Financial Reporting Council

September 2012

Financial Reporting Review Panel Annual Report 2012

As part of the reform and restructuring of the Financial Reporting Council ('FRC') that took effect on 2 July 2012, statutory responsibility for the application to court to rectify corporate reports and accounts passed from the Financial Reporting Review Panel ('the Panel') to the Conduct Committee of the FRC ('the Conduct Committee'). BIS have approved the Conduct Committee's Operating Procedures for the review of corporate reports and accounts, which retain substantially all the Panel's procedures within the new structure. This report is, therefore, issued by the Conduct Committee but as the Panel was the responsible body when all of the reviews were initiated, this report refers to the Panel rather than the Conduct Committee.

The characteristics of corporate reporting which we believe make for a good annual report are set out at the outset of this report as an aide memoire for boards when preparing their reports and accounts.

A Good set of Report and Accounts

Beyond basic compliance with the fundamental requirements of the law and accounting standards and the need for complete and accurate publication of accounting information, there are characteristics of corporate reporting which we believe make for a good annual report.

A single story

The narrative in the front end is consistent with the back end accounting information; significant points in the financial statements being explained in the narrative reports so that there are no surprises hidden in the accounts.

How the money is made

The business review gives a clear and balanced account which includes an explanation of the company's business model and the salient features of the company's performance and position, good and bad.

What worries the Board

The risks and uncertainties described in the business review are genuinely the principal risks and uncertainties that the Board are concerned about. The descriptions are sufficiently specific that the reader can understand why they are important to the company. The business review also describes the mitigating actions taken by the Board to manage the impact of its principal risk and uncertainties. The links to accounting estimates and judgements are clear.

Consistency

Highlighted or adjusted figures, key performance indicators (KPIs) and non-GAAP measures referred to in the business review are clearly reconciled to the relevant amounts in the accounts and any adjustments are clearly explained, together with the reasons why they are being made.

Cut the Clutter

Important messages, policies and transactions are highlighted and supported with relevant context and are not obscured by immaterial detail. Cross-referencing is used effectively; repetition is avoided.

Clarity

The language used is precise and explains complex accounting and reporting issues clearly; jargon and boiler-plate are avoided.

Summarise

Items are reported at an appropriate level of aggregation and tables of reconciliations are supported by, and consistent with, the accompanying narrative.

Explain change

Significant changes from the prior period, whether matters of policy or presentation, are properly explained.

True and fair

The spirit as well as the letter of accounting standards is followed.

A true and fair view is a requirement of both UK and EU law and applies equally to accounts prepared in accordance with UK GAAP and IFRS.

Contents

Introduction and conclusions

The Financial Reporting Review Panel seeks to ensure that the reports and accounts published by public and large private companies comply with the requirements of the Companies Act 2006 which includes applicable accounting standards. It also aims to improve the quality of financial reporting in the UK.

The Panel adopts a risk-based approach to its selection of reports and accounts for review, which includes responding to matters drawn to its attention by others. Where there is, or may be, a question of non-compliance, it asks boards for additional information and explanation to help it understand the company's reporting which it may then pursue through further correspondence and meetings.

This annual report focuses on particular aspects of non-compliance that the Panel identified in the course of its reviews of company reports and accounts in the year to 31 March 2012 and aims to help boards address issues that are likely to be significant in the current reporting season. As an aide memoire to Boards, the characteristics of corporate reporting which the Panel believes make for a good annual report are set out on the inside cover of this report.

2012 in summary

In the year ended 31 March 2012, the Panel reviewed 326 sets of reports and accounts (2010/11: 301) issued by public and large private companies, the majority being in respect of financial years ended between 31 December 2010 and 30 September 2011. It wrote letters to 130 companies (2010/11: 141).

In December 2010[1] the Panel announced that its 2011/12 reviews would:

- Pay particular attention to companies which operated in certain specific market sectors - commercial property, insurance, support services and travel - or which were outside the FTSE 350. These companies were considered to face more risks in the year under review given the difficult economic conditions or to have, potentially, more limited resources to manage the financial and reporting challenges facing them;
- Challenge companies that provided boiler-plate disclosures when identifying and describing their principal risks and uncertainties; and
- Continue to focus on disclosures in financial statements relating to significant judgements.

The Panel's approach and changes to its procedures

Constructive co-operation is a key characteristic of the FRC's monitoring approach and the Panel welcomes the continued willingness of boards to deal with it in an open, transparent and timely manner. Boards, generally, provided additional information and explanations as requested and understood the concerns expressed, often volunteering improvements to their future financial

[1] FRRP Press Notice 128

reporting having discussed our concerns with their Audit Committees and external auditors. The Panel is encouraged by the pride most boards take in their financial reports and their readiness to continually improve their quality.

When the Panel believes that a company's report and accounts do not comply with the law it tries to persuade the company to address its concerns, either by restatement or by making improvements for the future if this is the more proportionate outcome. If this approach fails, the Panel is empowered to apply to the court to decide whether the particular report complied with the law. **The Panel was successful in settling all of its cases during the year without having to apply to the court.**

Once a company agrees that its report and accounts require corrective action or clarification and publishes the amended information, the Panel's objectives are achieved. When corrections required to the report and accounts are significant, the Panel may issue a press notice focusing on how the company's improvements to its future financial reporting had addressed the Panel's concerns. **The Panel did not publish any such press notices in the year.**

When a company makes a prior year correction following a Panel enquiry, the Panel sometimes asks for a reference to be made to the Panel's intervention in the note to the accounts explaining the correction ('a Panel reference'). **Seven Panel references were agreed and published during the year. Three further Panel references have since been agreed in respect of accounts reviewed during the period.** The key issues in these Panel references are summarised by standard in section 4.

Where, in the course of an enquiry, the Panel believes that it is necessary to enquire further into whether there has been a breach of relevant reporting requirements, a Panel Group may be established consider the matter. **Five Panel Groups operated during the year, all of which have now concluded.** One resulted in a Panel reference. Three led to the companies concerned agreeing to enhanced disclosure in their next report and accounts either to explain the subsequent events or actions which had resolved the Panel's concerns or to significantly enhance the quality of information provided. In the remaining case, the Panel accepted the company's proposal to change an accounting policy.

When the number or significance of corrections required to a company's accounts is exceptional, the Panel may copy to the senior partner or chairman of the company's auditor its letter to the company closing a case. **The Panel issues such letters sparingly and did not write any such letter in the year under review.**

Following public consultation, the Panel amended its operating procedures to enable it to contribute to three improvements to the effectiveness of the FRC by:

- relaxing its restrictions to share otherwise confidential information provided by companies with the FRC's Audit Inspection Unit (Audit Quality Review). This change has reduced the potential for duplication of effort and inconsistent outcomes within the FRC's Conduct Division.
- reserving to itself a right to make an announcement in any case in which a company makes a significant change to its corporate reporting following Panel intervention, thereby increasing the transparency of the Panel's work and the ability of companies generally to be aware of its views.
- permitting it to release its own announcement where the existence of a Panel enquiry has become public.

The revised procedures applied to all cases started after 1 April 2012.

Conclusions

The Panel found the general quality of reporting by companies whose accounts it reviewed to be good.

There was further improvement in all aspects of reporting of principal risks and uncertainties. The reporting of mitigating actions, in particular, was considered to be done well.

In recent years, to support its objective of improving the quality of corporate reporting, the Panel has highlighted features which it associates with a good annual report. It is pleased to see some evidence this year of boards focussing on key messages by eliminating unnecessary and obscuring detail. Others have reconsidered the presentation of their financial statements by giving greater prominence to material disclosures or by changing the order of content to assist shareholders' understanding of their company's business, policies, performance and position.

We do, however, remain concerned about the quality of reporting by some smaller listed and AIM quoted companies that lack the accounting expertise of their larger listed counterparts. The Panel raised more potentially substantive issues with a number of such companies and these frequently took more time to resolve satisfactorily. Directors should not under-estimate the importance of their legal responsibility to prepare accounts that comply with the law and accounting standards.

The Panel was pleased that boards of directors continued to co-operate well with it during the year, often voluntarily giving undertakings to improve the quality of their future reporting. In the one instance where a company did not respond constructively to the Panel's request for additional information and explanations, the Panel wrote to the chairman invoking its statutory power to require such information as it believed necessary. Such information was then provided.

