and a
financial reporting analyst. She is
a qualified accountant and has
significant experience in credit
rating and equity analysis.

The FRC thanks the ICAEW for
hosting both the Lab's launch event
and this first year event.

Lab Steering Group

Chair:

Stephen Haddrill
Chief Executive Officer –
Financial Reporting Council

Members:

Mike Ashley
Head of Quality & Risk – KPMG
Vice Chairman – Technical Expert
Group, European Financial Reporting
Advisory Group

Amra Balic
Head of Corporate Governance and
Responsible Investment – EMEA

Nick Osborne
Head of Research UK Equity Team -
BlackRock Investment Management

Hussein Barma
Chief Financial Officer (UK) –
Antofagasta

David Barnes
Managing Partner Public Policy –
Deloitte

Richard Carter
Director Business Environment –
Dept. for Business, Innovation &
Skills

Michael Izza
Chief Executive Officer –
Institute of Chartered Accountants in
England & Wales

Roger Marshall
Chairman – FRC Accounting Council
Non-Executive Director and Audit
Committee Chair – Old Mutual

Melanie McLaren
Executive Director Codes &
Standards - FRC

Joanna Osborne
Deputy Chair – Financial Reporting
Review Panel, FRC

Sallie Pilot
Director of Research and Strategy –
Black Sun

Michael Power
Professor of Accounting and Director
- Centre for the Analysis of Risk and
Regulation, London School of
Economics

Alison Thomas
Global Head of Investment
Community Engagement – PwC

Charles Tilley
Chief Executive – CIMA

Alan Trotter
Finance Director - Alliance Trust

Andrew Tusa
Managing Director of Corporate
Broking, Europe – Bank of America
Merrill Lynch

William Underhill
Partner – Slaughter & May
Chairman – City of London Law
Society Company Law Committee

Tim Ward
Chief Executive –
The Quoted Companies Alliance

Also serving as members of the Lab's Steering Group during the year:

Margaret Ewing
Deloitte - retired

Fiona Ellard
BlackRock Investment Management

Initial projects

From the start, we have made it a priority that the agenda of the Lab be driven by companies and investors, not the FRC. In that spirit, shortly after launching the Lab in October 2011, the Lab announced a list of project topics which had been suggested by both companies and investors in pre-launch discussions. The Lab encouraged companies and investors to express interest in participating in these projects directly.

These topics were:

Financial statements

- Net debt reconciliation
- Debt terms and economic obligations
- Debt maturity schedule
- Cash flow statement
- Tax reconciliation
- Own credit adjustments
- Accounting policy disclosures
- Share-based payments (materiality)

Narrative reporting

- Business models

Governance

- Remuneration report

To date, the Lab has published three reports relating to disclosure of debt and cash flows (the first four projects on the list) and a report on a single

figure for directors' remuneration, related to the last project on the list.

The Lab intends to take forward a project on accounting policy disclosure. The projects on own credit and share-based payment disclosure are unlikely to be taken forward by the Lab (there are related accounting standard projects underway). The scope for a project on business models and other aspects of narrative reporting continues to be considered.

Projects completed

Debt and cash flows

The Lab combined the first four topics into a single project on which we have published three separate reports:

- Net debt reconciliations (September);
- Debt terms and maturity tables (November); and
- Operating and investing cash flows (November).

Five companies that have already worked to improve disclosures in these areas offered the potential for the Lab to highlight existing reporting practice found to be useful by the investment community. These companies are BT, National Grid, Royal Dutch Shell, Vodafone and Xchanging. Over 30 investors and analysts from 16 investment organisations provided input.

In this project, the Lab facilitated discussion on aspects of reporting that investors showed a relatively greater interest in, to understand whether and how various characteristics of information are used by individual investors.

The three reports aim to help companies enhance their own reporting of debt and cash flows. In an environment where liquidity is far from being assumed, clear reporting on these topics can be essential for a company, particularly when debt is significant to its capital structure.

The reports provide practical hints from companies, investors and analysts on how to make reporting on these topics more straightforward, and illustrate many of the points using examples from the published reports of the five companies.

