Financial Reporting Council

FRC urges clarity in the reporting of complex supplier arrangements by retailers and other businesses

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The Financial Reporting Council (FRC) today calls on Boards of retailers, suppliers and other businesses to provide investors with sufficient information on their accounting policies, judgements and estimates arising from their complex supplier arrangements. Investors need to receive enough clear and relevant information to be able to evaluate the company's performance and financial position where such amounts are, or could become, material.

The FRC's Conduct Committee expects to see high quality disclosure of this area of reporting in forthcoming annual and interim reports and accounts and plans to include it as an area of focus when it reviews audits and accounts during 2015.

Fees, contributions, discounts, multiple offers and volume rebates (collectively referred to in this announcement as "complex supplier arrangements") are regular features of supplier contracts in a number of industry sectors, including retail.

The amounts involved are often significant in aggregate to operating margins and other key metrics. Many arrangements require significant judgements to be made by companies when estimating period end amounts receivable and payable for both annual and interim reporting.

Richard Fleck, chairman of the FRC's Financial Reporting Review Panel, said:

> *"Complex supplier arrangements such as fees and discounts may have a significant impact on the reported margins and other results of a company and on investors' views of its performance. Where this is the case, it is essential that investors are able to understand the basis and extent of judgement and estimation involved and the potential uncertainties affecting the accounts and future prospects. Today's announcement is a reminder to Boards of retail companies in particular of what they should consider and encourages them to review their reporting in this area as many have already announced."*

There is no single standard within IFRS which addresses the required accounting or disclosures for these types of commercial arrangements. This, together with an absence of well-known industry norms, underscores the benefits of clear information about the extent to which the results and KPIs of retail and other businesses are reliant on judgements and estimates surrounding their complex supplier arrangements. The FRC observes that IFRS, in addition to providing a clear set of principles on how to develop relevant accounting policies, also includes explicit requirements on disclosure of material judgements and significant uncertainties.

The recent report by the FRC's Financial Reporting Lab on accounting policies pointed to a need for companies to provide more detail than at present to help investors understand how a company accounts for its material transactions and business streams. It also reinforced the value investors place on understanding each judgement and each estimate which has an impact on the reporting of a company's results and financial position.

Notes to editors:

1. 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.

2. The Conduct Committee is a body authorised under the Companies Act 2006 ("the Act") to review and investigate the annual accounts and directors' reports of public and large private companies to see whether they comply with the requirements of the Act, including applicable accounting standards. Following implementation of the Accounting Regulation (EC) No. 1606/2002, this may mean compliance with UK or International Financial Reporting Standards.
3. Where breaches of the Act are discovered, the Conduct Committee seeks to take corrective action that is proportionate to the nature and effect of the defects, taking account of market and user needs. Where a company's accounts or directors' report are defective in a material respect, the Conduct Committee will, wherever possible, try to secure their revision by voluntary means. Should this approach fail, the Conduct Committee is empowered to make an application to the court under section 456 of the Act for an order for revision. To date, no court applications have been made.
4. The Conduct Committee maintains a Financial Reporting Review Panel (FRRP). The Chairman is Richard Fleck and the Deputy Chairs are Joanna Osborne and Ian Wright. There are currently 20 other members drawn from a broad spectrum of commerce and the professions. Individual cases may be dealt with by a specially constituted Review Group of the FRRP.
5. The Conduct Committee is also responsible for audit quality reviews. The overall objective of this work is to monitor and promote improvements in the quality of auditing of listed and other major public interest entities. Findings from corporate reporting reviews are shared with the Audit Quality Review team and are considered in the selection and review of audits for inspection.
6. The July 2014 report of the FRC's Financial Reporting Lab on **accounting policies and integration of related financial information** (PDF) drew attention to the need to provide investors with disclosures that avoided boilerplate text by being specific to the company and providing sufficient detail to understand how the company accounts for its transactions and provides an understanding of the impact of judgement and estimation on the reporting of a company's results and position.
    a. IFRS provides relevant guidance on both accounting policies and disclosure. In relation to complex supplier arrangements the following standards in particular may warrant detailed consideration depending on the precise facts and circumstances:
    b. IAS 1 provides overarching guidance on what should be included in a set of accounts - including significant accounting policies; disclosure of judgements; disclosure of sources of estimation uncertainty; prohibition on netting unless expressly permitted; and sub-classification of balances by nature in the notes.
    c. IAS 2 deals with the cost of inventories and when they should be expensed.
    d. IAS 8 contains principles on the selection of accounting policies, including how to apply judgement in developing a policy where an item is not specifically covered elsewhere in IFRS; an explicit requirement to consider standards dealing with similar and related issues.

e. IAS 18 specifies what can be included in revenue and how it should be measured.
f. IAS 34, which is concerned with interim financial reporting, addresses the allocation of amounts under complex supplier arrangements between periods; and the disclosure of the effect of a change in an interim period accounting estimate.
g. IAS 37 addresses accounting for contingent liabilities and contingent assets.
h. IAS 39 addresses accounting for financial assets and liabilities arising from performance under contracts where cash flows may be subject to revision other than for credit risk.