Directors' reports

Business reviews

The Companies Act 2006 requires all business reviews to contain a fair review[2] of the company's business and a description of the principal risks and uncertainties facing the company.

Principal risks and uncertainties

The Panel is pleased to report a significant improvement this year in the overall quality of reporting in relation to all aspects of principal risks and uncertainties. The Panel, however, still had cause to raise questions of some boards whose disclosures fell short of what shareholders might expect given that the purpose of the business review is to help them assess how the directors have performed their duty to promote the success of the company:

- Some companies continued to provide a list of bullet point headings rather than a clear description of the principal risks they faced.
- Others did not clearly separate the company's principal risks and uncertainties providing instead a long list of potential risks. The Panel questioned the companies concerned as to whether all the risks and uncertainties in a long list were, in fact, principal.

The Panel continued to challenge companies that did not provide an explanation of actions taken or processes adopted to mitigate the likelihood and impact of the principal risks and uncertainties. It was pleased to note that such cases were relatively infrequent and that the reporting of mitigating actions is generally being done well.

The Panel takes the view that the law requires an account of the management of risk and will continue to encourage boards of all sizes of company which publish a business review to refer to their actions and proposals to reduce the likelihood of risks crystallising.

Other considerations

The Panel wrote to some companies where there was a question whether the business review was fair, balanced and comprehensive.

The Panel has previously referred to the importance of explaining the impact of significant events or items, including any described by the company as exceptional, on the results for the period as required by law. In several cases the Panel recommended enhanced explanation in future should similar circumstances arise: for example, significant impairment charges, the financial effect of acquisitions and significant redundancy and re-organisation charges. The Panel continued to query references in the review which were not separately disclosed in the accounts; for example, an

[2] Section 417 (3)(a) Companies Act 2006

unexpected significant finance cost and a significant release of a provision against receivables that was net of an undisclosed impairment charge.

In addition, the Panel asked some companies to explain in the business review material variations in the current period compared to the previous year. Examples include significant variations in the tax charge, such as a material prior year adjustment and significant movements in allowances against trade receivables.

During the year, the Panel considered a case where the description of changes in employee remuneration arrangements and how they related to service and performance gave rise to questions regarding the recognition and measurement of the remuneration in the accounts. On the basis of the further information and explanations received from the company, the Panel accepted the company's judgement in applying IFRS to the period over which the expenses should be recognised. However, the company undertook to improve its explanations in its future business reviews and clarify the basis on which expenses recognised and deferred related to awards made before and after the year end. Additional undertakings were secured to enhance and expand the description of the accounting policy applied to the new arrangements.

In its last report, the Panel drew attention to the need to include an analysis using financial key performance indicators (KPIs) to the extent necessary for an understanding of the development, performance or position of a company's business. The Panel continued to find examples where KPIs were disclosed as a bullet point list in the business review but were not explained or referred to in the discussion of the company's performance.

Where financial statistics, including non-GAAP measures, were used in the business review without further expansion, the Panel sought to understand the relationship between them and amounts appearing in the IFRS accounts. It requested reconciliations from some companies that referred to IFRS measures 'adjusted' for certain items but did not explain the nature or amount of the adjustments concerned. A commonly used measure in business reviews is an "adjusted operating profit", where operating profit is a sub-total in the income statement. In such cases, the nature and amount of the adjustments should be clearly explained and the measures referred to consistently.

During the year, the Panel concluded a case about the use made by a company in its business review of external data in order to support its strategy. The Panel was concerned that undue emphasis might have been placed on one particular projection to indicate that demand for the products of the industry concerned would increase substantially in the future and, accordingly, that the business review might not have been balanced. In reaching its conclusion not to press for corrective action, the Panel took account of the subsequent publication by the company of its own long term analysis of demand for the industry's products, which was broadly consistent with the external data it had cited in its annual report and had been used by the company in connection with the development of its business strategy.

Other disclosures

The Panel's remit extends to certain other disclosures required to be made in the directors' report, either by the 2006 Companies Act or by regulations made under that Act, principally Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("the Regulations").

Part 6 of Schedule 7 of the Regulations requires a number of disclosures to be given, where relevant, in the directors' reports of companies which have securities admitted to trading on a regulated market. In particular, it requires the disclosure of detailed information of any significant agreements to which the company is a party that take effect, alter or terminate upon a change of control of the company following a takeover bid and the effects of such agreements. The absence of all or part of this disclosure was raised with a number of companies during the year. Directors are reminded to consider all of the required disclosures to assess which are relevant to them in their corporate reports.

The Act also requires a statement to be made on behalf of each director regarding disclosure of information to the company's auditor. The Panel encountered circumstances where that statement was missing.

Corporate Governance statements

The Panel's authority in respect of corporate governance disclosures is restricted to monitoring whether certain information required by the FSA's Disclosure and Transparency Rules has been provided. It does not extend to challenging companies about the fairness of the information disclosed.

In its 2011 report, the Panel referred to the variable quality of explanations provided by listed companies where they departed from the requirements of the UK Corporate Governance Code, noting that many could be clearer or more informative. It announced that the FRC would stimulate a debate about the characteristics of a good quality 'explanation' in such circumstances. In February 2012, following roundtable meetings with preparers and users of corporate reports, the FRC published a paper intended to promote a better understanding of explanations. The paper noted that features of a meaningful explanation include a clear rationale for the particular departure and any mitigating actions. The main conclusions of the paper were incorporated in a draft revision to the Code which is currently out for public consultation.

It is fundamental to the efficient operation of the 'comply or explain' regime on which the UK Corporate Governance Code is based that boards should provide clear and meaningful explanations when they deviate from the Code. Such explanations should enable, shareholders to understand the reasons for the deviation and to judge whether they are content with the approach the company has taken - for example, when it has sought to satisfy the principle of the Code through a different route from that specified.

Targeted reviews

Half yearly financial reports

The Panel is authorised under the Supervision of Accounts and Reports (Prescribed Body) Order 2007 to keep under review the half-yearly financial reports of companies with securities traded on a regulated market and, if it thinks fit, to report its findings to the FSA.

With very few exceptions, the issues raised in reviews of half yearly accounts were not of such substance as to justify an approach to the companies concerned. The Panel used the reviews, however, to contribute to its selection of annual reports for review. In many cases, the potential disclosure omissions identified at the half year stage had been addressed in the audited annual accounts and there were no concerns to raise.

As in previous years, matters identified in half yearly reports largely related to the disclosure requirements of the FSA's Disclosure Rules and Transparency Rules (DTR) rather than compliance with IAS 34, 'Interim Financial Reporting'. The responsibility statement required by the FSA was not always provided in the required form with the appropriate signatories. In other cases, the required statement regarding whether or not the half-yearly report had been audited or reviewed was not provided and users may not have appreciated the level of assurance attached to the reports.

In periods of economic uncertainty when markets can be volatile, investors may pay close attention to half yearly reports. Although detailed impairment testing is not necessarily required at an interim date, boards should review for indications of significant impairment since the end of the most recent financial year. A potential trigger could be a reduction in the company's market capitalisation to a level significantly below the amounts at which its assets and liabilities are stated in its accounts.

There is no specific requirement in IAS 34 to provide a going concern statement in half yearly reports. In periods of heightened economic uncertainty, however, the Panel expects companies for whom funding is a particular challenge to reconsider the disclosures provided in their year end accounts and to update them to reflect the current position as appropriate at the half year stage. For the future, it reminds boards of the FRC's Update for Directors, Country and Currency risk – interim reports which highlights points to consider in respect of heightened country and currency risk when preparing half yearly reports.

Insurance company reports and accounts

Insurance was a priority sector for the Panel in the year under review. It reviewed ten sets of reports and accounts of companies with insurance businesses selected from the full range of entities within scope, including life and non-life insurers, writing to five for further information or explanation in accordance with its normal operating procedures.

In the absence of a comprehensive IFRS standard specifying the accounting for insurance contracts, industry specific reporting requirements are sparse leading to continued inconsistency in the accounts of insurers. The Panel focussed its reviews on the transparency of the insurers' results reporting. Matters queried included the clarity of presentation of non-IFRS measures and terminology and the comprehensiveness of the description of the key accounting policies applied.

