December 2012 – Quarterly edition

iGAAP Newsletter
Beyond the standards

Published for our clients and staff in the UK

Contents

Upfront

After several years of relative stability, 2012 has seen the start of a major change in corporate reporting in the UK.

The first steps in replacing UK GAAP have been taken with the FRC's issue of FRSs 100 and 101 – allowing some entities to report under IFRS accounting policies but with significantly reduced disclosure. FRS 102, the replacement for UK GAAP, will follow shortly behind, and almost all companies will need to make a decision about which framework is the right one for them to report under and when to make the switch between now and 2015.

The rest of the annual report has not been forgotten. In the last edition of this newsletter we covered remuneration reporting and corporate governance disclosure changes; we've now seen proposals from BIS for a new Strategic Report – will these be a big change or largely business as usual?

Bringing both these strands together is the FRC's paper 'Thinking about disclosures in a broader context' – a welcome look at how the future of the whole annual report might evolve. Whilst this gives food for thought, companies can still make good progress towards 'joined up' information under existing standards and rules – we also give some very high-level findings from our annual reporting survey.

All these developments, including relevant Deloitte resources, are covered in our December issue. The eager amongst you may wish to adopt FRS 101 for December year ends; all of the rest will need at least some initial planning if the re-energised reporting envisaged by the government is to bear fruit over the next few years.

We also wish you a very enjoyable festive season!

Deloitte LLP
December 2012

Practical issue: Joined up writing – annual reports

This article is prepared on the basis of our 2012 annual reporting survey *Joined up writing* (for more information about this publication please see page 14).

It is said that human beings work best when both sides of their brains are working together in harmony. The same is true for corporate reporting. Our survey of annual reporting shows that the quality and integrity of reporting has probably never been higher. Meanwhile, all the noise of discussion tends to focus on the difference between the two sides of the annual report. Much of the latest thinking and regulation is trying to bring what are popularly known as the 'front end' and the 'back end' of the report together. The move is towards a greater emphasis on the use of narrative and explaining the business model. In short, the future of annual reporting is about joined up writing. And that also means joined up thinking.

Regulatory requirements and initiatives

There is no shortage of new requirements and initiatives in the regulatory field aiming to achieve the same objective. Under the requirements of the latest update of the UK Corporate Governance Code company boards now need, for periods commencing on or after 1 October 2012, to explain why they think their annual report is fair and balanced. 'Boards', the Code now says, 'would set out in the annual report the reasons why they considered the annual report and accounts, taken as a whole, was fair, balanced and understandable and provided the information necessary for users to assess the company's performance, business model and strategy'.

The Department of Business, Innovation and Skills published long-awaited proposals on narrative reporting. This places the current business review with a new standalone report which will put more emphasis on strategic objectives. It will reduce the number of mandatory disclosure requirements but add responsibilities to talk more about a company's business model. (For more information about BIS proposals please see page 8.)

Current practice

There is absolutely no doubt that the quality of reporting has come on by leaps and bounds over the past few years. Our this year's annual reporting survey shows, for example, that ever more companies are saying that when it comes to the Corporate Governance Code they are complying with everything. Back in 2010 only 35% of companies claimed full compliance. This year the figure is 54%.

The best reports provided a consistent story and explained how their

- objectives
- business model
- strategy
- risks and
- KPIs

all join together. Unfortunately, only 14% of companies surveyed did this, though the number of companies providing a clear link between their KPIs and their strategy and objectives of their business has nearly doubled from 12% last year to 22% this. Meanwhile, eleven companies (out of 100) listed the measures they claimed to be KPIs but never gave the numbers nor referred to them in the report.

Governance in Focus – *Describing Your Strategy and Business Model* will be available at http://www.deloitte.co.uk/corporategovernance

85% of companies had a go at explaining their business model. This requirement is a relatively recent addition to the Code, and set to become a legal requirement under the latest BIS proposals, so companies are still feeling their way. Companies find it harder to use their imagination in how they do this. But they are doing so and moving away from the old safety blanket of boilerplate. It was disappointing that only 37% included a section giving the 'clear and meaningful explanation' which the Code suggests should be used in efforts to 'comply or explain'.

Cutting clutter

Over the years the number of disclosures required in an annual report has increased tremendously. Whilst certain disclosures may be of interest to certain stakeholders the feeling of discontent appears to be growing, with stakeholders sometimes struggling to identify the truly important disclosures in an annual report.

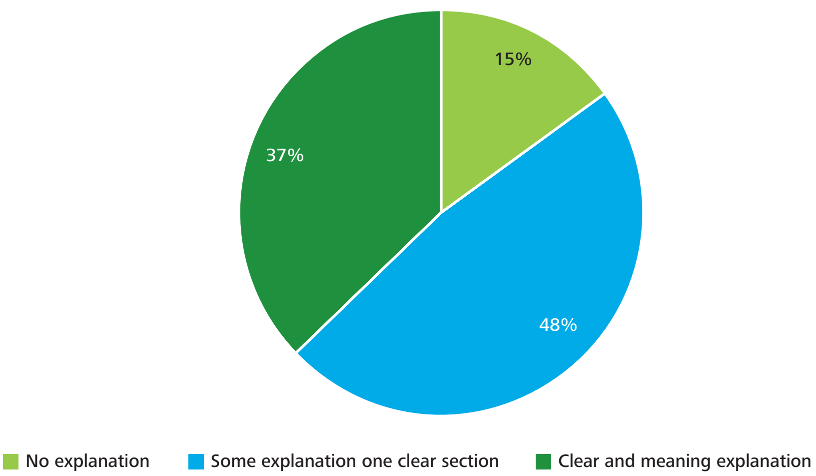
The BIS proposals described above will address this to an extent as regards the front of the annual report, but for many this will not go far enough, particularly since it will not deal with disclosures made in the financial statements. The FRC has just released (in October 2012) its second paper on the cutting clutter issue. The paper is entitled 'Thinking about disclosures in a broader context', setting out a road for a disclosure framework. (For more information about FRC paper please see page 10.)