While the project has generally demonstrated the need for clear, and potentially more, disclosure on these topics in light of the economic climate and company circumstances, there are a few areas highlighted that could help companies consider trimming disclosure. For example, effective reporting could mean that:

- debt maturity tables that present the maturity of the balance sheet amount of debt could generally be removed, as long as contractual payment amounts are disclosed;
- cash flow statements that start with operating profits could eliminate the repetition of amounts

between operating and net profits at the top of the statement; and

- by capturing certain information in a clearly worded table, for example in a net debt reconciliation or debt maturity table that is shown to relate to the carrying amount of debt on the balance sheet, related narrative text could be shortened.

Remuneration - single figure

An initial phase of this project was undertaken at the request of the Department of Business Innovation and Skills (BIS) in connection with their policy decisions on executive remuneration. The project specifically focused on a single figure for directors' remuneration.

The Lab worked closely with nine leading companies and 12 investment organisations in preparing the proposals contained in the project report. The proposals describe the components of remuneration that the investors involved in the project believe should be contained within a single figure, as well as how these components should be measured and related disclosure.

The BIS *Consultation on revised remuneration reporting regulations* aimed at 'increasing transparency on directors' pay', and was published on 27 June 2012. The consultation acknowledges that the proposals contained within the revised reporting regulations 'build on the outcomes of the Lab's project.' Also at the request

of BIS, the Lab is undertaking a second project on remuneration, described in the section *Forward agenda*.

While we currently expect the final requirements to be published by BIS in the Spring of 2013, we understand that some companies are beginning to incorporate the proposals in their reporting this year.

We thank Janice Lingwood for her leadership of this project.

Projects in progress

Presentation of market risk disclosure

We have also undertaken a project with the support of HSBC, exploring the presentation of market risk disclosures in interim and annual reports. The project focused on changes made by HSBC to separate key assumptions and current period risk results from static policy and procedure information that is now shown in an appendix to the risk disclosure. We also sought investor views more broadly on the content and timeliness of risk disclosures. We expect to publish a report on this project by the end of the year.

Is the approach taken to reporting Lab project results helpful?

Initial project list – other topics

Tax reconciliation

This project would explore the usefulness of reconciliations that explain the relationship between actual tax expense and the tax expense at statutory rate, and other aspects of tax disclosure that are of interest to companies and investors.

For example, options under IFRS allow the reconciliation to be made from the rate of the country in which the company is domiciled or from a blended rate for individual jurisdictions in which it operates, and allow the reconciliation to be presented in either currency amounts or rates of tax. The usefulness of specific reconciling items could also be explored, as well as explanations of the relationship between tax paid and tax expense.

Before starting another project focused on financial statement reporting, we felt it would be best to first complete the work on debt and cash flow disclosure. With this now complete, we will again consider initiating this project if there seems to be sufficient interest.

Accounting policy disclosures

See the section *Forward agenda* as this is one of the four projects that the Lab intends to undertake next.

Own credit adjustments

This project would consider the disclosure of adjustments for changes in the company's own credit risk that have not yet been realised, including the 'cumulative' amount of such gains or losses. Regulators and analysts regularly seek to adjust various financial measures to remove this accounting effect, and banks often disclose non-GAAP measures that exclude these amounts.

While this continues to be topical and significant particularly for banks, we did not receive sufficient interest from companies to warrant a project. Longer term, the accounting will be changed under IFRS 9, once it is endorsed for use in Europe.

Share-based payments (materiality)

This project would highlight innovations to cut back on disclosure of less material share-based compensation plans. While we believe that companies are generally making progress on this topic, the interest from companies in participating in a project with investors has been insufficient to warrant a project, and accounting standard research is underway.

Narrative reporting / Business models

The initial aim of this project was to evaluate the effectiveness of descriptions of company business models, seeking to highlight some initial published examples that investors feel are useful. In order to help companies most effectively, we have held off starting this project while BIS has progressed its new narrative reporting requirements. The consultation on this has now closed and we await the final requirements from BIS. Related to this, early next year the FRC will consult on the associated guidance.