Four companies gave undertakings which will improve the clarity of their future narrative reporting. In two cases, these related to amounts and descriptors used in the business review in the discussion of the company's performance and KPIs that were apparently IFRS measures but could not be linked directly to amounts reported in the accounts.

The Panel also considered the netting of assets against liabilities in the reporting of contract acquisition costs and third party commitments to settle insurance liabilities but did not seek changes in relation to these matters, in the light of the wide range of permissible financial reporting practices in insurance accounting.

A number of companies undertook to improve the descriptions of their principal accounting policies, by removing boiler-plate wording and setting out, more specifically, how they are applied to their particular transactions and arrangements. These included policy descriptions for revenue recognition, the methodologies adopted for the valuation of available for sale securities and investment property and the application of consolidation principles to special purpose insurance or investment entities or arrangements. In other cases, enhancements were sought in segment and capital management disclosures.

In addition to its review of the sampled reports and accounts, at the request of the European Securities and Markets Authority (ESMA), as described later in this report, the Panel considered the reporting of Greek sovereign debt held directly by the UK's insurers in 2011.

Annual financial statements – IFRS commentary

Since introducing an element of proactivity into its selection of reports and accounts for review the Panel has reviewed around 300 sets of reports and accounts a year. The Panel is proportionate in its regulatory approach, recognising the administrative burden and potential cost to companies of managing an enquiry into its financial reporting. It writes to Boards for additional information and explanation only when there appears to be the potential for a substantive error or non-compliance. Accordingly, it found it necessary to write to less than half of the companies whose accounts it has reviewed requiring a substantive response to the questions raised by their reporting.

The Panel discourages companies from including unnecessary disclosures in their accounts. The Panel is aware that some companies prefer to err on the side of caution and include in their accounts all disclosures raised by the Panel in their letters whether or not they are material. The Panel encourages boards to interpret these reminders from the Panel in the helpful spirit in which they are intended and to have the confidence to make judgements about those disclosures which are material and those which are not. Disclosure points which featured most commonly in Panel letters are set out in Appendix A.

The Panel's 2011 Report drew attention to points raised in the FRC's Discussion Paper 'Cutting Clutter' and emphasised the need for companies to avoid immaterial detail and to focus on key messages in corporate reports. During the year, the Panel sought to reinforce this message when writing to companies by stating explicitly that it discourages boards from including unnecessary information in their accounts. Such an approach requires a careful assessment of materiality, in both its qualitative and quantitative aspects, in relation to a company's specific facts and circumstances. The test of materiality lies in the value of the information, not from the disclosure requirement in the Standard - what is material for one company will not be material for another; what may be material for a specific company one year may not be the next.

The FRC's call to arms has been taken up by others engaged in corporate reporting[3]. In particular, the International Accounting Standards Board (IASB), the primary standard-setter for accounts that are reviewed by the Panel, recognised its part in creating 'disclosure overload', by sometimes requiring disclosures that do not provide useful information to investors and that can lead to boiler-plate reporting[4].

The areas highlighted below represent matters of substance where, from the Panel's reviews of company accounts, there was room for further improvement in transparency and quality. Areas where compliance has improved are also referred to.

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3 'Losing the Excess Baggage', published by the Institute of Chartered Accountants in Scotland and the New Zealand Institute of Chartered Accountant, July 2011

'A Disclosure Framework for the notes to the Financial Statements', published by EFRAG in partnership with the ANC and the FRC's ASB, July 2012

4 Hans Hoogervorst, Chairman IASB, speech to CINIF, Mexico City on 7 March 2012 published on the IASB website

IAS 1 'Presentation of Financial Statements'

IAS 1 prescribes the basis for presentation of general purpose financial statements to ensure comparability both with a company's previous financial reporting and with the financial statements of other entities**.**

Accounting Policies

IAS 1 requires companies to provide a summary of their significant accounting policies that are relevant to an understanding of the financial statements.

The Panel continued to challenge the omission of policies which it judged to be significant in view of the nature and complexity of a company's business. It also suggested the removal of policies from company summaries if satisfied that they related only to immaterial amounts as they detracted from the substantive policies underlying key areas of reporting. Examples included descriptions of leasing and hedging policies.

Most substantive questions about accounting policies related to aspects of revenue recognition, often triggered by policy descriptions in the accounts that were generic and repeated terms and phrases directly from the relevant standards without reference to the company's particular business and transactions.

Disclosure of judgements

IFRS is a principles-based reporting framework which requires management judgement in its application. IAS 1 requires those judgements which have the most significant impact on the carrying amounts in the accounts to be disclosed separately to enable users to appreciate the reported aspects of performance most influenced by the board's decisions.

The Panel challenged companies that either failed to make any such disclosure or that were not sufficiently specific as to the precise nature of the judgements they make, sometimes merely cross-referring to the broader descriptions of the accounting policies and in other cases stating that the judgemental aspects of specific amounts were further explained in the relevant notes to the accounts when in fact no such explanations were provided. We expect boards to explain the nature of the judgements applied to significant items in the accounts such that users can better appreciate the importance of the area and its sensitivity to management opinion. Where the financial statement item concerned is significant and the judgement applied has a material impact on the recognition or measurement of the item, the board should consider discussing the impact on the financial statements of reasonably possible alternative judgements that it has rejected.

Disclosure of estimation uncertainty

IAS 1 imposes an over-arching requirement on boards to disclose information about the assumptions they make in preparing their accounts and other major sources of estimation uncertainty that could result in a material adjustment to the reported amounts of assets and liabilities within the next twelve months. The only exception to this requirement is where it is impracticable to disclose the extent of the possible effects of any such assumption or uncertainty, in which case directors are required to explain that it is reasonably possible that results may vary and could require a material adjustment. Boards should not view this exemption as a default setting.

In view of the uncertain economic environment, the Panel might have expected greater disclosure of the sensitivity of the carrying amounts to the methods, assumptions and estimates underlying their calculation but in most cases detected no evidence of this. Directors are encouraged to be specific in these disclosures and to refer to the actual issues they face, consistent with disclosures in the business review.

Other comprehensive income

IAS 1 provides Boards with options as to how they may present the income and expenses they recognise in a reporting period – in a single statement of comprehensive income or in two statements, an income statement and a statement of other comprehensive income (OCI), which is the presentation used by most UK companies.

The standard specifies certain items for inclusion in OCI. During the year, the Panel reviewed a number of sets of accounts where items charged or credited to OCI should either have been included in the income statement or taken directly to equity. Examples included:

- Share based payments and related deferred tax
- Put options written on non-controlling interests
- Convertible bonds

In the absence of a clear underlying principle to help determine the presentation of items, boards should pay attention to the required presentation of the specific items set out in paragraph 7 of the standard.

IAS 1 requires reclassification adjustments from OCI to profit or loss to be disclosed separately. In a number of sets of accounts reviewed by the Panel no disclosure of such items was made, for example in relation to amounts reclassified from the cash flow hedge reserve in relation to interest rate hedges.

A recent amendment to the Standard, mandatory for periods beginning after June 2012, requires companies to present items in OCI in two separate groups, based on whether or not they may be recycled to profit or loss in the future. The IASB encourages early adoption as it may help users to appreciate the potential significance of items that have not yet been reflected in the income statement.

Disaggregation

IAS 1 specifies a minimum set of line items for inclusion in the statement of financial position. Further sub-classifications are presented as appropriate to the company's business, the detail of which depends, for assets, on their nature, function and liquidity and, for liabilities, on their amount, nature and timing. A number of companies that aggregated accrued income with prepayments and combined deferred income with accruals, were asked to disclose the amounts separately in the notes as the assets are different in nature and liquidity and the liabilities in nature and timing. For some companies, for example those which engage in significant outsourcing, the separation of the amounts provides useful information to users about the pattern of operations.

Netting

Setting assets against liabilities or income against expenses in the primary statements can mask the substance of the underlying events or transactions and make it difficult for users to appreciate their significance. IAS 1, therefore, precludes offsetting unless required or permitted by another standard.