It remains to be seen what action the standard setters, including the IASB, will take on this front. In the meantime preparers should endeavour to avoid clutter in their annual reports, providing integrated, company-specific disclosures that users can readily understand.

Looking ahead

There is no doubt that the purpose of annual reports and what needs to be included and explained in them is changing. The essential requirement now for the application of joined up writing is partly a consequence of this. Annual reports now require a serious level of content, cohesion and connected thought and information. The best of them, as our survey shows, create a platform which effortlessly explains the business model, performance and future strategic hopes of a company to its shareholders, stakeholders and other users. To pull this off requires all the joined up writing and thinking that can be mustered. This, in practice, requires from preparers and auditors more than compliance with regulatory requirements; this requires a certain mind set, time and effort.

Proportion of companies explaining their business model in the annual report



The future of UK GAAP has arrived – almost

Prepared using IFRS recognition and measurement bases

Technically Companies Act accounts (therefore must comply with company law)

Granted a number of disclosure exemptions

Available to "qualifying entities" in individual financial statements only

FRS 101 Financial statements

FRS 100 "Application of Financial Reporting Requirements" and FRS 101 "Reduced Disclosure Framework" have been published and can be applied for 31 December 2012 year ends. FRS 100 establishes rules on how to select the appropriate accounting framework for a particular entity. FRS 101 introduces a **new reduced disclosure framework** enabling most entities within a group to use the recognition and measurement bases of International Financial Reporting Standards (IFRSs), while being exempt from having to make a number of disclosures required by full IFRSs.

Companies can apply the reduced disclosure framework from FRS 101 if certain conditions are met. The main one is that the company must be a "qualifying entity". A parent company can be a qualifying entity in relation to its own separate financial statements.

A qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and into which that entity is included via full consolidation.

Financial statements prepared under IFRS recognition and measurement bases with FRS 101 reduced disclosures will be "Companies Act accounts" and, therefore, subject to applicable legal requirements including the formats and some additional disclosures. For those qualifying entities already applying IFRSs, the benefits of the disclosure reductions will have to be balanced with the need to grapple with the legal issues. For most, we believe that the benefits will outweigh the costs.

The following are some of the key areas where disclosure exemptions are granted. Some of them are dependent on "equivalent" disclosures being made in the consolidated financial statements but these can be made in aggregate or abbreviated form.

- Cash flow statement
- Share-based payments
- Business combinations
- Financial instruments*
- Related party transactions
- Capital management*

* The exemptions from financial instruments and capital management disclosures are not available to a "financial institution" as defined in FRS 100.

Further details can be found in our ukGAAP Alert *An update on the Future of UK financial reporting and the reduced disclosure framework for listed groups* at http://www.deloitte.co.uk/auditpublications

The suite of new standards will be completed early in 2013 with the publication of FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" which will contain the replacement for current UK GAAP. It will be mandatory for financial years beginning on or after 1 January 2015 but early application is expected to be permitted.

These developments have far reaching implications for nearly all UK reporters who will need to start thinking about how the change will impact their financial statements and the wider business considerations of change including tax, distributable profits, banking arrangements, systems and performance management.

Interview with Bill Hicks – future of UK GAAP

Bill Hicks is a veteran of the financial reporting world and noted for his outspoken views. Currently Chairman of the CBI Financial Reporting Panel, he was previously Group Financial Controller at Tate & Lyle and before that Director, External Financial Reporting at AstraZeneca. He sits on the Hundred Group's Financial Reporting Committee and is a founding member of the Global Preparers' Forum, established to present preparers' views to the International Accounting Standards Board.

Can we talk a little about FRS 101. There's been a lot of pressure on the ASB to simplify company reporting for subsidiaries of listed groups, FRS 101 is the result. Has this been welcomed by listed companies?

Well it's taken a long time for the ASB to get there. They've been working on it for four or five years At the CBI we were right there at the beginning and we said, when they were talking first about replacing UK GAAP with the IFRS for SMEs, that a reduced disclosure framework off the back of that would be really good as well. And they took that on board, huge credit to them, even though that lengthened the amount of time it took. Yes, I think listed companies will want to commit, particularly because in the end UK GAAP is going. Many disclosure exemptions are already in UK GAAP, so if UK GAAP goes and if IFRS for SMEs or full IFRS comes in, they've got to go somewhere and this was something that listed companies will welcome because it gives them the choice. UK GAAP has withered on the vine and so they needed to do something. This is one of the disadvantages of where we'd got to. IFRS for SMEs will be reviewed next year I think it is. I think the IASB needs to introduce an annual improvements cycle into that, I suspect they're not minded to do that, but we'll see. But overall I think it's a good initiative, I welcome it.

The Deloitte annual reporting survey "Joined up writing" found that 40 per cent of parent companies of listed groups still follow UK GAAP. With UK GAAP being replaced with a new UK standard, do you think that it's likely that most listed groups whose subsidiaries and parent company currently use UK GAAP will make the move to FRS 101 rather than FRS 102, the new replacement for UK GAAP?

Yes, it's worth reflecting on the problems – why parent companies didn't move to IFRS and then arguably some subsidiaries did. You could move your parent to IFRS and keep your subsidiaries on UK GAAP, but as soon as you moved one subsidiary to IFRS you had to move the lot. You didn't move your parent for a number of reasons. The primary one was IAS 27 as it then was, which gave you problems around distributable reserves. IAS 27 had a principle that a dividend was a reduction in the carrying value of the subsidiary. They changed it to a presumption that it wasn't a reduction but by then it was kind of too late, people were already preparing under UK GAAP and carried on. I think we've now got an incentive. People will be saying 'right, what do I want to do, do I want to move my parent company to IFRS and then maybe my subsidiaries to IFRS or do I want to keep them on UK GAAP, which is going to be broadly equivalent to IFRS?'. I think many people will move everything to FRS 101.