We will continue to consider whether there is an opportunity beyond the new BIS requirements and the FRC guidance, for the Lab to provide evidence of practices that will most effectively meet the requirements and help companies innovate in this area. This might include the specific aspect of disclosing information on the business model, or other aspects of narrative reporting.

Participants in initial projects

We are grateful for the participation of companies, investors and analysts, and others that worked with us over the year to deliver on the promise of the Lab.

In all, 13 companies and 24 investment organisations contributed to projects that have been reported on thus far.

Company participation

In the first year, the following 13 companies worked with the Lab to provide insight on what is practical from a company perspective and in some cases, volunteer aspects of their reporting to be 'tested' for investor views:

- BHP Billiton
- BT Group
- Cobham
- GlaxoSmithKline
- HSBC Holdings
- InterContinental Hotels Group
- Legal & General
- National Grid
- Rio Tinto
- Royal Dutch Shell
- The Royal Bank of Scotland Group
- Vodafone
- Xchanging

Investment community participation

The following 24 organisations contributed views from the investor community in their capacity as investors or other analyst organisations that work in the interest of investors:

- Allianz Global Investors
- Association of British Insurers
- BlackRock Investment Management
- CFA Institute
- CFA Society of the UK
- CreditSights
- Deutsche Bank
- Fidelity Management and Research
- Fidelity Worldwide Investments
- Fitch Ratings
- Goldman Sachs Asset Management
- Henderson Global Investors
- Hermes Fund Managers
- Institutional Investment Advisors
- Investment Management Association
- JP Morgan
- Legal & General Investment Management
- Moody's Investors Service
- Royal London Asset Management
- RPMI Railpen Investments
- Schroder Investment Management
- ShareSoc (UK Individual Shareholders Society)

- UBS
- USS Investment Management

These 24 organisations cover a wide spectrum of use of reported information by institutional and retail investors, broker sell-side and independent research organisations, credit rating agencies, analyst associations and other advisors.

Often, views were presented from several vantage points within an organisation, for example, from the perspective of investors in debt instruments and in equities, and from governance specialists, portfolio managers and company and sector analysts.

The FRC would also like to thank the following for their help on projects, research, and administration of the Lab:

Corinne Berg, secondee from Deloitte

Andrew Del Boccio, secondee from PwC

Fredré Ferreira, secondee from PwC

Jill Goscomb, PA to the Lab

Janice Lingwood, consultant

Hayley Stone, intern from the Syracuse University London Programme

Forward agenda

The Steering Group has suggested that the Lab prioritise projects on the following four topics, given appropriate interest of companies and investors. The full scope of each project will be determined with the help of participating companies, investors, and other stakeholders.

Remuneration reporting – phase II

On 27 June 2012, the Secretary of State for Business issued BIS' *Consultation on revised remuneration reporting regulations* aimed at 'increasing transparency on directors' pay'. The consultation period closed on 26 September 2012 and BIS expect to issue final regulations in the Spring.

The draft regulations propose a new two part remuneration report, which 'replaces rather than adds to current reporting requirements.' At the request of BIS, the Lab has agreed to undertake a further short-term project to obtain views from the corporate and investment community on two specific disclosure requirements proposed in the consultation document, namely:

- scenarios for what directors will get paid for performance that is above, on and below target; and
- chart comparing company performance and CEO pay, with company performance measured using Total Shareholder Return (TSR).

The responses to BIS' consultation highlighted some of the challenges of these new disclosure requirements. For example, companies need sufficient flexibility to report in a manner which is meaningful to their individual circumstances and the regulations must provide for some degree of consistency in reporting.

This second Lab project is an opportunity to help shape the final regulations. On 1 November, the Lab published a call for a number of listed companies to develop example formats of the disclosures proposed by BIS and we plan to conclude on this project early next year. Already, we have over 20 companies supporting this second project.

Audit committee reports

This Lab project will research the content and style of existing and newly developing Audit Committee Reports.

