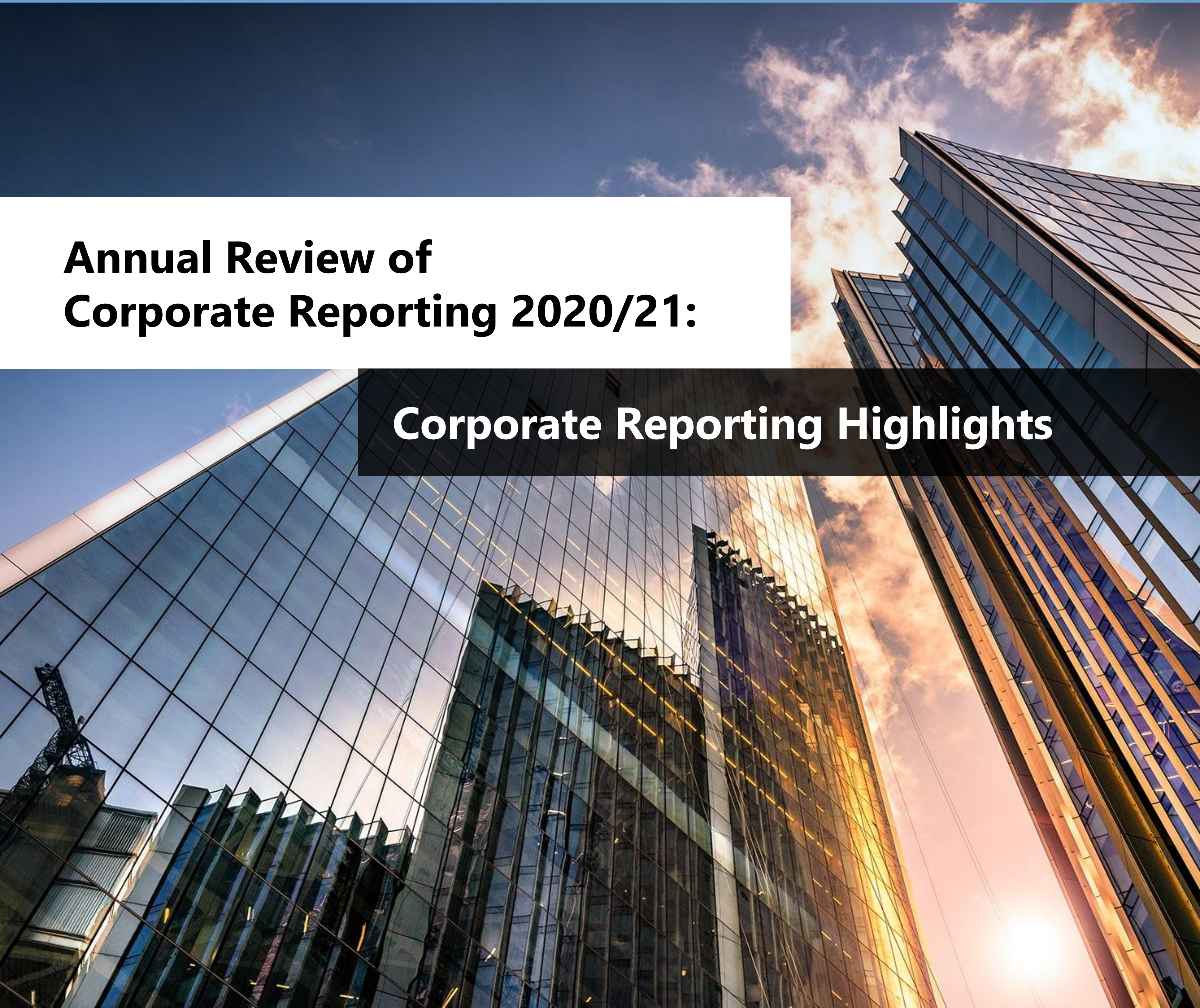
Financial Reporting Council

Annual Review of Corporate Reporting 2020/21:

Corporate Reporting Highlights



Introduction

Introduction

During these challenging times for the UK economy it is even more important that investors and other stakeholders have confidence in the information that companies provide. A strong regulator is central to creating trust in the quality of corporate reporting and building confidence from investors. The Corporate Reporting Review team monitors the application of accounting standards and other corporate reporting requirements, seeks correction where needed and promotes improvements by encouraging companies to enhance their disclosures to better meet investor expectations.