From talking to companies some are looking at the differences between FRS 101 and FRS 102, in particular around the tax effect of some of the accounting differences, and also possible impacts on distributable profits, and also financial instruments as well. You could take your more basic accounting for financial instruments if you stuck with FRS 102. Do you think those are real drivers in the listed groups?

You can mix and match, so there is that opportunity. I think there will be drivers, particularly on key subsidiaries with regard to distributable reserves. We've long heard that the rules around distributable reserves would be dealt with, but I'm not holding my breath. There are negative goodwill and impairments of goodwill and the ability to write back things that are allowed in Companies Act that IFRS doesn't allow and deals with differently. I think people will do it on a case by case basis. The relative cost of preparation will also be a consideration. What I think you might find is people may look at key subsidiaries and say, 'this will affect distributable reserves so I will make the decision based on what it's going to do to my distributable reserves'.

So technically you could do a mixture of FRS 101 and FRS 102 because they're both Companies Act accounts. I'm not sure that we'd want to see that, it looks a bit odd.

It does look a bit odd. My own guess is that it would be the exception if you have to mix and match. For example, if you find that a key subsidiary results in a black hole for distributable reserves under one and not under the other than I can see that you would go with the other. Because in the end fixing the black hole and getting distributable reserves, that can be expensive.

The FRC has made an effort to publish FRSs 100 and 101 before the year end in the hope that some companies might want to use it for their December year end. How likely is it that companies might rush to adopt it?

I think it's unlikely that people will rush to adopt it. I think it's a good gesture, providing you don't publish something with a huge glitch in it. Preparers tend to be an ungrateful lot so if they didn't do it they would say, 'well you could have done it and it would have helped us'. I would be surprised if many companies adopt it, given where we are in the cycle. But what I would say is that, to the extent that you prepare subsidiary accounts through the course of the following year and you've got seven to ten months to get them then people may adopt it more.

That's a very good point. But obviously, this comes into the cost of preparation that you alluded to; preparing a set of financial statements under the IFRS reduced disclosure framework isn't as simple as just crossing out some of the disclosures due to the restrictions of company law. So do you think this slight complication is going to put people off 101 and maybe just stick with 102 because then the accounts will still look similar to what they're like if they currently use UK GAAP?

Yes, there may be a little bit of that, certainly it might prevent early adoption. I think though the fact that 101 means that you have consistent sets of numbers between your subsidiaries and your consolidated financial statements will be a big driver. In the end you're going to have to adopt something, so there is going to be a change. I think the relative differences mean it will be fairly neutral between the two.

It probably depends how many consolidation adjustments you have to do as well. There was quite a lot of debate around intra-group related party transactions and whether that should be in or out and on balance they decided that you could be exempt from disclosing your intra-company transactions. What do you think about that decision?

Well currently you are exempt anyway under UK GAAP. Intra-group transactions can be voluminous. There can be a huge amount of information. Speaking personally, there's a risk that a set of accounts don't show a true and fair view if you don't put them in. So for example if a subsidiary is utterly dependent upon activity with other fellow subsidiaries, then I think you could argue it should reflect that. Where there's a risk of not doing anything and Dunn and Bradstreet if they're doing a credit check might say, 'right, you're not getting enough information'. But they're not going to the company itself. So I'm getting to the point of: 'what's the effect of excluding them?' Well the key people who are affected by this effect have the means to overcome it. And we did lobby for this.

What about the technicalities of the cost of the transition?

Well we're going to have to transition anyway. One of the benefits that perhaps is really worth identifying is the fact that UK GAAP is withering on the vine, people aren't being trained in current UK GAAP. I always have to go and remind myself which financial instrument standard applies to which company within my group, so those are going to be real benefits and they're worth considering.

Could we talk about the Government proposals on narrative reporting? Do you think that these proposals will result in a step change in the quality and transparency of company reporting, which is obviously what they were intended to do when they were originally put out a year ago?

No.

Is that a good thing or a bad thing?

They are trying to respond to various criticisms about the directors' report and whether the business review should be in the directors' report. If somebody's good at reporting their business in a narrative section then they'll be good under these new guidelines. If they're bad, they'll be bad under the new guidelines. You've now also got to introduce something on human rights and gender.

Do you think that the regulation should have gone further?

There are ideas in the regulation of putting certain parts of the annual report on-line and slimming down the annual report. And a lot of people found that attractive. My own view is that if the end result of all your disclosures is an annual report that's too long as a printed thing, then you've still got a problem. You're not solving the overriding thing by sticking half of it on the net. You're still not dealing with the overall problem that there's too much of it. The benchmark has to be that if you're printing the annual report under existing conditions and it's still too long, then you've still got a problem and sticking it on the net is just a kind of bandage. I can see the benefits, but it doesn't deal with the overriding problem.

There has been a lot of debate about the increasing complexity and decreasing relevance of financial reports. What are your thoughts about the increasing length of the reports?