The Panel challenged companies that appeared to have introduced an element of netting into their reporting where underlying support from IFRS was not obvious. These included companies operating overseas which were engaged in wide-scale plantation activities. The Panel acknowledges that the IAS 41 requirement to measure agricultural produce at fair value at the point of harvest while also recognising as revenue the proceeds of sale of the produce creates practical difficulties. This is particularly the case when the produce is routinely sold shortly after harvest. In order to avoid "grossing up" the income statement it appears to be common practice among plantation companies effectively to offset the gain on initial recognition of the agricultural produce against inventory expense in the income statement. The Panel acknowledges the difficulty of drawing up an income statement that presents financial performance fairly and in an understandable manner in these circumstances but, where relevant, obtained undertakings from boards to disclose more clearly in their accounts the presentation adopted, the reasons for adopting it and the amounts offset.

One company netted certain costs against revenue from the routine disposal of vehicles previously held for hire. Further instances of netting challenged by the Panel are noted below in the sections on the relevant IFRS.

A Panel reference was given in the accounts of one company which restated its balance sheet for certain amounts owed to its dormant and semi-dormant subsidiaries. The amounts, which the directors believed would be settled only when the reserves of the subsidiaries were distributed on liquidation and were therefore effectively reducing the parent company's investments in the subsidiaries, were previously netted against the parent company's investments in the subsidiaries. Following discussion with the Panel, the parent company concluded that the amounts owed to the subsidiaries should be reported as creditors due after more than one year because the parent company did not have a legally enforceable right of set off.

In other accounts which it reviewed, the Panel was able to accept the presentation on the grounds of materiality but cautioned against wider application should the amounts concerned increase.

Capital management disclosures

IAS 1 requires qualitative information about a company's objectives, policies and processes for managing capital, including a description of what it manages as capital and summary quantitative data.

Requests for further information to assess compliance with these requirements continued to be common in the Panel's approaches to companies. Many had to be reminded of the need to provide both the quantitative and qualitative disclosures required which, by their nature, are always considered material. In a number of cases the narrative identification of the component parts of what the company identified as capital and the relevant balances did not add up to the quantitative disclosures provided leading to uncertainty about the quality of management's policies, the description of which was often then revealed as incomplete. The Panel also noted that this was an area where qualitative disclosures tended towards boiler-plate even where there were specific transactions and events which should have featured in a more company-specific disclosure – for example, share buy backs, suspension or reintroduction of a dividend policy.

IAS 7 'Statement of Cash Flows'

The statement of cash flows helps users to assess a company's ability to generate the cash that it needs to support its activities, including the timing and certainty of such cash flows.

The Panel's questions about cash flows were often initiated by an apparent inconsistency between matters reported in the statement of cash flows and elsewhere in the narrative reports or accounts.

This year, as last, a number of companies either misclassified or misstated certain cash flows or reported non-cash movements as cash flows. Examples included:

- cash flows related to the purchase of own shares classified as investing rather than financing
- cash inflows and outflows relating to assets held for rental and routinely resold classified as investing rather than operating
- classifying as investing cash flows that did not result in the recognition of an asset
- the acquisition of assets under finance leases reported as a cash outflow
- ordinary shares issued following the conversion of debt into equity incorrectly reported as cash flows
- reclassification from current to non-current liability reported as a cash inflow and outflow

We will continue to challenge companies where cash flows reported in the cash flow statement do not appear to be consistent with other parts of the annual report and accounts. In this context, we encourage companies to explain large and unusual cash flows in the business review or in the notes to the financial statements. Clear presentation and consistency of descriptions between items reported in the cash flow statement and elsewhere in the report and accounts also help investors to understand the relationships between items.

The Panel sought undertakings from several companies that had netted certain items in the cash flow statement to present gross movements in their future financial reporting. Examples included one company that reported ‘net increase in borrowings’ and others reporting ‘interest paid’ net of interest received.

A Panel reference was given in the accounts of one company which restated its cash flow statement for the effect of changes in foreign exchange rates. The restatement was required because the changes in working capital incorrectly included the re-translation differences relating to foreign operations which had been recognised in equity. The operating cash flow reported for the year also included a loss on translation relating to an inter-company balance between fellow subsidiaries which should have been included in the reconciliation between the profit for the year and cash flows from operations.

Cash equivalents are defined in the standard as short-term highly liquid investments that are readily convertible to known amounts of cash and which are not subject to significant risk of changes in value. The Panel continued to challenge companies that appeared to adopt a different definition by including bank loans or longer term deposits, obscuring the real short term position, but was pleased to note that such errors did not appear to be as widespread as in previous years.

In periods of difficult trading conditions where access to funding may be restricted, cash flow information is of critical significance to investors. Interest may be focussed particularly on operating cash flows derived from the principal revenue-producing activities of the company where clear historical information is useful in forecasting future cash needs and flows and in understanding the relationship between profitability and net cash flow. We are concerned that a number of companies do not appear to take as much care in the presentation of their cash flow statements and supporting notes as they do with other primary statements.

IAS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’

We take this opportunity of reminding directors about the raft of new accounting standards that are expected to be endorsed and to become effective for 2014 year ends, although early adoption may be possible.[5] These will pose challenges for a number of companies who may need to reconsider their scope of consolidation and how to account for joint ventures. Boards are, therefore, encouraged to review the new requirements and consider their implications at an early point.

5 IFRS 10, ‘Consolidated Financial Statements’, IFRS 11, ‘Joint Arrangements’, IFRS 12, ‘Disclosures of Interests in Other Entities’, IAS 27, ‘Separate Financial Statements’ and IFRS 28, ‘Investments in Associates and Joint Ventures’.

IAS 12 'Income Taxes'

The standard is clear that current and deferred tax are recognised outside profit or loss if they relate to items that are recognised outside profit or loss, whether or not in the same reporting period. In a number of cases companies' disclosures appeared inconsistent with this requirement and were, therefore, challenged by the Panel. The most common error was the reporting of deferred tax on share based payments in other comprehensive income rather than directly to equity.

We understand that many investors regard the effective tax rate (tax charge as a percentage of profit before tax) as a helpful performance measure and seek to understand factors that could affect it in the future. The Panel continued to challenge companies where the reconciliation of profit before tax to the tax charge was unclear or appeared inaccurate, for example where deferred tax movements were shown as reconciling items. The Panel encourages companies to provide reconciliations that enable the reader to identify and understand unusual and non-recurring items included in the tax charge for the period.

Several companies had to be reminded that current and deferred tax liabilities and assets are to be measured using the tax rates that have been enacted or substantively enacted by the end of the reporting period as they had not reflected the reduction in corporation tax rate. Some companies included an incorrect amount for tax paid and received in the cash flow statement and misclassified current tax assets and liabilities. Where appropriate, undertakings were obtained to correct the relevant amounts in the next set of accounts.

A number of companies were asked whether deferred tax liabilities should have been recognised in respect of separately identifiable intangible assets acquired in a business combination effected through the acquisition of shares. Where this was the case, an undertaking was obtained to take corrective action in the next set of report and accounts. Similarly, the Panel also questioned companies where it appeared that a deferred tax liability had not been recognised in respect of all taxable temporary differences arising from roll-over relief and capital gains.

A Panel reference was provided by one company which had not recognised a deferred tax liability in respect of temporary differences arising from a business combination. The company had acquired an entity and provided disclosure, in its accounts, which showed that, apart from certain monetary items, all the consideration had been allocated to intangible assets, which had been revalued. No goodwill or deferred tax liability had been recognised as a result of the acquisition and it was not clear from the accounting policies that the requirements of the standards in these respects had been considered.

As reported last year, the Panel continued to have to remind a number of companies with a record of losses of the need to recognise a deferred tax asset for the carry forward of unused tax losses and credits only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. When a company has a history of losses, in the absence of sufficient taxable temporary differences 'convincing other evidence' is required to support the company's judgement that it is probable that future taxable profits will be available against which the tax losses can be utilised. The Panel sought undertakings that, in future, as required by the standard the deferred tax asset should be quantified and the nature of the evidence supporting its recognition disclosed.

IAS 16 ‘Property, Plant and Equipment’

The standard prescribes the treatment and disclosures applying to the accounting for an entity’s tangible fixed assets.

Historically, the Panel has not had reason to challenge a significant number of companies to provide further information or explanation to support their reporting of property, plant and equipment. Occasionally, however, and in the period under review, it has questioned those whose descriptions of accounting policies in respect of highly material tangible fixed assets are unclear as to whether a cost or revaluation model has been adopted and has secured appropriate improvements to future disclosures. The Panel also asked a number of companies to explain the basis on which they had grouped material amounts of different assets which did not appear to meet the test for aggregation under the standard, namely, that they are of a similar nature or put to similar use in their operations.

