

## **FRC Annual Review of Corporate Reporting (Lecture A839 – 8.17 minutes)**

On 5 October 2023, the FRC published its *Annual Review of Corporate Reporting* ('the Review') which reports the findings of the FRC's monitoring activities, together with expectations for the forthcoming reporting season.

While the Review is primarily concerned with public interest entities and listed companies, the feedback from the Review can be used by UK and Ireland GAAP preparers on the grounds that FRS 102 is broadly aligned to the requirements of IFRS Accounting Standards.

The FRC reviewed 263 sets of company reports and wrote to 112 companies raising queries about their accounts. Following these enquiries, 25 companies were required to restate their financial statements.

The quality of financial reporting has been maintained and the FRC report improvements in a number of areas such as Alternative Performance Measures (which has fallen out of the 'top ten' issues for the first time in several years). However, the most frequently raised issues in 2022/23 were impairment, and judgements and estimates. The FRC suspect this may reflect the heightened economic uncertainties which companies should factor into their financial reporting.

The focus of the FRC's work during 2022/23 was on companies in sectors that the FRC considered were of higher risk as follows:

- Travel, hospitality and leisure
- Retail
- Construction and materials
- Gas, water and multi-utilities

In 2023/24, the FRC will focus on the following sectors:

- Travel, hospitality and leisure
- Retail and personal goods
- Construction and materials
- Industrial transportation

### **1.1 The 'top ten' issues**

The FRC ranks the topics which frequently result in a substantive question to companies, and these are detailed overleaf.

## **1. Impairment of assets**

Companies must ensure that key inputs and assumptions applied in impairment testing have been disclosed and explained.

This must include relevant values and a sensitivity analysis, where required.

The FRC has reminded companies that additional disclosures are required where headroom is low, and heightened uncertainties over inflation, consumer demand and interest rates may drive a wider range of reasonably possible outcomes for future cash flows and discount rates.

Companies are reminded that users should be able to understand how assumptions are consistent with the discussion of uncertainties elsewhere in the annual report.

In addition, the FRC reminds companies to ensure that impairment testing methodology complies with the requirements of IFRS, in particular:

- that the grouping of assets into cash-generating units is appropriate;
- the treatment of inflation in the discount rate and cash flows is consistent; and
- cash flows used in 'value in use' calculations reflect the current condition of assets before any future enhancement expenditure.

## **2. Judgements and estimates**

Companies are required to ensure that all significant judgements, including those applied in performing going concern assessments, have been adequately described. It will not be sufficient to simply list the matters that require judgement.

There should be adequate disclosures concerning estimates, including values, sensitivities and an explanation of significant changes. All sources of estimation uncertainty with a significant risk of resulting in a material adjustment within one year should be clearly distinguished from other estimates.

Companies are also reminded to reassess disclosures on an annual basis to ensure all relevant matters are captured, immaterial issues are not rolled forward and the assumptions and ranges of reasonably possible outcomes remain appropriate in the company's individual circumstances.

## **3. Cash flow statements**

Down from the 'number one' spot to number three in 2022/23, cash flow statements still appear to be causing issues for some reporting entities. The FRC emphasises the need for a robust pre-issuance review to be performed prior to publishing the annual report.

A drop from the number one spot in the previous year to number three confirms the FRC have found fewer 'routine' errors, but they continue to identify basic consistency checks

when they compare the cash flow statement to other information in the financial statements.

Other errors the FRC have noted during their desktop reviews relate to classification, netting and reporting non-cash movements in the cash flow statement.

#### **4. Strategic report and other Companies Act 2006 matters**

No surprises here as the strategic report tends to raise issues for many companies (including private ones). The FRC reminds companies that the strategic report must provide a fair, balanced and comprehensive review of the company's development, position, performance and future prospects.

This should include an **unbiased** discussion about:

- both positive and negative aspects of the business;
- a clear articulation of the effects of economic uncertainty on the business; and
- should address significant movements in the financial statements (including those in the cash flow statement and balance sheet).

The FRC has also reminded companies to ensure that all statutory requirements for the payment of dividends have been met. This includes ensuring the requirement to file interim accounts where distributions are not supported by the most recent audited accounts.

#### **5. Financial instruments**

Down from the number two spot to number five in 2022/23 are financial instruments. Again, no surprises here because these also seem to cause problems for many companies. Companies must ensure that material risks arising from financial instruments are adequately disclosed together with how these risks are managed. This includes risks driven by inflation and rising interest rates as well as any related hedging instruments.

Companies are also reminded to provide adequate information concerning banking covenants. The exception to this requirement would be where the likelihood of any breach is considered remote.

#### **6. Income taxes**

Any forward-looking assessments which support the recovery of deferred tax assets must be based on appropriate assumptions concerning future taxable profits. Deferred tax assets arising from utilised tax losses have always been a contentious issue due to accounting standards taking a pessimistic approach to their recognition. To that end, the FRC reminds companies that where the company has been loss-making, the nature of the **convincing evidence** supporting recognition of the deferred tax asset must be disclosed.

Companies must also ensure that tax-related disclosures throughout the report and accounts are consistent. Material reconciling items in the effective tax rate reconciliation should also be adequately explained.

## 7. Revenue

It should not come as a shock that one of the issues is in relation to accounting policies. The FRC has reminded companies that accounting policies must be provided for all significant revenue stream. These policies should describe the methodology applied, including the timing of revenue recognition, the basis for recognising any revenue over time, and any significant judgements made in applying those policies.

Where there are any inflationary features contained in customer contracts, these should be adequately described in the financial statements together with the corresponding accounting treatment.

## 8. Provisions and contingencies

Companies must ensure they provide clear and specific descriptions of the relevant exposure. This includes the basis for determining the best estimate of the relevant cash outflow and the timeframe over which it is expected to crystallise.

The FRC has also found it necessary to remind companies to ensure the calculation and presentation issues comply with IFRS. This is also an issue that UK and Ireland GAAP preparers can take on board as well. Remember, the provision cannot be presented in the balance sheet net of any reimbursement asset. The FRC has also reminded companies to ensure that a consistent approach is taken when reflecting the effects of inflation in cash flows and discount rates.

## 9. Presentation of financial statements

The financial statements must contain **company-specific** information concerning material accounting policies and transactions. This information must also explain how the policies apply to the company's particular circumstances.

The FRC have also reminded companies to ensure that the financial statements are carefully reviewed. Common issues found during the FRC's reviews include:

- errors in the classification of inter-company receivables balances between current and non-current; and
- a failure to disclose material impairments of receivables on the face of the income statement (profit and loss account).

## 10. Fair value measurement

Finally, at number ten, is fair value measurement. There is no change in position for this one.

The FRC has reminded companies to ensure that fair value measurements use market participants' assumptions and provide high-quality disclosures. The FRC has found the most issues in the disclosure of recurring Level 3 measurements, for which the significant unobservable inputs should be quantified, and a sensitivity analysis provided.

The FRC has also reminded companies to consider the need for specialist third-party advice where there is no internal expertise available.