The FRC issued updated UK Corporate Governance and Stewardship Codes, together with guidance for Audit Committees on 28

September 2012. The revised code requires (on a comply or explain basis) the Annual Report to include certain new information, for example information on:

- matters that are significant to the financial statements;
- how the Audit Committee assessed the effectiveness of the external audit process; and
- the approach to appointing the auditor and how objectivity and independence is safeguarded relative to non-audit services.

The specific content and presentation of this information will largely be left to each Committee's discretion.

The aim of the Lab's project is to provide insight from the reporting and investment communities on effective approaches to reporting, including both the content and style. The Lab will shortly be calling for listed companies and investors to participate in this project.

Accounting policy disclosure

Over the past few reporting cycles, several companies have revised their reporting of accounting policy information, for example by integrating the policy information with the notes to which they relate, reordering items in the accounting policy summary to highlight

significant policies or judgements, or splitting the policy disclosure in two, with less significant policies being disclosed in an appendix.

This project will involve several companies whose reporting could be used to illustrate the following:

- integration of policy information and related notes, and whether a list of policy information is also still desired;
- materiality judgements to remove immaterial policies or separately present less significant policies;
- reducing boilerplate, making clear where policy choices have been made, and relating accounting policies to the resulting amounts reported in the statements; and
- explaining the impact of new policies adopted and new IFRS requirements not yet adopted.

The FRC's emphasis on 'cutting clutter' in particular will be explored in the context of this topic, for example some policies may not be significant in the context of a company's transactions and related amounts reported.

It could also be timely for the Lab to obtain investor input on how integrating policy information into the other footnotes is viewed, as this specific trend has grown over the past year.

Risk reporting

Risk reporting has been a focus of the FRC's Financial Reporting Review Panel (FRRP) in recent years.

The reporting of risk remains highly topical, and the following developing requirements will be considered in the Lab's project to the extent they will influence required and discretionary aspects of reporting:

- update of the FRC's guidance for directors on risk management and internal controls; and
- update of the FRC's guidance for directors on implementing the Sharman recommendations on going concern issues.

This project will likely involve several companies whose current or developing reporting could be used to illustrate various approaches taken or that could be taken, across a range of sectors. The scope of this project could include reporting of:

- how principal risks are determined and materiality judgements are made;
- how such risks are described in a meaningful manner (reduce boilerplate);
- how steps taken to address/mitigate risk are disclosed, and approaches that some companies have adopted in their global reporting taking account of reporting in jurisdictions that have a different

approach to reporting of risk and mitigation; and

- how risk information is presented - tables versus text, integration of IFRS 7 disclosure, etc.

Are there specific aspects of what might be covered in the scope of the Lab's four planned projects that would be most useful to the reporting community?

What other areas of reporting are problematic, and should the Lab consider addressing these in future projects?

Other reports focusing on what is important

Recent FRC guidance published in *Cutting clutter: Combating clutter in annual reports* (2011) and *Financial Reporting Review Panel: Annual Report 2011* and *Financial Reporting Review Panel: Annual Report 2012* has encouraged all those involved in preparing financial reports to exercise judgement to determine and apply a quantitative threshold and qualitative assessment for materiality in relation to disclosures.

A more rigorous approach to materiality judgements might result in financial reports that are more meaningful, focused and relevant to investors because inconsistencies and superfluous material will have been avoided. Clutter undermines the usefulness of annual reports and accounts by obscuring important information and inhibiting a clear understanding of the business and the issues it faces.

In July 2012, the FRC, in partnership with the European Financial Reporting Advisory Group (EFRAG) and the Autorité des Normes Comptables (ANC), published a Discussion Paper *Towards a Disclosure Framework for the Notes*. That paper forms an essential part of the full disclosure picture but is deliberately limited in scope. The FRC considers that a disclosure framework might contribute to improvements in corporate reporting, and has recently published a Discussion Paper *Thinking about disclosure in a broader context* which considers disclosures more holistically.

Reports published by the Lab:

November 2012: [Debt terms and maturity tables](#)

November 2012: [Operating and investing cash flows](#)

September 2012: [Net debt reconciliations](#)

June 2012: [A single figure for remuneration](#)