Deloitte.

The Deloitte Academy
October 2018

Governance *in brief*

FRC issues advice on annual reports for 2018/19 reporting season

Headlines

- The FRC has issued its Annual Review of Corporate Reporting and annual letter to finance directors and audit committee chairs covering its perspective on key developments for 2018/19 annual reports.
- Key areas for this year's annual reports include:
  - The impact of new IFRS standards 9 & 15 and the likely future impact of IFRS 16;
  - Disclosure of critical judgements and estimates;
  - Reporting on the risks associated with Brexit;
  - Transparency of complex supplier arrangements;
  - Risk and viability reporting;
  - Application of the ESMA Guidelines for reporting Alternative Performance Measures; and
  - Inclusion of a non-financial information statement in the Strategic Report – which many companies omitted in the first year of the new requirements.
- The FRC has also stressed that companies need to avoid basic errors in reports and accounts caused by a poor control environment around compliance with reporting requirements.

New accounting standards

The first area covered by the FRC, separated from other financial statement disclosure matters, is the importance of disclosing the impact of the two new accounting standards on the financial statements in this first year of full implementation.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. With a focus on identification of performance obligations, there is new guidance on whether revenue should be recognised at a point in time or over time, which replaces the previous distinction between goods and services.

Companies are encouraged to invest sufficient time during their year-end preparation to ensure that:

- explanations of the impact of transition are comprehensive and linked to other relevant information in the annual report and accounts;
- changes to revenue policies are clearly described and explained, reflecting company specific information – as are any associated management judgements;
- performance obligations, a new concept introduced by IFRS 15, are identified and explained, with a focus on how they have been determined and the timing of delivery to the customer; and
- the impact of the standard on the balance sheet is also addressed, including accounting policies for contract assets and liabilities.

IFRS 9 Financial Instruments

IFRS 9 includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. The main impact here will be on financial reporting by banks but for other companies it is also important that they:

- have updated their hedging documentation and assessed the effectiveness of existing hedges on application of the new requirements;
- explain and, where possible, quantify material differences between IAS 39 and IFRS 9, including key assumptions adopted on implementation;
- remember that the scope of the impairment requirements has been extended to include, for example, IFRS 15 contract assets, lease receivables and will also apply to loans to subsidiaries and other undertakings in individual parent company accounts;
- take particular care when considering the application of the standard to embedded derivatives and the different treatment required where the host contract is a financial asset compared to where it is a financial liability;
- reconsider the accounting for previous debt modifications, such as refinancing, that did not result in derecognition;
- reflect the additional disclosure requirements of IFRS 7; and
- if relevant, explain why the impact is not material, particularly where significant financial instruments are recognised in the accounts.

IFRS 16 Leases

IFRS 16 sets out a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lesseees and lessors. IFRS 16 applies a control model for the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. As the standard is mandatory for periods beginning on or after 1 January 2019, in their December 2018 companies are expected to:

- provide meaningful information about the application of the standard with a focus on their specific facts and circumstances;
- disclose qualitative and quantitative information, identifying any lease portfolios that are significantly impacted by the new requirements;
- explain the specific judgements and policy changes prompted by the new model and provided detail about the structure of their implementation projects; and
- identify the exemptions that companies intend to apply.