This document highlights the key messages from the FRC's Annual Review of Corporate Reporting 2021. It 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. It includes:

- the ten areas that prompt the most questions to companies from the 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 were pleased to note that our detailed monitoring work did not identify a decline in reporting quality despite the challenges of reporting in the continuing Covid-19 pandemic.

We saw examples of good quality reporting, and improvements in certain areas. For example, companies did better at defining, labelling and reconciling alternative performance measures ('APMs') to their IFRS equivalents. We were also pleased that the quality of interim reporting was generally good.

There remain, however, opportunities for further improvement, as evidenced by the fact that a large majority of our reviews result in companies enhancing their disclosures, as a minimum.

Companies should carefully consider the issues most frequently identified in our reviews. We also remind companies to consider the overarching objectives of the reporting requirements, as well as the detailed disclosure requirements.

Thematic reviews

In addition to our routine monitoring work, we performed thematic reviews of:

- Interim reporting
- Viability and going concern
- Alternative Performance Measures (APMs)
- Streamlined Energy and Carbon Reporting
- Provisions, Contingent Liabilities and Contingent Assets

A summary of the findings of these reviews can be found in the Annual Review of Corporate Reporting 2021.

2021/22 priorities

Our routine monitoring of annual reports and accounts during the 2021/22 cycle will include a focus on:

- climate-related risks, including the new disclosures required for premium listed companies; and
- Judgements and estimation uncertainty in the face of the continuing economic and social impact of Covid-19.

Companies should ensure that the impact of these matters on their business is appropriately reflected in the financial statements and wider annual report.

Corporate Reporting highlights – key disclosure expectations

Companies can reduce the risk of regulatory challenge by meeting our expectations in their 2021/22 reporting. These are driven by our top ten findings (see pages 4 and 5).

We expect to see…

… clear explanation of the significant judgements made by management, including those used in their assessment of going concern, with sufficient detail to understand the specific judgements made and their financial reporting effects.

… clear description of key assumptions underlying major sources of estimation uncertainty, including information about the sensitivity of amounts recognised in the financial statements to changes in assumptions.

… information in the financial statements to be consistent with that reported in the rest of the annual report and accounts.

… material climate change policies, risks and uncertainties to be discussed in narrative reporting and appropriately considered and disclosed in the financial statements, particularly where investors may reasonably expect a significant effect on the expected life or fair value of an asset or liability.

… the nature and extent of material risks arising from financial instruments and related risk management are adequately addressed, including: the use of factoring and reverse factoring in working capital financing; the approach to and significant assumptions made in the measurement of expected credit losses; concentrations of risks and information about covenants (where material).

… APMs not to be given greater prominence or authority than amounts stemming from the financial statements and the basis for classifying amounts as adjusting, 'non-underlying' or 'non-core' explained.

… information that meets the disclosure objectives of the relevant accounting standards, as well as the specific disclosure requirements.

… material information that is not obscured by immaterial items.

