11 December 2014

With preparation for the December 2014 reporting season underway, we would like to highlight recent changes to annual reporting requirements which may affect your company for the first time and the best practice lessons learnt from early adopters of other changes. Whilst the initiatives below apply in the first instance to statutory annual reports, you might also consider the application of the underlying principles to your company's preliminary statements.

Clear & Concise reporting

During 2014, the FRC launched a programme of work to help ensure that annual reports provide relevant information for investors.

This "Clear and Concise" programme is not a new reporting requirement. Instead it is a call to action. We encourage you and your management to consider how best to tell the story of your company's strategies, performance, position and prospects as clearly and concisely as possible to improve the accessibility of relevant information for investors.

The Clear & Concise principles are embedded in the Guidance on Strategic Reports[1] we issued in 2014. Matters for preparers to consider include the application of materiality, so that information that is particularly important for investors is not lost amongst immaterial detail; the placement of information so that the relationships between strategies, KPIs and director remuneration are clear; and the clarity of language, avoiding jargon and boiler-plate disclosure.

The Financial Reporting Lab has issued a report, "Towards Clear & Concise Reporting"[2] on the steps taken by companies during 2014 to improve the quality and clarity of their reports. This includes practical guidance that may be useful to you. Our Corporate Reporting Review team also aims to help companies improve their reports by highlighting those instances, such as irrelevant or unclear accounting policy notes, that might constitute clutter or undermine clarity and concision.

UK Corporate Governance Code

During 2014, we saw improvements in the quality of corporate reporting following the introduction of the requirement for accounts to be "fair, balanced and understandable". This requirement is entirely consistent with the notion of Clear & Concise reporting, and we encourage you to find ways of ensuring continual improvements in this area.

In September 2014, the FRC issued a revised UK Corporate Governance Code following a number of consultations in response to the findings of the Sharman Panel Inquiry. Whilst these changes only become applicable for years beginning after 1 October 2014 (and before then companies should continue to report against the September 2012 Code) you may wish to adopt some or all of the provisions earlier.

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[1] https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf

[2] https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-Towards-Clear-Concise-Reporting.pdf

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To comply with the new Code directors should:

- confirm they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. This assessment should include consideration of the company's resilience in severe but plausible scenarios. The use of stress testing and sensitivity analysis may be useful in this regard;
- describe those risks and how they have been managed or mitigated;
- make a statement on the viability of the company over a period that must be explained and justified; and
- state whether the going concern assumption of accounting is appropriate, identifying material uncertainties over a period of at least twelve months from the date the accounts are approved.

Further guidance on these provisions was issued with the revised Code in September 2014. As with the rest of the Code, these provisions will operate on a "comply or explain" basis.

Extended audit committee and auditor reporting

During 2014 investors have been able to see improvements as a result of the changes made to the UK Corporate Governance Code and UK Auditing Standards in 2012 and 2013. In particular:

- Audit committees now report on the issues they considered in relation to the financial statements and how these issues were addressed; and
- Auditors now provide an extended report which summarises how they responded to the risks of material misstatement and applied materiality.

We welcome the responses of both audit committees and audit engagement partners to these changes. In particular, a number of audit engagement partners have gone considerably further than the requirements of the standards. We encourage you and your auditors to continue to innovate and improve the quality of reporting in these areas. Some risks and issues may prevail from year-to-year whilst others become less important; disclosures should reflect developments and your current responses.

As the audit committee and auditors report on different matters the audit committee report and the auditor's reports may not be perfectly aligned. However, directors, management and auditors are encouraged to obtain a mutual understanding of the reasons for this significant non-alignment. This could arise, for example, when the auditor raises an assessed risk of material misstatement that is not discussed as a significant issue by the audit committee.

Corporate Reporting Review

We recently published the annual report of our Corporate Reporting Review team. All Chairmen of listed companies should have received a copy.

The report identifies issues we raised last year and sets out our areas of challenge in the year and highlights those aspects of focus for the forthcoming reporting cycle.

We will continue to challenge the appropriateness of key judgements and estimates and the quality of supporting disclosures to assess whether users have sufficient information to understand the basis on which the board came to its conclusions. This is particularly important for unusual or complex arrangements be they with customers or suppliers. Such arrangements are commonly found in retail and some other sectors. We recently issued a Press Notice[3] urging clarity in the reporting of such arrangements.

[3] https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/December/FRC-urges-clarity-in-the-reporting-of-complex-supp.aspx

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Particular attention must be given to the implementation of new international reporting standards where applicable. Where a new standard has been introduced but not yet implemented, disclosures of any material impacts on the accounts must be made where they can be reasonably estimated. The IASB has introduced two substantial new standards during 2014, IFRS 9 on financial instruments and IFRS 15 on revenue and, whilst they are not yet effective, you are encouraged to consider, at the earliest possible stage, making appropriate disclosures on their likely impact.

Financial Reporting Lab output

In November, we published a summary of points from the Financial Reporting Lab's reports, "Lab reminders for the 2014 reporting season", reflecting practices that investors have told us are helpful, including net debt reconciliations and cash flow disclosures, Audit Committee reporting, and a report this year providing insights on what investors want from accounting policy disclosures.

The Lab also has an ongoing project on 'Disclosure of dividend policy and capacity'. This project was initiated earlier in the year, following interest from a group of investors wanting enhanced disclosure of capital maintenance and distributable reserves. In October, these investors wrote to the Audit Committee chairs of FTSE 100 companies to encourage additional disclosure of distributable reserves in this year's annual reports. These investors are participating in the Lab's project, which is addressing disclosure of overall dividend policy; of risks to dividends under the policy; and of links to the company's strategy, capital commitments, capital investment and liquidity needs. We expect to report on this in the middle of next year but you may wish to look at the clarity of disclosures on dividend policy and capacity in the meantime

In summary, 2014 has been a year of encouraging improvements in the quality of corporate reporting as they have become more "fair, balanced and understandable" and greater insights have been provided into the work of the audit committee and the auditor. We hope this trend will continue and hope you will be able to contribute in relation to your company.

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