IAS 17 ‘Leases’

The standard prescribes for lessees and lessors the accounting policies and disclosures applicable in relation to leases.

The matter drawn most frequently to boards’ attention was once again the failure to disclose the total of future minimum lease and sub-lease payments under non-cancellable operating leases in the periods specified by the standard. This is of particular importance to users when reviewing the accounts of companies who are experiencing funding difficulties.

The Panel also sought further information from several issuers that reported sale and leaseback transactions as operating leases but where, from the descriptions provided, there was a question whether the risks and rewards of ownership had been substantially transferred, indicating that the leasebacks may be finance leases.

IAS 18 ‘Revenue’

As in previous years, most of the Panel’s substantive questions of companies about accounting policies related to revenue recognition, where the reported descriptions did not clearly explain the basis on which the relevant qualifying criteria for recognition required by the standard had been met in respect of the specific income streams of the company concerned.

Policies were often drafted in broad generic terms or simply repeated text from the standard which did not enable users to understand the transactions entered into or the point at which revenue would be reflected in the income statement. The Panel often had to ask for additional information to help it understand the basis on which management satisfied itself that:

- The significant risks and rewards of ownership had been transferred to the customer or the stage of completion could be determined reliably;
- The amount of revenue could be measured reliably; and
- It was probable that the company would benefit economically from the transaction.

Boards are encouraged to consider the following when assessing the appropriateness and adequacy of their disclosure of revenue recognition policies.

Categories of revenue

IAS 18 requires disclosure of each significant category of revenue recognised during the period. Some companies, while satisfactorily quantifying their major revenue streams, did not provide revenue policies in respect of all categories identified, most frequently for the rendering of services. Questions were also asked of companies that referred in their business review referred to different categories of business which did not appear to be reflected in the disclosures in the financial statements.

Stage of completion

Companies that derive revenue from the provision of services are required to disclose the methods they use to assess the stage of completion and the amount of revenue to be recognised at each stage. Progress payments and advances or amounts invoiced do not necessarily reflect the stage of completion and boards that say they base revenue recognition on such transactions and events can expect a challenge from the Panel.

It was not always clear from the descriptions provided whether IAS 18 or IAS 11, which requires more extensive disclosures, was the appropriate standard to be applied in accounting for contracts.

Complex arrangements

Particular attention needs to be paid to the policy description where there may be other parties with an interest in the financial outcome of a sales transaction. During the year, the Panel approached a number of companies that had entered into franchise-type arrangements, or that traded through an agent or distributor where it was not clear from the disclosed accounting policy at what point the transfer of the risks and rewards of ownership occurred or where further information and explanation was required in order to understand the basis for accounting for the revenue as principal rather than agent.

In circumstances where the decision is finely balanced, it may be appropriate to treat it as a significant judgement and provide enhanced disclosure as required by IAS 1. Particular care should also be taken in relation to descriptions of complex transaction types. Examples include: extended credit sales, long term projects where discounting may be appropriate or transactions involving the provision of both goods and services where it should be clear, from the description, how the various components are accounted for.

IAS 19 'Employee Benefits'

The standard prescribes the accounting to be adopted in respect of employee benefits, requiring a liability to be recognised when services have been provided in exchange for future employee benefit and an expense when the company consumes the economic benefit arising from the service.

In an environment of continuing low returns on investments, many companies continue to show significant pension liabilities on their balance sheet. The Panel approached several companies for additional information and explanations to support their accounting for a particular type of arrangement with pension trustees in which company assets are transferred to a partnership in which the pension fund is a limited partner. Each of the arrangements is specific as to the terms and conditions applying. A Panel Group was formed to consider one such case resulting in a Panel reference which is described in the section under IAS 32.

Particularly in view of the sensitivities and the significance of some pension deficits, the Panel suggested to some boards that it might be helpful to make certain disclosures not explicitly required by the standard relating, for example, to the source of mortality data and life expectancies.

IAS 21 'The Effects of Changes in Foreign Exchange Rates'

Companies that enter into transactions in foreign currency or have foreign operations are required to report them in accordance with IAS 21.

For several companies where the amounts were material, retranslation differences were not recognised in the group accounts in a separate component of equity as required. In a number of other cases, predominantly in the accounts of smaller listed and AIM quoted companies, errors came to light during investigation of other matters; for example, apparent inconsistencies in cash flow statements or inconsistencies with the front end narrative. In several cases this arose from a poor understanding of how to account for the effects of changes in foreign exchange rates.

IAS 24 'Related Party Disclosures'

As in previous years, the Panel had to remind a number of smaller IFRS reporting companies that all directors, including non-executives, are considered by the standard to be key management personnel and, therefore, must be included in the disclosures required by the standard. A number of companies failed to disclose the amount of remuneration in each of the five categories specified in the standard.

The required disclosure of key management personnel compensation in total and in the five categories may be provided in the remuneration report provided that a cross reference to the specific information in the remuneration report is included in the accounts and the information is covered by the audit report. Care must be taken, however, to include all of the information required by the standard. In particular, share based payments attributable to key management personnel need to be disclosed and included in total compensation. Clarity is also required when identifying other employees who are considered to satisfy the criteria of key management personnel.

IAS 27 'Consolidated and Separate Financial Statements'

The objective of the standard is to secure relevant, reliable and comparable information in the consolidated accounts of a company which has a group of companies under its control.

Most challenges about compliance with the standard were prompted by a concern that the consolidated accounts might not include all relevant subsidiaries. Considerable judgement can be needed to determine whether a company has the power to govern the financial and operating policies of another and the necessary supporting explanation describing the basis of control was lacking in a number of cases where the decision was finely balanced. Unclear disclosure around the timing of events also prompted questions as to the date on which control was obtained – for example, where the disclosure in the accounts appeared to conflict with information included in market announcements at the time or where there was reference to the signing of conditional agreements.

In no case did the Panel find it appropriate to seek corrective action in the accounts under review. It did, however, require additional disclosure in future accounts to explain the board's judgement.

A number of companies were questioned about their reporting of transactions involving non-controlling interests (NCI). Where, after such a transaction, the parent retains control of an entity, no gain or loss is reported in the income statement but the carrying amount of the non-controlling interest is adjusted to reflect the change in the other parties' ownership interests.

The Panel noted in its reviews that a small number of companies had increased their stake in a subsidiary and recognised goodwill, rather than treat the transaction as an equity transaction as required by the revised standard. When challenged, in one case a board gave an undertaking to correct the accounting in their next accounts which the Panel was able to accept as appropriate in the circumstances.

Liabilities arising from NCI put options, for example acquisitions involving earn-out arrangements, are not uncommon but such transactions may contain complex or unusual features. As indicated by the IFRS IC's continuing deliberations on this matter uncertainty remains about certain aspects of the requirements, leading to a choice of available accounting treatments. Examples of judgements that directors may need to make include:

- whether an item should be reported in the income statement or equity, for example changes due to re-measurements and re-negotiations; and
- whether or not the put option should be treated as contingent consideration in the related business combination.

Boards are encouraged to ensure that the accounting treatment and judgement applied to such transactions are clearly disclosed and that the descriptors of non-routine movements in the statement of changes in equity are clear, comprehensive and appropriately cross-referenced to other notes providing relevant supporting detail.

The Panel continued to draw boards' attention to the need to present non-controlling interests separately from the equity of the owners of the parent. Total comprehensive income must be attributed to the owners of the parent and the non-controlling interests respectively, even if this results in the non-controlling interests showing a deficit.

The Panel reminds parent company directors that, when preparing their reports and accounts, they should take steps to obtain all relevant information and explanations necessary to support their consolidation of subsidiary undertakings.

A Panel reference was given by an investment company which restated its financial statements to consolidate a previously non-consolidated subsidiary. A restructuring of the subsidiary's shareholdings had resulted in the investment company acquiring a controlling interest but the directors were of the view that, given the envisaged short term nature of control, it would have been misleading and impracticable to consolidate the subsidiary. Following discussion with the Panel, the company concluded that the subsidiary should have been consolidated from the date control was obtained and adjusted its prior year accounts accordingly.