It's inevitable as businesses have become more complex over the last 15 years, particularly in the areas of financial instruments, innovative ways of paying employees and pension issues. If you look back 15 years I think it would be fair to say that annual reports were a bit skimpy then. Now I think we'd all accept that they're probably too long. We've all heard stories of postmen not being able to deliver the HSBC report. Somewhere there has been a tipping point but I don't know where that tipping point was. There's been a lot of pressure on the IASB to increase disclosures. Meanwhile, auditors are under regulatory pressure so the instinct is, if we've got the disclosures in, there we can't be criticised. As a preparer the amount of time to demonstrate whether disclosure isn't needed is pretty much the same, or indeed probably slightly longer, than actually dealing with the disclosure in the first place. Let me give you an example. If I demonstrate that I don't need to make a disclosure I have to convince several layers of the auditors up to a partner level that it isn't necessary. And I have to calculate it anyway, so I might as well put the thing in by the time I've gone through that. It's not a one off exercise to demonstrate that it's not material. There probably are benefits in defining disclosures between 'never going to be material', 'potentially material' and 'material'. For those disclosures that are 'never, ever going to be material', then you probably have got a one-off exercise. But there are a lot of disclosures of small amounts that are still potentially material. For example, a share-based payment to a key employee, not a director, a key employee, in a multibillion dollar company won't be material, but to the extent it may offer that person three or five million dollars remuneration, that is likely to be material in their hands. And it may be material in non-financial regards, so it is difficult. In the end people say that financial reports are no longer an effective tool of communication and I think we have to ask ourselves whether we should worry about this. It depends on what we think is the function of financial statements.

What other issues worry you?

The thing that I bang on about at the moment is the fact that I think the direction of standard-setting is wrong at the moment. I have a fundamental problem with their fundamental principle about the purpose of financial statements being predictive in nature. I think that's wrong. I think that financial statements have become more of an academic exercise than a communication exercise and I think that should be addressed. How the IASB is persuaded in that direction, if people agree with that, I don't know. But I think that's a fundamental problem. I do try and articulate it and I don't do it very well, to the Board, that as a preparer I am the user of their output. I am a user of financial information as well, because I consolidate financial information, so I'm a valuable user of their products. So if I say to them something is not practical, then you know, they should take notice of that. So I have a problem with the fact that it's too academic now and it's not a tool of communication, and it is flawed in many, many ways. Some of it is rubbish. A lot of it is bonkers. And I take it very seriously.

And finally, what is the most enjoyable part of your role?

There are two things. One is if you enjoy the people you work with. It's always good to go to work because you talk to people and chat and have ideas. But most of all it's seeing people evolve. For example, I always look back to my time at Astra Zeneca where we had somebody who came in to do one thing. He was a good lad from Bury and then we said, can you do this as well, and he said, I'll try, and he could and then we said, can you manage a team, oh I'll try, he said, and he was brilliant at it and I love that, it's great and I admire him so much, so that's it.

Topic of focus: The future of narrative reporting

The draft regulations can be obtained at http://www.bis.gov.uk/Consultations/future-of-narrative-reporting-further-consultation

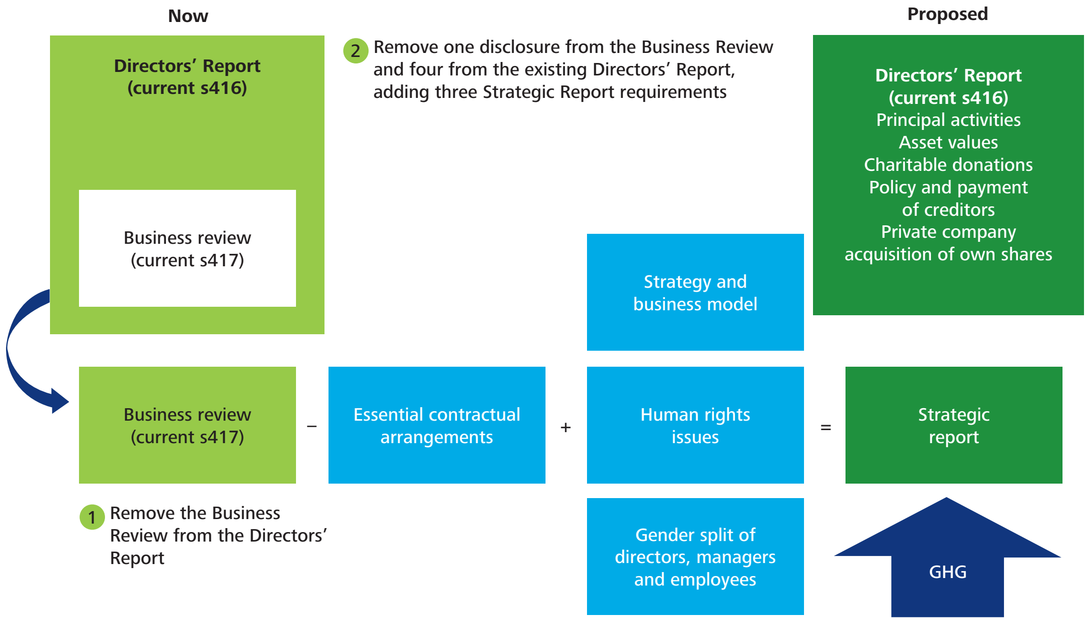
A Deloitte iGAAP Alert is available at http://www.deloitte.co.uk/auditpublications

BIS issued policy proposals and draft regulations

Back in August 2010 the Department for Business, Innovation and Skills (BIS) started a project to reenergise narrative reporting in the UK. After a further consultation in September 2011 and spending time digesting responses and holding workshops, BIS has published their final policy proposals together with draft regulations for comment.

Structure of reporting

Currently all companies are required to prepare a directors' report. For with large and medium-sized companies, this must contain a Business Review which provides a fair review of the company's business and the principal risks and uncertainties facing it. Quoted companies are required to include certain additional disclosures.



The draft regulations propose:

- separating the Directors' Report and Business Review, which will be renamed a Strategic Report;
- deleting four Directors' Report disclosure requirements; and
- for quoted companies, removing the requirement to disclose essential contractual arrangements and introducing three new disclosures around strategy and business model, human rights issues and gender diversity.

Separate Defra proposals will mandate disclosure of Greenhouse Gas (GHG) emissions in the Strategic Report.