Corporate Reporting highlights – findings

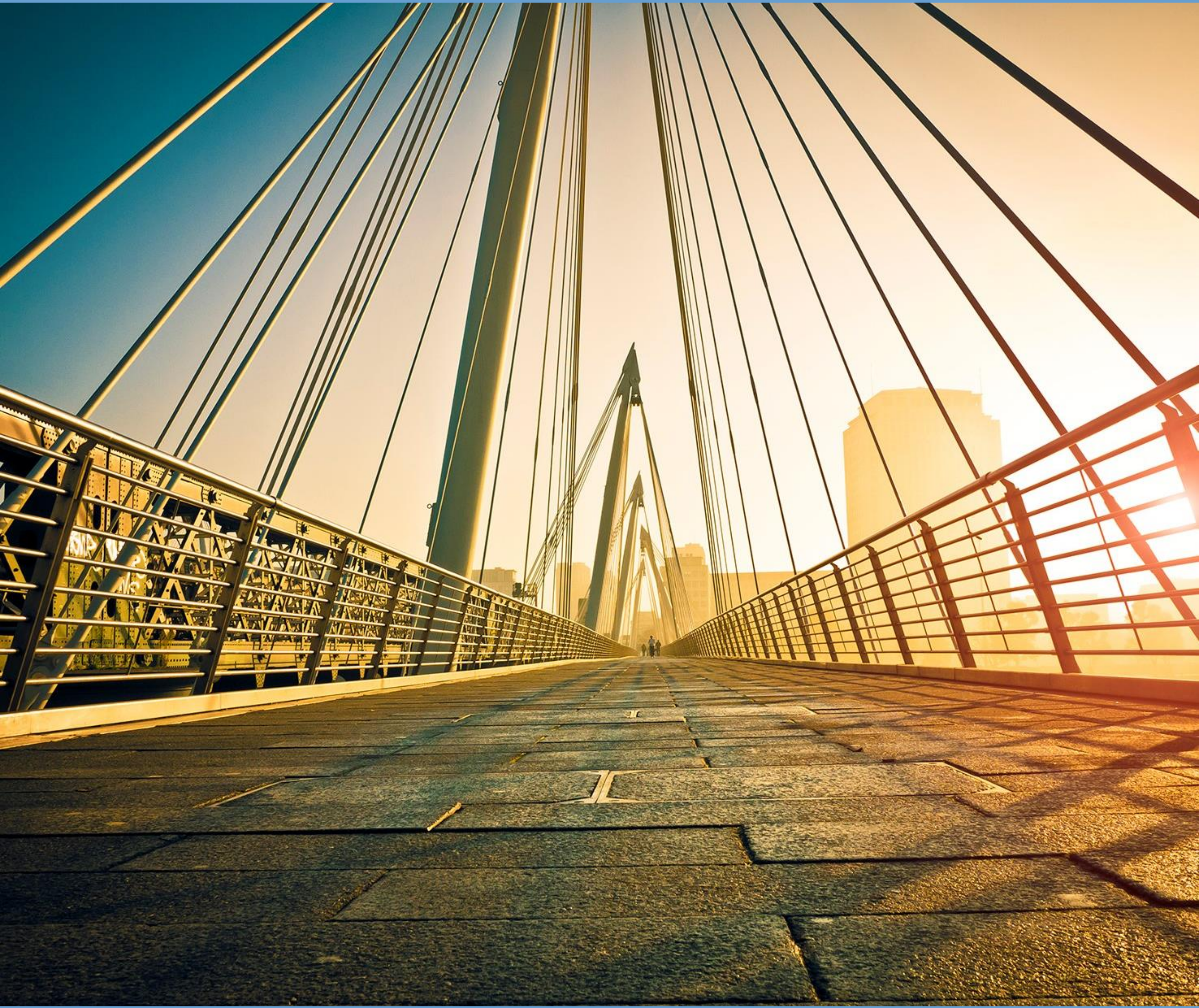
Top ten most frequent areas of FRC findings – and how to address them	
1. Judgements and Estimates	Critical judgement disclosures should be entity-specific and not just repeat the accounting standards. They should explain the specific accounting judgements made and their effects on the financial statements. Assets and liabilities at risk of material adjustment within the next financial year and the key assumptions underlying their measurement should be identified. Information about the sensitivity of assumptions to changes, or ranges of possible outcomes, should be provided.
2. Revenue	Accounting policies should be provided for all significant performance obligations and address: the timing of revenue recognition; the basis for recognising any revenue over time; and the methodology applied. Companies need to explain the nature of any variable consideration and how it is estimated and, where necessary, constrained, using either the 'expected value' or 'most likely amount' method. Disclosures that refer to a significant risk of a downward adjustment to revenue suggest that the constraint may not have been appropriately applied. Significant judgements made in relation to revenue recognition should be disclosed (for example, in relation to the allocation of the transaction price and the timing of satisfaction of performance obligations).
3. Statement of Cash Flows	Robust pre-issuance reviews should be performed to ensure that: the reported cash flows are consistent with amounts reported elsewhere in the report and accounts; the classification of cash flows and cash and cash equivalents complies with the requirements of the standard; and that cash flows are not inappropriately netted. Companies should also consider: the presentation of the parent company cash flow statement (where provided); disclosure of material non-cash transactions; and the reconciliation of changes in financing liabilities.
4. Impairment of Assets	Impairment remains an area of focus for users, due to the continuing effects of the Covid-19 pandemic and the risks posed by climate change. Where uncertainties identified elsewhere in the report and accounts signal a possible impairment, users need to know how this was reflected in any impairment reviews. Users need to understand whether the key assumptions used in impairment reviews are consistent with past experience or external sources of information, the reasons for any significant changes in the assumptions, and whether reasonably possible changes could result in an impairment. Information about impairment testing of investments in subsidiaries needs to be provided where impairment indicators are present; for example, when the net assets of the parent company exceed the market capitalisation of the group.
5. Alternative Performance Measures (APMs)	Companies should not give undue prominence to APMs; for example, by only giving meaningful commentary on a non-GAAP basis. The basis for classifying amounts as adjusting, 'non-underlying' or 'non-core' should be explained; APMs should be reconciled to the most directly reconcilable line item presented in the financial statements; and adjustments made in calculating APMs should include gains as well as losses, where relevant.