IAS 32 'Financial Instruments: Presentation'

IAS 32 establishes the principles to apply to the presentation of financial instruments as liabilities or equity.

Enquiries were made of companies where it was not clear that the principles had been applied as required by the standard. Several were asked to demonstrate that the method used to allocate amounts paid to extinguish convertible loan stock, either through redemption or purchase, was consistent with that used in the original allocation to the separate liability and equity components of the proceeds when the instrument was issued, as required by AG 33.

One company had failed to present the liability and equity components of a convertible debt instrument separately on the grounds that, on the date of issue, the company's share price was significantly lower than the conversion price. A pricing anomaly does not negate the requirement to recognise both the financial liability and the right to convert to a fixed number of shares.

A Panel reference was provided in the accounts of one company which, following enquiry, decided to change the terms of an arrangement and reclassify as a liability rather than as equity the interest held by its pension fund in a partnership controlled by the company.

The company is the general partner, and the trustee of the company's pension scheme a limited partner, in a Scottish limited partnership which is consolidated in the accounts of the company. The company transferred a number of its properties to the partnership subject to leaseback. The limited partnership interest held by the pension scheme entitled it to receive an annual distribution from the profits of the partnership earned from rental income, other than in the event that the company did not pay a dividend or make any other form of return to its shareholders, in which case the agreement entitled the partnership to defer the distribution until such time as the company did pay a dividend. In the circumstances and context of the partnership arrangements, the Panel was concerned that this discretion was not truly unconditional and, therefore, that classification of the partnership interest as equity was inappropriate.

Following discussions with the Panel and in view of the fact that the company has a stated dividend policy and expects that future dividend payments will continue to be made, the company decided to reflect the obligation as a liability by means of indefinitely waiving its discretionary right. Consequently, the company changed the terms of its partnership and changed the company's accounting treatment prospectively. The change will result in the de-recognition of the related equity instrument and recognition instead of a financial liability in the company's next published accounts.

IAS 33 'Earnings per Share'

IAS 33 prescribes the way in which companies should calculate earnings per share to facilitate comparisons of performance between different entities in the same reporting period and between different reporting periods for the same entity.

The Panel raised queries where it appeared that earnings per share had not been calculated in compliance with the standard. Examples included:

- Inclusion of NCI amounts in the 'earnings' figure which should be the profit attributable to equity shareholders
- Inclusion of shares held by the company or employee share ownership plans in the weighted average number of ordinary shares in issue during the period
- Inclusion of anti-dilutive options and warrants in the determination of the weighted average number of ordinary shares in which only dilutive instruments should be included.

The Panel also reminded some boards that if they choose to present additional per share amounts, such amounts are not to be given greater prominence than the basic and diluted earnings per share as required by the standard and are to be calculated using the weighted average number of shares determined in accordance with the standard. If the component of income used for such an amount is not reported as a line item in the statement of comprehensive income, a reconciliation is required between the component used and a line item that is presented in the statement of comprehensive income. On occasion, the reconciliation was not provided and could not be satisfactorily performed from the disclosures provided.

A Panel reference was given in the accounts of one company which had incorrectly included shares issued for cash after the year end in the number of shares used as the denominator in the calculation.

IAS 36 'Impairment of Assets'

IAS 36 sets out the procedures that a company should apply to ensure that its assets are carried at no more than their recoverable amount and the disclosures required in specific circumstances. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount that can be recovered through its continuing use in the business or through its sale. If the carrying amount exceeds its recoverable amount, the asset is described as impaired and the company must recognise an impairment loss.

Boards are required to review indefinite life intangible assets and goodwill carried in their balance sheets for impairment at least once a year and other assets where at the end of the reporting period there is an indication of possible impairment. One of the specified trigger events prompting a review is where the carrying amount of the company's net assets is greater than its market capitalisation, as this indicates that the carrying value of the company's assets might exceed their recoverable amount. Where this is the case, the Panel is likely to ask companies to confirm that they performed the required impairment test and, where relevant, to explain how they concluded that no reasonably possible change in a key assumption applied in determining the recoverable amount of assets would cause the recoverable amount to exceed the carrying amount.

The following matters were raised with a number of companies:

- As the testing of material assets, including goodwill, for impairment requires management to make both significant judgements and estimates, the Panel would usually expect to see them identified as such as required by IAS 1.
- When a significant proportion of total goodwill is allocated to a cash generating unit ("CGU") or group of CGUs, the disclosures provided should indicate the amount allocated to the CGU or group of CGUs concerned together, where recoverable amount is based on value in use, with the key assumptions on which the cash flow projections are based and a description of the company's approach to determining the value assigned to each key assumption.
- Where the company's CGUs have disparate activities, the Panel will generally query the application of a single discount rate to the testing for impairment of all CGUs. IAS 36 requires the pre-tax discount rate used to reflect the risks specific to the CGU for which the future estimated cash flows have not been adjusted.

Value in use versus fair value less costs to sell

The standard requires a company to estimate the recoverable amount of the asset being tested, defined as the higher of the asset's value in use and its fair value less costs to sell. The Panel continued to observe confusion around the different considerations that apply to each basis.

There are specific requirements regarding which cash flows should be included in the calculation of value in use, by far the most frequently used basis for determining the recoverable amount as management will usually be seeking to use the assets in the business to drive operating profit and cash. Cash inflows or outflows that are expected to arise from future restructurings or from improving the asset's or CGU's performance may not be included in the case of value in use. The same consideration does not apply when determining an asset's or CGU's fair value less costs to sell where the assumptions supporting the valuation should be similar to those a market participant would make. For example, in determining fair value it might be reasonable to expect that a potential hypothetical purchaser would implement appropriate restructuring or capital expenditure plans and factor this into their offer price.

In calculating value in use, cash flows are to be estimated in the currency in which they will be generated and then discounted using a rate appropriate for that currency. The present value is to be translated using the spot exchange rate at the date of the value in use calculation. On occasion, the Panel asked companies why, in the light of these requirements, they had estimated future exchange rates in order to determine value in use.

The Panel also considered disclosures where there was a question of potential double–counting in a company's approach to its impairment review. For example, explanations were required where it was unclear whether the benefit of prior year tax losses had been recognised as an asset within deferred tax and then also included within the recoverable amount for testing purposes.

Discount rates

The future cash flows used in estimating value in use are to be discounted at a pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the asset or CGU for which future cash flow estimates have not been adjusted.

The Panel continued to remind boards that the discount rate selected, if not an asset-specific rate directly available from the market, should be an estimate that reflects the return that an investor would require, at the date of the impairment test, to invest in the particular CGU. In some accounts reviewed, it was evident that little thought had been given to how to determine 'an investor's return' in such circumstances and rates proposed were, on occasion, unrealistically low. The standard suggests that a board might consider the company's weighted average cost of capital, its incremental borrowing rate and other market borrowing rates. This must, however, be adjusted for the market's assessment of the risks attaching to the particular asset's cash flows. Some companies appeared to have decided the rate to apply without regard to any of these considerations. Others selected out of date rates which did not reflect either current circumstances or market conditions and some used rates that were based on the company's borrowing rates that, inevitably, were lower than the company's cost of equity. Some companies claimed to have what seemed to the Panel an unrealistically low weighted average cost of capital, suggesting that their understanding of the concept was poor. Companies may be challenged where there is no evidence of the basis on which they determined the rates to apply, particularly where headroom is slim.

Where a company's market capitalisation is below its net asset value at the date of an impairment test, boards should take care to understand the reason. One reason may be that the market is more cautious about the projected future cash flows of a CGU included in the impairment test, and would include a risk premium in the investors' return used if discounting management's future operating cash flow forecasts, rather than its own more cautious cash flow projections. In such circumstances, an adjustment to the WACC implicit in the market price of the shares may be appropriate in determining the discount rate for value in use.

Disclosures

Specific information is required for each CGU or group of CGUs, as applicable, for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant. When the recoverable amount has been determined on the basis of value in use, the standard requires a description of each key assumption on which management has based its cash flow projection for the period covered by the most recent budgets or forecasts and of management's approach to determining the value(s) assigned to each assumption. In many accounts reviewed by the Panel, the description of management's approach to determining the value(s) assigned to each assumption was either poor or non-existent. The Panel, therefore, intends to focus on compliance with this requirement in the future.