In a significant departure from the September 2012 proposals, there will be no requirement for the strategic report to include any information about directors' remuneration. BIS consulted separately on revised requirements for the directors' remuneration report in June 2012. These proposals include splitting the report into a 'policy report' which will be subject to a binding shareholder vote and an 'implementation report' which will be subject to an advisory vote. They will also require disclosure of a single total figure for the remuneration of each director.

What is the government seeking to achieve?

The biggest changes will be for quoted companies. The Ministerial Foreword to the draft regulations states that "The Kay Review of equity markets called for the restoration of trust and confidence in the investment chain, and to realign incentives throughout the investment chain. Getting reporting right is an important step on the way to achieving this."

Only time can tell whether these changes will achieve this end. Some companies might pay lip service to the Regulations by including any additional new mandatory disclosures (business model, gender diversity, human rights, and GHG emissions) somewhere in the "front half" of their annual report and stating that the Strategic Report covers the existing plethora of documents such as CEO and CFO Reports, Business Reviews and corporate social responsibility reports. Good companies will take the opportunity to review all of their existing "front half" disclosure and take the advantage to reduce overlap and provide one clear narrative.

The death knell of summary financial statements?

One other proposal is to abolish summary financial statements and replace this with the option of sending only the Strategic Report to shareholders who have not opted to receive the full annual report. Typical summary financial statements include a shortened narrative report; it is not yet clear if investors will be happy to receive a longer narrative with (potentially) no balance sheet or income statement.

When will this happen?

Assuming the government stick to the proposed timetable, this will apply to financial years ending on or after 1 October 2013. In that time we are expecting:

- an exposure draft and final version of an FRC Reporting Statement to assist companies in preparing the Strategic Report. The exposure draft is expected in early 2013;

- finalisation of the GHG emission regulations. It is possible that this reporting obligation may be deferred for one year due to the difficulty in collecting the data for a financial year that has already started. Our comment letter to Defra noted that there remains one big issue around the organisational boundary, with landlords struggling to collect data for properties they own but where they have no control over energy usage; and

- minor amendments to the UK Corporate Governance Code to align with the new structure for narrative reporting.

All companies (other than those entitled to the small companies exemption and therefore not producing a strategic report) will need to make some changes; the more extensive changes are for quoted companies. Directors of quoted companies will need to consider urgently whether they have in place systems to collect gender diversity and GHG emissions information.

The annual report of the future?

Chairman's Statement	How he/she is running the board and their effectiveness in achieving the company's strategy and objectives	Directors' Responsibility Statement	Directors' formal statement they have prepared what is required of them
Strategic Report	The company's business model and strategy, a review of how it has done in achieving that strategy and the risks facing it for the future	Auditors' Report	Auditors' Report on the financial statements and other matters
Corporate Governance Statement	How the board and its committees are run to provide oversight and strategic direction	Financial Statements	Information on financial position and performance
Directors' Report	Basic legal information		
Directors' Remuneration Report	How the directors will be remunerated in future and how much they were paid last year		

Topic of focus: Thinking about disclosures in a broader context

The paper can be found at http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2012/October/FRC-publishes-paper-to-enhance-disclosure-in-finan.aspx

FRC issued Paper

In the last edition of this Newsletter, we focussed on two recently issued discussion papers looking at disclosure in financial statements – one from the FASB (the US standard setter) and one from EFRAG together with standard setters from France (the ANC) and the UK (the FRC). The UK FRC has now issued a paper 'Thinking about disclosures in a broader context' which, as the name implies, looks more widely at disclosure throughout the annual report. It builds on work started by the FRC in their 2009 report 'Louder than words' which looked at the increasing complexity and decreasing relevance of financial reports.

The comment period runs until 31 January 2013. The project will not itself lead to a standard, but could influence other standard setters.

What is the aim of the project?

The paper sets out a road map for a disclosure framework with the overall aim of reducing clutter and improving the quality of disclosure in annual reports. A disclosure framework might result in more targeted disclosures, elimination of duplication, a reduction of the burden of preparation, and better organisation of reports making them easier to read.

The paper also notes that the issue of 'standing data' will not go away – information which remains unchanged from annual report to annual report. This includes information contained in the directors' report (now that BIS has not taken forward their original proposal that such information should be maintained on the company's website and updated on an as and when basis), certain corporate governance information and accounting policies.

What does this mean for companies?

In due course, disclosures may move around the annual report or be removed altogether. In advance of standards and rules changing, this paper provides a useful prompt to directors to:

- Review whether disclosures are necessary. For example, is discussion or an accounting policy relating to a transaction stream that is now immaterial still needed?

- Think about overlapping information. Is it consistent? Could some of it be better dealt with by cross-reference?

- Document reasons why something omitted was viewed immaterial. This will help respond to challenges by the FRC's Conduct Committee (formerly the FRRP).

A four stage approach

The paper proposes a four stage approach:

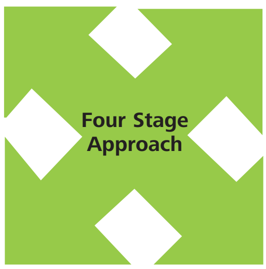
What information do users need?
Six principles are given deciding which information is useful for making resource allocation decisions and assessing management's stewardship:

- Context for understanding the performance, position and development of the entity.
- The specific risks to which an entity is exposed, including their context and management's approach to those risks.
- An explanation of the corporate governance arrangements in place including setting out the responsibilities of the board.
- A disaggregation of amounts at a level that enables the key components of primary financial statements to be understood.
- An explanation of the basis for recognition and measurement of line items in the primary financial statements.
- Information relating to items not recognised in the balance sheet that, if or when recognised, would have a significant effect on future cash flows.

