FRC

Annual Review of Corporate Reporting 2019/20

Corporate Reporting Highlights

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Introduction

This document highlights the key messages from the FRC's Annual Review of Corporate Reporting 2019/20. It is new this year and is designed for those with an interest in corporate reporting but who do not need the detail in the main report or who would find a summary helpful. The highlights include:

- the ten areas that prompt the most questions of companies by FRC's monitoring function and what to do to avoid challenge; and
- other disclosure improvements we expect to see next year.

Quality of corporate reporting

We assess the quality of corporate reporting in the UK through our routine monitoring activities and thematic reviews. The overall quality of reporting by UK companies has remained consistent in recent years.

We have seen incremental improvements in certain matters, for example fewer inconsistencies between disclosures relating to judgement and estimation uncertainty in different parts of the annual report and accounts.

However, there is still room for improvement in others: explanation of judgements and estimates, and disclosures of impairment testing and impairment losses, for example. We also found scope for better disclosure of revenue recognition, especially variable consideration and performance obligations.

The statement of cash flows remains the most common source of identified material errors.

Disclosures in reports and accounts should be sufficient for users to understand the effect of significant matters on the company's performance, cash flows and financial position. The most common outcome of our work is that companies enhance the quality of their future disclosures.

Companies need to meet the overarching objectives of accounting standards as well as their detailed disclosure requirements. This is particularly relevant where companies have to explain novel transactions or unusual circumstances, such as the effects of the Covid-19 pandemic.

Impact of Covid-19 on financial reporting

The context for company reporting has changed in the Covid-19 crisis. However, the key considerations for companies when preparing their report and accounts, such as clarity, consistency, relevance and transparency, remain. Better disclosures:

- are specific to the company;
- explain clearly how Covid-19 has affected the company's reported position and performance, and how it may affect future prospects;
- address any material uncertainties, and the basis of any significant judgements made, in adopting the going concern assumption;
- provide information on significant accounting judgements, sources of estimation uncertainty and other assumptions applied; and
- show a consistent outlook across the business model, principal risks and uncertainties, viability statement, going concern and accounting judgements and estimates.

Our report, 'Covid-19 Thematic Review: Review of financial reporting effects of Covid-19', and the Financial Reporting Lab's ('the Lab') reports on 'Reporting in times of uncertainty' and subsequent updates provide further guidance and examples of better disclosures.

David Rule, Executive Director of Supervision, comments:

"The impact of the Covid-19 pandemic on businesses is pervasive but also differs across sectors, geographies and individual companies. Our thematic review highlighted how important it is for companies to explain not only how the pandemic has affected company performance but also how it might affect a company's future prospects.

"The findings in the Annual Review of Corporate Reporting, and our key expectations for 2020 reporting, further emphasise that clear disclosure of forward-looking information is key to providing users with the insights they need to make informed decisions."

Corporate Reporting highlights – findings

Top ten most frequent areas of FRC findings - and how to address them	
Judgements and Estimates	Critical judgement disclosures should be tailored and not just repeat the accounting standard. They should explain the specific accounting judgements made and the effects. Sources of estimation uncertainty should be quantified. Information about sensitivities or ranges of outcomes should be disclosed to help users understand the effect of management's assumptions.
Impairment of Assets	Users of accounts are likely to have a focus on impairment in the light of the economic effects of the Covid-19 pandemic. Companies which disclose significant judgements about whether to test investments, tangible or intangible assets for impairment need to explain the outcome of those judgements, the basis for the assumptions made and any sensitivities to changes in those assumptions. Companies should give specific information about the basis on which cash-generating units are identified for the purpose of testing goodwill and other assets for impairment. Any changes year-on-year should be explained. Companies should give the required disclosures around the selection and quantification of assumptions when modelling future cash flows. They should explain the effects of sensitising those assumptions on any headroom in calculations.
Revenue from Contracts with Customers	When revenue is recognised over time, rather than at a point, companies should explain the basis for selecting this accounting policy. They should also explain the basis for monitoring how performance obligations are satisfied over time. Where companies have arrangements with multiple elements, they should explain any significant judgments made in identifying relevant performance obligations. Accounting policies should explain the nature of any variable consideration receivable and how it is estimated and constrained.
Financial Instruments	We expect companies to give more information about liquidity risk in the current circumstances, to include: risk management, covenants, and the use of facilities, drawn and undrawn. We expect information about factoring and reverse factoring/ supplier financing arrangements to be disclosed if material. This includes the effect on the balance sheet and cash flows, the accounting policies applied and the effect on covenants.
Alternative Performance Measures (APMs)	Companies should not give undue prominence to APMs; for example, by only giving meaningful commentary on a non-GAAP (generally accepted accounting practice) basis. Reconciliations to GAAP measures should be given for all APMs, including ratios. Users should be able to relate reconciling items to GAAP measures in the report and accounts. Adjustments made in calculating APMs from IFRS numbers should include gains, as well as losses, when relevant to the definition of the APM.

Corporate Reporting highlights – findings (continued)

Top ten most frequent areas of FRC findings - and how to address them	
Strategic Report	This should give a fair, balanced and comprehensive view of the performance and position of the business, which includes consideration of the balance sheet and cash flows, as well as the result for the year. Other matters, taxation for example, may also be particularly relevant.
Statement of Cash Flows	The Statement of Cash Flows was the main source of restatements arising from our monitoring activities. Companies need to focus on complying with the specific requirements of the standard. They should also pay attention to: the classification of cash flows from unusual transactions, the inappropriate netting of gross cash flows and the disclosure of non-cash changes in financing liabilities.
Provisions and Contingencies	Companies should disclose sufficient information to enable users to understand the nature of provisions, related uncertainties and the potential timing of cash outflows.
Fair Value Measurement	Fair value disclosures should be provided for all relevant areas of the financial statements, with explanations supporting judgements, and assumptions with sensitivity analyses where appropriate.
Business Combinations	Companies should clearly explain how acquired assets and liabilities, and any contingent consideration are measured.

We also expect…

… disclosure of forward-looking information that is specific to the entity and which provides insights into the board's assessment of the business's prospects and the methods and assumptions underlying that assessment.

… a clear explanation of any material changes in the business model. We will also assess whether a changed business model is appropriately reflected in the financial statement disclosures of, for example, operating segments, or the allocation and impairment testing of goodwill.

… going concern disclosures that explain the basis of any significant judgements, including whether there are any associated material uncertainties, and the matters considered when confirming the preparation of the financial statements on a going concern basis.

… consistency between the business model, going concern disclosures, the viability statement and financial statement assumptions and estimates, notably for impairment testing at group and parent company level.

… 'adjusted for Covid-19' alternative performance measures only in exceptional circumstances. Allocation of items such as impairment charges between Covid-19 and non-Covid-19 are likely to be highly subjective and therefore generally unreliable.

Information on the findings in our most recent thematic reviews can be found in:

- IFRS 15 'Revenue from contracts with customers': a follow-up thematic review
- IFRS 16 'Leases': A thematic review of disclosures in the first year of application
- Quality of reporting in relation to climate change (forthcoming)
- Cash flow and liquidity disclosures (to be published in November 2020)

The Annual Review of Corporate Reporting provides case studies and example disclosures on:

- estimation uncertainty in the recoverable amounts of tangible assets;
- significant judgements in revenue recognition about contract modifications, variable consideration and the 'highly probable' constraint;
- earnings per share calculations and the effect of capital restructuring; and
- dividends declared without due attention being given to accounting and legal considerations.

Financial Reporting Council

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

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