A number of companies identified the growth rate used to extrapolate cash flow projections and the pre-tax discount rate as their key assumptions. While these rates are important, they are not "key assumptions" on the basis of which the cash flow projections for the period covered by the most recent budgets or forecasts are based. Rather, they are applied to those cash flow projections after the projections have been prepared. It is for this reason that the standard includes disclosure requirements in respect of the growth and discounts separately from and in addition to each key assumption on which the cash flow projections are based. In this context, a reference to 'growth' is meaningless unless the item is identified – for example, as sales, margins or costs.

The Panel welcomes the practice, observed in a small number of companies, of quantifying, as well as describing the key assumptions in the cash flow projections even where no reasonably possible change in the key assumptions would indicate an impairment. In the Panel's view, such disclosures assist users in evaluating the reliability of the estimates used by management to support the carrying value of goodwill and intangibles with indefinite lives.

IAS 37 ‘Provisions, Contingent liabilities and Contingent Assets’

IAS 37 establishes the principles to apply to the measurement and recognition of provisions, contingent liabilities and contingent assets and the disclosures required to enable users to understand their nature, timing and amount. Questions asked of companies focussed on the apparent absence of provisions when other disclosures indicated their existence, for example, why there was no provision for rehabilitation in the accounts of a mining company whose development costs were stated to comprise amounts incurred to rehabilitate production facilities.

Other companies were challenged where items that are generally accepted to be provisions were treated as accruals with no disclosure of their nature or of the expected timing and any uncertainties regarding the amount or timing of the outflows. For example, onerous lease liabilities and restructuring costs were, on occasion, presented as accruals rather than provisions in circumstances, however, which indicated that there was still uncertainty regarding their timing or amount. Similarly, aggregation of provisions was questioned where it appeared that the aggregation might include amounts that differ significantly in their nature and/or timing, such that the disclosure requirements of IAS 37 were not met.

IAS 38 ‘Intangible Assets’

IAS 38 prescribes the accounting treatment of intangible assets that are not dealt with specifically in another standard.

Companies were challenged to explain why internally generated intangible assets were included in statements of financial position when, from the disclosures provided, they did not appear to satisfy all the criteria required to support recognition; for example, when the company’s business model was based on the sale of products and it was not clear how the intangible assets generated would be used or sold.

Other companies were asked to justify why certain classes of intangible assets were aggregated when it was apparent that the assets had substantially different useful lives and disclosure of the relevant amortisation charges might, of itself, be useful information for investors. The Panel also had cause to remind some companies that any impairment charges should be aggregated with accumulated amortisation and not disclosed as a deduction from cost.

One company had treated an intangible asset as having an indefinite life on the grounds of its ability to renew indefinitely. Following challenge by the Panel regarding the substance of the renewal right, it decided to start amortising it.

Boards are reminded that they should also disclose a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to a company’s financial statements.

A Panel reference was given in the accounts of one company which, following enquiry, restated intangible assets to write off previously capitalised costs associated with the development of an international candidate database. The directors reconsidered their previous judgement and concluded that the costs incurred in collecting information about identified candidates did not meet the definition of an intangible asset as the costs did not result in the company having sufficient control over the individual candidates. As such, they were indistinguishable from the costs of developing the business as a whole and should be expensed as incurred.

IAS 39 'Financial Instruments: Recognition and Measurement'

The Panel's comments on IAS 39 in its 2011 report focussed on areas which were of particular significance to companies that, in the wake of the banking crisis, had renegotiated their banking facilities. In order to apply the appropriate treatment under the standard, boards have to determine whether the renegotiations result in an extinguishment of the loan or whether they represent a continuation of the previous arrangements.

The Panel raised fewer questions of this nature in the current year but did so where the treatment adopted was not clear.

As referred to in Appendix B, in the wake of the crisis surrounding Greek sovereign debt in the summer of 2011, the European Securities and Markets Authority (ESMA) established a working group to conduct a fact-finding exercise in respect of the reporting of sovereign debt in the 2011 half-year accounts of a number of EEA listed financial institutions. The Panel, working together with the FSA, represented the UK on the group and undertook reviews of relevant accounts disclosures to determine whether any action was necessary in relation to UK banks' and insurers' reporting of sovereign debt exposures. The working group subsequently conducted a further detailed review of accounting practices in the IFRS financial statements of financial institutions for the year ended December 2011. The accounting treatment adopted by UK issuers was in line with expectations. The amounts held were wholly immaterial in some cases. Where they were more substantial, significant impairment charges were recognised.

IAS 40 'Investment Property'

All companies are required to determine the fair value of their investment properties, either for measurement purposes (if they adopt the fair value model) or disclosure (if they choose the cost model).

Where an investment property is carried at fair value, IAS 40 requires disclosure of the methods and significant assumptions applied in determining that fair value, including a statement as to whether the determination was supported by market evidence or was more heavily based on other factors, which the company should disclose, because of the nature of the property and lack of comparable market data. In the Panel's view, this requirement is not satisfied by a statement that the valuation was carried out under the standards issued by the Royal Institution of Chartered Surveyors or under International Valuation Standards. We will, in future, challenge any such minimal disclosures.

The Panel has asked boards how they exercise their judgement when distinguishing owner-occupied property from investment property. Where classification is difficult, IAS 40 requires the criteria applied to be disclosed.

It also challenged companies where there was a question whether a valuation obtained for investment property had been adjusted significantly for the purpose of the financial statements. IAS 40 requires the disclosure of a reconciliation in such circumstances.

As noted in last year's report, the Panel continued to raise questions when it appeared that direct operating expenses should have been analysed between properties generating rent and properties that did not.

IFRS 3 'Business Combinations'

Last year, the Panel identified business combinations as a particular area of focus in the accounts of those companies that were applying IFRS 3 (Revised) for the first time. It is pleased to note that fewer enquiries of companies were raised on this area of financial reporting than before, albeit that there was a general shift in the nature of the issues raised by the Panel during the year.

Whereas many of last year's enquiries were prompted by accounting policy statements that had not been updated to reflect the changes introduced by IFRS 3 (Revised), this year the Panel had cause to challenge some boards on how they had applied particular aspects of the revised reporting requirements to the specific circumstances of business combinations entered into during the year, for example reacquired rights and transactions with non-controlling interests. Boards should remain alert to the wide-ranging impact of key changes introduced by the revised standard which need to be considered in every case.

A few companies were asked to provide additional information supporting their accounting for a transaction as a purchase of assets when there was a question as to whether the transaction was a business combination which should be accounted for in accordance with the standard. The Panel also challenged a small number of companies' business combinations under common control where the applied accounting was unclear. Common control acquisitions fall outside IFRS 3, and companies that had adopted merger accounting, as permitted, were challenged when disclosures explaining their approach were weak and included inappropriate terminology.

The Panel continues to be concerned that not all identifiable intangible assets which meet the criteria for recognition and measurement in the financial statements are appropriately recognised on acquisition. All intangibles acquired as part of a business combination are now deemed to be capable of reliable measurement. The Panel continued to challenge companies where there was reason to believe that an asset had been subsumed within goodwill rather than accounted for separately. Last year the Panel also drew attention to the changes in the required reporting of contingent consideration liabilities, particularly where the consideration is payable to vendors and is conditional on the vendors continuing to provide services to the business following its purchase by the acquirer. In one case this year a company agreed to restate an acquisition so as to account for such consideration as post-acquisition remuneration for services. Where there is, or may be, a question as to the detail of the arrangements or the accounting adopted, the Panel may ask the company for further information explaining the basis on which it made its decision.

IFRS 7 'Financial Instruments: Disclosures'

Disclosures relating to financial instruments are provided in annual accounts to enable users to evaluate the significance of financial instruments for the company’s financial position and performance, and the nature and extent of risks arising from the financial instruments to which the company is exposed and how the company manages those risks.

In view of the heightened country and currency risk in the present economic environment, FRC reminded directors earlier this year of the range of disclosures required in financial statements in order to give a balanced and fair view of their companies’ exposures.