Where should disclosures be located?
Duplication and overlapping information should be reduced. This would mean:

- Management commentary to put the financial statements in context.
- A corporate governance statement to cover the responsibilities of the board.
- Financial statements that would include new information on disaggregation, explanatory material essential for an understanding of the financial statements and information on unrecognised items.

Information on risks and uncertainties could be included in any or all of these sections – for example, management's view of a risk would go in their commentary, information on related controls to mitigate the risk in the corporate governance statement and an analysis of balances by risk exposure in the notes.



When should disclosure be provided?
Disclosures need to be proportionate to the nature of an entity taking into account the needs of the users of those financial reports. It can be harder to apply this principle to disclosure than to recognition and measurement due to a lack of precise definition. Materiality is a matter of judgement and varies depending upon the viewpoint (investor, regulator, director). All users have different priorities and different ideas on what is material. The IASB's Conceptual Framework essentially defines whether information is material or not by whether its omission or misstatement could influence decisions that users make on the basis of financial information.

How should disclosures be communicated?
The report identifies four communication principles, disclosures should:

- be entity-specific;
- be clear, concise, and written in plain language;
- be current; and
- explain the substance of the transaction.

In addition there is an overarching principle that the information given should provide a clear link between an entity's business, financial performance and position.

UK Reporting round up

More details of the audit exemption changes can be found in an iGAAP Alert *Audit exemptions* available at http://www.deloitte.co.uk/auditpublications

Changes to audit exemption and relaxation of rules on switching accounting framework

Three changes have been made by the government for periods ending on or after 1 October 2012:

- a new exemption from audit is available for subsidiaries with an EEA parent that is willing to guarantee the subsidiaries' liabilities as at the balance sheet date for as long as those liabilities remain outstanding. Dormant subsidiaries with such a guarantee will additionally be exempt from preparing and filing financial statements;
- the small companies audit exemption has been aligned more closely with small company accounting exemptions. This will mostly benefit small companies with big balance sheets, although the law still 'gold plates' European requirements as the largest group of which the company is part must be small; and
- companies that have prepared accounts under IFRSs as adopted in the EU will be able to move back to preparing Companies Act accounts without a 'relevant change of circumstances'. This welcome change will allow subsidiaries to adopt the newly issued FRS 101 (see page 4) which allows many subsidiaries to prepare their accounts on an IFRS basis but with reduced disclosures provided that equivalent disclosures are given in a parent's group accounts.

Details of the Lab's projects, including published project reports, can be found at http://frc.org.uk/Our-Work/Codes-Standards/Financial-Reporting-Lab/Published-public-reports.aspx

FRC Financial Reporting Lab publishes three reports

The Financial Reporting Lab was established by the FRC to provide "an environment where investors and companies can come together to develop pragmatic solutions to today's reporting needs." The Lab is not a standard setter; its output tends instead to be either a way of exploring what good practice looks like, or a way to test out new ideas before others set standards.

In the period from September to November, three reports have been issued on related topics:

1. **Net debt reconciliations** – In the past UK GAAP defined 'net debt' and required a reconciliation. IFRS does not do either of these and some companies no longer present a reconciliation. A strong majority of investors (both equity and fixed income) noted that they used a net debt reconciliation (reconciling opening to closing components of net debt) and/or a reconciliation of net cash flows to net debt (reconciling cash flow to movement in debt). If these reconciliations were not published, they attempted to construct them – to use for equity valuation and to look for potential debt or liquidity issues. The report suggests seven characteristics of good reconciliations.

2. **Operating and investing cash flows** – Nine suggestions were made to improve communication of how cash is generated from operations and invested in the business. These included presenting the indirect method reconciliation of profit to operating cash flows on the face, rather than in a note; starting from operating income or loss rather than net profit or loss; separating out adjustments and components of cash flow clearly; and using clear descriptions that can be tied back to other primary statements. Clarity of definition is also important when using words like "unusual" or "exceptional" and using cash flow metrics and targets.

3. **Debt terms and maturity tables** – Disclosure of debt terms and maturity tables is, inevitably, sought more by investors when a company has significant net debt or significant debt related interest costs compared to free cash flows. This will help companies explain how cash shortfalls are likely to be met. Investors wanted to understand, on an obligation by obligation basis, the principal of the debt; the currency (and 'economic' currency if hedged); due month and year, interest rate and profile before and after hedging. Investors also wanted to know about bank facilities drawn and undrawn, renewal processes, financial covenants and credit rating triggers. IFRS 7 does not specify how a maturity table should be set out – investors welcomed annual amounts for each of the first five years, with more granularity for earlier periods; separation of interest and principal; and reconciliation to the balance sheet.

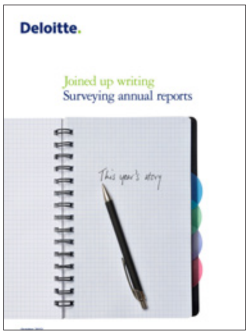
The Lab had previously issued a report on presenting a single figure for the remuneration of each director, which was been taken forward in a BIS consultation. The BIS consultation period closed in September. Consultation responses indicated some challenges in implementing these proposals, and BIS has asked the Lab to test two particular aspects of the proposals before finalising the regulations:

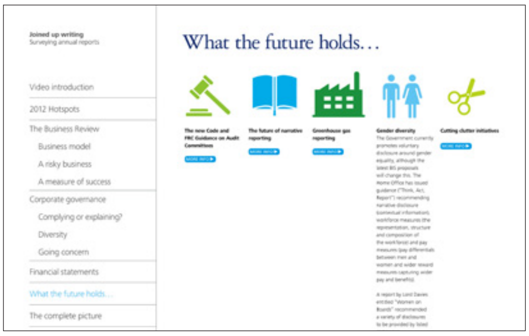
- 'Scenarios for what directors will get paid for performance that is above, on and below target'; and

- a 'Chart comparing company performance and CEO pay', with company performance measured using Total Shareholder Return (TSR).