Corporate Reporting highlights – findings (continued)

Top ten most frequent areas of FRC findings – and how to address them	
6. Financial Instruments[1]	The nature and extent of material risks arising from financial instruments and related risk management should be adequately disclosed, including: the use of factoring or reverse factoring in working capital financing, if relevant; the approach and significant assumptions applied in the measurement of expected credit losses; and concentrations of risks and information about covenants, where material.
7. Strategic Report and the Companies Act	The strategic report should: address the positive and negative aspects of the company's development, performance, position and future prospects openly, and without bias. Companies should highlight and explain linkages between information presented within the strategic report and the annual report and accounts more broadly. We remind companies of the specific statutory requirements around distributions, including the requirement to file accounts to support interim distributions in excess of retained earnings at the previous year-end.
8. Provisions and Contingencies	Clear and specific descriptions of the nature of each material exposure for which a provision or a contingent liability is recognised should be disclosed, as well as the timeframe over which it is expected to crystallise and the basis for determining the best estimate of the probable or possible outflow.
9. Leases	All material aspects of leasing arrangements need to be covered by entity-specific accounting policies. Judgements about whether the arrangements meet the definition of a lease and the length of a lease should be disclosed. Information in the notes, together with the information provided in the statement of financial position, statement of profit or loss and statement of cash flows, should enable users to assess the effect of leases on the financial position, financial performance and cash flows. This could include information about variable payment features in leases and disaggregated information about future cash flows.
10. Income Taxes[1]	Where material deferred tax assets are recognised by loss-making entities, the nature of the evidence supporting their recognition should be disclosed. Significant accounting judgements and sources of estimation uncertainty will also often need to be disclosed in such cases.

1 The Annual Review of Corporate Reporting provides case studies , which contain examples of good disclosure of:

- the credit risk-related disclosures, required by IFRS 7; and
- the nature of evidence supporting the recognition of the deferred tax assets.



Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS

+44 (0)20 7492 2300
www.frc.org.uk