During the year, the Panel engaged with companies when it was apparent that liquidity risk had been a major concern during the year but when the disclosures in the annual report and accounts were bland and generally uninformative. Where liquidity risk has become more material, boards are encouraged to reconsider the nature and extent of their disclosures rather than merely repeat previously published information, particularly about their policies and processes for managing the risk. They should also consider whether the quantitative information provided as at the year end is representative of the position during the year and, if it is not, provide further information that is representative.

Companies were also challenged where the disclosures provided did not enable an understanding of the nature or extent of the company’s exposure to risk or how it is managed in practice. One example is of a company which changed its banking facilities after the year end but which did not amend its disclosures to reflect that fact.

The Panel continues to note some confusion about the items that are to be included in the quantitative information required. This may be because the scope of IFRS 7 is somewhat wider than that of IAS 39. IFRS 7 can, for example, apply to finance leases and certain loan commitments, while contingent consideration payable in a business combination meets the definition of a financial liability and should, therefore, be included in the relevant quantitative data disclosed.

Appendix A

Common disclosure points raised with companies

The Panel often draws attention to possible omissions of more minor disclosures in an appendix to its main letter, distinguishing them from points of potential substance. It does not ask for a response to these issues but brings them to the company's attention for consideration in connection with the following year's annual report and accounts if they are material or relevant and have been overlooked.

The Panel encourages boards and their advisers to interpret these reminders from the Panel in the helpful spirit in which they are intended and to have the confidence to make judgements about those disclosures which are material and those which are not.

The more common disclosure points raised were as follows:

IAS 1 'Presentation of Financial Statements'

Information that enables users of financial statements to evaluate the company's objectives, policies and processes for managing capital (IAS1.134).

Total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests (IAS 1.106(a)).

Dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to owners during the period (IAS1.137(a)).

Liabilities and assets for current tax separately from other current liabilities and assets (IAS1.54(n)).

IAS 2 'Inventories'

The amount of any write-down of inventories recognised as an expense (IAS2.36(e)).

IAS 11 'Construction Contracts'

Methods used to determine the stage of completion of construction contracts in progress (IAS 11.39(c)).

IAS 12 'Income Taxes'

The nature of the evidence supporting recognition of a deferred tax asset when utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences (IAS 12(82(a)(b)).

The amount of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the statement of financial position (IAS 12.81 (e)).

The aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognised (IAS 12.81(f)).

In respect of each type of temporary difference and in respect of each type of unused tax losses and unused tax credits, the amount of the deferred tax assets and liabilities recognised in the statement of financial position, together with the amount of the deferred tax income or expense recognised in profit or loss, if it is not apparent from the changes in amounts recognised in the statement of financial position (IAS 12.81(g)).

IAS 17 'Leases'

For lessors under finance leases, disclosure of both the gross investment in the lease and the present value of minimum lease payments receivable over specified time periods and a reconciliation between the two (IAS 17.47(a)).

For lessees, the total of future minimum sublease payments expected to be received (IAS 17.31(d) and 35(b)).

For lessees under operating leases, lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents and sublease payments (IAS 17.35(c)).

IAS 21 'The Effects of Changes in Foreign Exchange Rates'

Foreign exchange gains and losses recognised in profit or loss except for those arising on financial instruments measured at fair value through profit and loss in accordance with IAS 39 (IAS 21.52(a)).

Foreign exchange gains and losses recognised in other comprehensive income and accumulated in a separate component of equity (IAS 21(53(b)).

IAS 38 'Intangible Assets'

Whether the useful lives of each class of intangible assets are indefinite or finite and, if finite, the useful lives or the amortisation rates used (IAS 38.118(a).

The aggregate amount of research and development expenditure recognised as an expense during the period (IAS 38.126).

IAS 40 ‘Investment Property’

Contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements (IAS 40.75(h)).

IFRS 2 ‘Share-based payment’

The number and weighted average exercise price of share options for various groupings of options such as options outstanding at the beginning and end of the period, and options granted, forfeited and exercised during the period respectively (IFRS 2.45(b)).

For share options exercised during the period, the weighted average share price at the date of exercise (IFRS 2.45(c)).

IFRS 3 ‘Business Combinations’ (2008)

The acquisition date fair value of the total consideration transferred and the acquisition date fair value of each major class of consideration, such as:

i. cash;
ii. other tangible or intangible assets, including a business or subsidiary of the acquirer;
iii. liabilities incurred, for example, a liability for contingent consideration (IFRS 3.B64(f))
iv. equity interests of the acquirer.

The total amount of goodwill that is expected to be deductible for tax purposes (IFRS 3.B64(k)).

The amount of acquisition–related costs for each business combination and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of comprehensive income in which those expenses are recognised, and also the amount of any issue costs not recognised as an expense and how they were recognised (IFRS 3. B64(m)).

IFRS 7 ‘Financial Instruments: Disclosures’

A reconciliation of the changes in the impairment allowance accounts (IFRS 7.16).

The impairment loss on receivables (IFRS 7.20(e)).

For cash flow hedges, the period when the cash flows are expected to occur and when the cash flows are expected to affect profit or loss (IFRS 7.23(a)).

For cash flow hedges, the amount reclassified from equity to profit or loss for the period, showing the amount included in each line item in the income statement (IFRS 7.23(d)).

IFRS 8 'Operating Segments'

Reconciliations of the reportable segments' revenues, assets and liabilities to the entity's revenue, assets and liabilities showing separately all material reconciling items (IFRS 8.28 (a),(c) and (d)).

The revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed (IFRS 8.32).

Appendix B

International Co-operation

Europe - ESMA

The Panel is an active member of the European Enforcers' Co-ordination Sessions ("EECS"), a sub-committee of the European Securities and Markets Authority ("ESMA"). EECS met regularly during the year to consider enforcement decisions and common reporting issues relevant to the co-ordination and consistency of IFRS reporting across the EEA. The Panel participates actively in these meetings to facilitate the consistent application of IFRS in Europe by national enforcers of IFRS financial information published by listed companies.

As permitted by its procedures, the Panel submitted a number of enforcement decisions to the sub-committee's private database for discussion with its European colleagues. The Panel is a member of the EECS agenda sub-committee and helps to prepare EECS publications informing issuers of IFRS application issues. The extracts from the EECS database that are published on the ESMA website, together with national reports and announcements of other enforcers, contribute to the convergence of practice and the sharing of acceptable accounting treatments under the international accounting framework.

The Panel was also represented on three ESMA working groups during the year, established to:

- review the two ESMA Enforcement Standards on Financial Information with a view to updating them
- consider aspects of materiality
- review and consider the reporting of sovereign debt in the accounts of EU listed financial institutions

Since the year end, the Panel has also been represented on a further Group which is reviewing impairment practices and disclosures.

The group established to review ESMA's standards of enforcement and associated guidance is doing so with a view to determining the changes needed to reflect the practical experiences of EECS members and to realise the potential for better co-ordination and enhanced consistency of enforcement activities in Europe. Proposed revisions will be subject to public consultation.

The review of sovereign debt disclosures in the 2011 half yearly accounts of EEA listed financial institutions led to the publication of a statement by ESMA, setting out expected disclosures. The working group continues to keep this matter under review (see page 26).

USA – Securities and Exchange Commission (SEC)

The Companies Act 2006 allows the Panel to share otherwise confidential information with overseas authorities where certain criteria are met.

In 2007, the FRC entered into a protocol with the FSA and the SEC to facilitate implementation of certain aspects of the CESR-SEC Work Plan. The protocol makes particular reference to the use of IFRS and US GAAP by internationally active issuers. The protocol provides for consultation and information-sharing between the SEC and FRC in relation to UK listed and SEC registered issuers when, amongst other things, the FRC staff view on an IFRS matter in the accounts of a UK-listed SEC registrant could result in a significant change to the issuer's financial statements.

Appendix C

Statistics

	FTSE 100	FTSE 250	Other listed	AIM	Third Country	Unlisted public and private	TOTAL
Accounts reviewed							
Annual	45	53	81	66	2	25	272
Interim	1	4	49	0	0	0	54
Selected by the FRRP							
Annual	38	51	77	55	2	22	245
Interim	0	4	48	0	0	0	52
Complaints/referrals							
Annual	7	2	4	11	0	3	27
Interim	1	0	1	0	0	0	2
Approaches to companies	20	25	42	35	1	7	130

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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