These remuneration proposals were covered in the second of June's editions of Governance in Brief, available at www.deloitte.co.uk/corporategovernance

Recent publications





Joined up writing – 2012 annual reporting survey

Our annual survey, released in November, looks at how companies are complying with current regulatory requirements and keeping up with latest developments. As well as giving a detailed insight into narrative and financial reporting in annual reports across our sample of 130 listed companies, the survey provides a host of key reporting insights, regulatory 'hotspots' and examples of better practice.

The survey of 130 listed companies, split between companies and investment trusts, looks, amongst other things, at:

- how well the companies 'tell the story' of their financial position and performance;
- compliance with regulatory requirements including the 2006 Companies Act, the Listing Rules, UK Corporate Governance Code and accounting standards;
- the business review, including principal risks and uncertainties and key performance indicators; and
- which critical judgements and key estimations directors consider to be the most significant.

Our high-level findings are discussed in more detail on page 2 of this newsletter.

The full survey and an iPad-friendly highlights version, together with Pieces of Eight, a mini survey of IFRS 8 segmental disclosures, can be found on the Deloitte website http://www.deloitte.co.uk/auditpublications.

Activities of the IASB

IASB issues investment entities amendments to IFRS 10, IFRS 12 and IAS 27

The IASB has published *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27*) providing an exemption from consolidation of subsidiaries under IFRS 10 *Consolidated Financial Statements* for entities which meet the definition of an 'investment entity', such as certain investment funds. Instead, such entities would measure their investments in subsidiaries at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*.

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The new requirements are applicable, on a modified retrospective basis, to annual periods beginning on or after 1 January 2014, a year later than IFRS 10 which is applicable to annual periods beginning on or after 1 January 2013. Early adoption is permitted. The EU endorsed version of the unamended standards will delay the mandatory effective date to 1 January 2014 and therefore eliminate the risk that companies will be forced to make two sets of changes. We expect EU endorsement of the unamended IFRSs 10, 12 and IAS 27 by the end of 2012 and of the amendments by the end of 2013. UK companies will not be able to adopt the new requirements for investment entities until the amendments have been endorsed by the EU.

IASB publishes proposals for limited amendments to IFRS 9

The IASB has released Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9 (proposed amendments to IFRS 9 (2010))*. The proposed changes would introduce a fair value through other comprehensive income (OCI) measurement category for particular financial assets.

A Deloitte iGAAP Alert is available at http://www.deloitte.co.uk/auditpublications

The proposed limited scope amendments to IFRS 9 Financial Instruments are designed to:

- address specific application questions raised by interested parties;
- consider the interaction of the classification and measurement model for financial assets with the IASB's Insurance Contracts project;
- reduce key differences with the US Financial Accounting Standards Board's tentative classification and measurement model for financial instruments.

The proposed new fair value through OCI measurement category would include certain financial assets when two conditions are met:

- the contractual cash flows of the assets are solely payments of principal and interest; and
- the assets are used in a business model which is neither to hold nor sell exclusively.

The amendments proposed are a step back towards current requirements in IAS 39 *Financial Instruments: Recognition and Measurement* even though important differences remain. Use of the new category would be mandatory.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015; it has not yet been endorsed for use in the EU. The ED is open for a comment period of 120 days, and closes on 28 March 2013.

IASB publishes proposals for limited amendments to equity accounting

The IASB has released Exposure Draft ED/2012/3 *Equity Method: Share of Other Net Asset Changes*, which proposes limited scope amendments to IAS 28 to include guidance on how an investor accounts for its share of the changes in net assets of an associate or joint venture that are not recognised in profit or loss or other comprehensive income of the investee ('other net asset changes').

The proposals would require an investor to recognise in its own equity its share of the changes in the net assets of the investee that are not recognised in profit or loss or other comprehensive income of the investee, or that are not distributions received.

The ED is open for a comment period of 120 days, and closes on 22 March 2013.

IASB publishes proposals arising from its 2011-2013 annual improvements cycle

The IASB has released ED/2012/2 *Annual Improvements to IFRSs 2011–2013 Cycle*, containing the latest proposals for minor corrections and edits to IFRS.

The ED proposes changes to the following pronouncements:

Pronouncement	Amendments proposed
IFRS 1 *First-time Adoption of International Financial Reporting Standards* (changes to the Basis for Conclusions only)	**Meaning of effective IFRSs** Clarifies that an entity, in its first IFRS financial statements, has the choice between applying an existing and currently effective IFRS or applying early a new or revised IFRS that is not yet mandatorily effective, provided that the new or revised IFRS permits early application. An entity is required to apply the same version of the IFRS throughout the periods covered by those first IFRS financial statements.
IFRS 3 *Business Combinations*	**Scope of exception for joint ventures** Clarifies that: • IFRS 3 excludes from its scope the accounting for the formation of all types of joint arrangements as defined in IFRS 11 *Joint Arrangements.* • the scope exception in paragraph 2(a) of IFRS 3 only applies to the financial statements of the joint venture or the joint operation itself.
IFRS 13 *Fair Value Measurement*	**Scope of paragraph 52 (portfolio exception)** Clarifies that the scope of the portfolio exception defined in paragraph 52 of IFRS 13 includes all contracts accounted for within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments,* regardless of whether they meet the definition of financial assets or financial liabilities as defined in IAS 32 *Financial Instruments: Presentation.*
IAS 40 *Investment Property*	**Clarifying the interrelationship of IFRS 3 and IAS 40** Clarifies that IFRS 3 and IAS 40 are not mutually exclusive when classifying property as investment property or owner-occupied property. Determining whether a specific transaction meets the definition of both a business combination as defined in IFRS 3 and investment property as defined in IAS 40 requires the separate application of both standards independently of each other.

The proposed effective date for the amendments is for annual periods beginning on or after 1 January 2014, although entities are permitted to adopt them earlier. The ED is open for comment for 90 days, with comments closing on 18 February 2013.

IFRS issued but not yet effective or endorsed by the EU

Title	Subject	Mandatory for accounting periods beginning on or after	Endorsed* or when endorsement expected (EFRAG 9 November 2012)
IFRS 9 (November 2009, revised October 2010)	Financial Instruments: Classification and Measurement	1 January 2015	To be confirmed
IFRS 10 (May 2011)	Consolidated Financial Statements	1 January 2013**	Q4 2012
IFRS 11 (May 2011)	Joint Arrangements	1 January 2013**	Q4 2012
IFRS 12 (May 2011)	Disclosures of Interests in Other Entities	1 January 2013**	Q4 2012
IFRS 13 (May 2011)	Fair Value Measurement	1 January 2013	Q4 2012
IAS 27 (May 2011)	Separate Financial Statements	1 January 2013**	Q4 2012
IAS 28 (May 2011)	Investments in Associates and Joint Ventures	1 January 2013**	Q4 2012
Amendments to IAS 12 (December 2010)	Deferred tax: Recovery of Underlying Assets	1 January 2012	Q4 2012
Amendments to IFRS 1 (December 2010)	Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters	1 July 2011	Q4 2012
Amendments to IFRS 7 (December 2011)	Disclosures – Offsetting Financial Assets and Financial Liabilities	1 January 2013	Q4 2012
Amendments to IAS 32 (December 2011)	Offsetting Financial Assets and Financial Liabilities	1 January 2014	Q4 2012
Amendments to IFRS 1 (March 2012)	Government Loans	1 January 2013	Q1 2013
Improvements to IFRSs (2009-2011) (May 2012)	Improvements to IFRS 1, IAS 1, IAS 16, IAS 32 and IAS 34	1 January 2013	Q1 2013
Amendments to IFRS 10, IFRS 11 and IFRS 12 (June 2012)	Transition Guidance	1 January 2013	Q1 2013
Amendments to IFRS 10, IFRS 11 and IFRS 12 (June 2012)	Investment Entities	1 January 2014	Q3 2013
IFRIC Interpretation 20 (October 2011)	Stripping Costs in the Production Phase of a Surface Mine	1 January 2013	Q4 2012

* The critical date when considering endorsement is the date of approval of the financial statements.

** On 1 June 2012, ARC voted on a regulation that requires IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28 to be applied, at the latest, as from the commencement date of a company's first financial year starting on or after 1 January 2014 (i.e. early adoption would be permitted once the standards have been endorsed).

FRC accounting and IASB project timetables

FRC accounting project timetable

FRS 100 – Application of financial reporting requirements	Issued on 22 November 2012. See page 4 for more details.
FRS 101 – Reduced disclosure framework	Issued on 22 November 2012. See page 4 for more details.
FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland	Expected to be issued in January 2013. Comment period for limited exposure of changes relating to multi-employer pension schemes and grantors of service concession arrangements closed on 3 December.
Insurance accounting	The FRC consulted separately on the future of UK insurance accounting, given that current accounting follows from regulatory requirements which were due to change in 2014 with the switch from Solvency I to Solvency II. As this switch has been delayed, the principles of IFRS 4 are to be introduced into FRS 102 (see above). The FRC's Accounting Council has tentatively decided to issue an exposure draft combining the principles of IFRS 4 Insurance Contracts with revised requirements of the ABI SORP and of a revised FRS 27 some time in 2013.

IASB project timetable

Agenda consultation	• Issued July 2011. Comments period closed November 2011 • Feedback statement expected third quarter 2012.
Annual Improvements to IFRSs 2010-2012	• ED issued May 2012. • Final IFRS expected second quarter 2013.
Annual Improvements to IFRSs 2011-2013	• ED issued November 2012. • Final IFRS expected third quarter 2013.
Annual Improvements to IFRSs 2012-2014	• ED expected third quarter 2013.
Equity method of accounting: accounting for other net asset changes (Proposed amendments to IAS 28)	• ED issued November 2012. • Final IFRS expected third quarter 2013.
Financial Instruments (replacement of existing standards)	• Classification and measurement of financial assets. Final IFRS issued November 2009. Exposure draft of limited amendments November 2012 (see page 15). • Classification and measurement of financial liabilities. Final IFRS issued October 2010. • Impairment ED issued November 2009, additional impairment ED issued January 2011 and re-exposure expected first quarter 2013. • Financial asset and liability offsetting. Final amendments to IAS 32 and IFRS 9 issued December 2011. • General hedging ED issued December 2010. Review draft issued September 2012 and final IFRS expected first quarter 2013. • Discussion paper on macro hedge accounting expected during 2013. • Deferral of mandatory effective date of IFRS 9 to 1 January 2015, amendment issued December 2011.
Insurance Contracts – Phase II	• Exposure draft released for comment July 2010. • Re-exposure draft expected first half 2013. • The issue and effective dates are to be confirmed.
Leases	• Re-exposure expected first quarter 2013. • The issue and effective dates are to be confirmed.
Revenue Recognition	• Re-exposed November 2011. Comment period closed March 2012. • Final IFRS expected 2013.
Post-implementation review – IFRS 8 *Operating Segments*	• Review started July 2012.
Post-implementation review – IFRS 3 *Business Combinations*	• Review expected to start in the fourth quarter of 2012.

This timetable is derived from the IASB's published timetable supplemented by decisions and comments made at recent meetings of the Board. You will find details on each project, including decision summaries from each Board meeting, at www.iasplus.com/agenda/agenda.htm

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