Other topical areas of reporting for attention

Area of focus	Description
Critical judgements and estimates	• A clear distinction needs to be made between judgements and estimates as different disclosure requirements apply. • Clear disclosure of the sensitivity of carrying amounts to the assumptions and estimates underlying a measurement calculation, or, if more meaningful, disclosure of the range of reasonably possible outcomes within the next year in respect of the carrying amounts of the relevant assets and liabilities. • Identification of any voluntary additional disclosures provided in respect of estimation uncertainty, for example, where the impact of any possible material change in estimate is not anticipated to have effect until a period outside the twelve-month window required by the standard.
Risks associated with Brexit	• Provide disclosure which distinguishes the specific and direct challenges to the business model and operations from the broader economic uncertainties which may still attach to the UK's position at the time you report. • Particular threats should be clearly identified and management should describe any actions they are taking, or have taken, to manage the potential impact (this may include recognising or remeasuring certain items in the balance sheet). • Consider and explain a wider range of reasonably possible outcomes when performing sensitivity analysis on their cash flow projections. • Decide whether Brexit uncertainties impact your statements on viability and even your ability to continue as a going concern. • Incorporate a comprehensive post balance sheet events review in the year-end reporting plan, in order to identify both adjusting and non-adjusting events and to make the necessary disclosures.

Area of focus	Description
Complex supplier arrangements	• The strategic report and the disclosures of financial instruments should describe the nature and amount of any material funding arrangement and the impact that it has on the company's liquidity.
Risk and viability reporting	• Provide a clear description of how the company has assessed its prospects and viability. • Apply a two-stage process to the viability statement: first, assessing the future prospects of the company; and, second, stating whether directors have a reasonable expectation that the company will be able to continue to operate and meet its liabilities as they fall due (potentially over a shorter period).
Alternative performance measures	• All companies that report alternative performance measures should apply the Guidelines produced by ESMA, i.e.: – Definitions for all APMs used; – Good explanations for their use; – Reconciliations to IFRS amounts appearing in the financial statements; – No greater prominence for APMs than measures directly stemming from the financial statements; and – Explanations for changes in APMs to be provided, which may include how they are defined or calculated.
Non-financial information statement	• The Strategic Report should include a non-financial information statement covering information (or references to where that information is disclosed in the strategic report) relating to environmental matters, employees, social matters, respect for human rights and anti-corruption and anti-bribery matters. • For companies within the scope of the new requirements, disclosures should focus on the impact of its activities in respect of these matters, the policies it has in place, any due diligence processes introduced through which it assesses and tracks their effectiveness and the related outcomes.

For further information:

The CRR Annual Report, the FRC's letter and press release are available at:
https://www.frc.org.uk/news/october-2018/frc-pushes-companies-for-improved-quality-reportin

FRC Thematic Review – Significant accounting judgments and sources of estimation uncertainty:
https://www.frc.org.uk/getattachment/651205c1-6521-49b4-9590-9cba1d899a53/Judgements-and-Estimates-thematic-review-2017.pdf

FRC Financial Reporting Lab – Business model, risk & viability reporting – Implementation Study:
https://www.frc.org.uk/getattachment/43c07348-e175-45c4-a6e0-49f7ecabdf36/Business-Models-Lab-Implementation-Study-2018.pdf

Deloitte's Annual Reporting Insights 2018: www.deloitte.co.uk/annualreportinsights

Deloitte view

- We welcome the earlier publication of this advice for Audit Committee Chairs and Finance Directors, as there is much to consider this year, particularly in relation to Brexit.
- Whilst none of these areas are surprising, this advice provides a timely reminder for audit committee agendas for the period ahead.
- Whilst disclosure expectations have been increasing over recent years, and continue to increase, audit committees should also take note of the FRC's message around the control environment for compliance with financial reporting requirements. They have a key role to play in ensuring that these controls are robust and fit for purpose.

The Deloitte Academy

The Deloitte Academy provides support and guidance to boards, committees and individual directors, principally of the FTSE 350, through a series of briefings and bespoke training. Membership of the Deloitte Academy is free to board directors of listed companies, and includes access to the Deloitte Academy business centre between Covent Garden and the City.

Members receive copies of our regular publications on Corporate Governance and a newsletter. There is also a dedicated members' website **www.deloitteacademy.co.uk** which members can use to register for briefings and access additional relevant resources.

For further details about the Deloitte Academy, including membership, please email **enquiries@deloitteacademy.co.uk.**

Contacts – Centre for Corporate Governance
Tracy Gordon – 020 7007 3812 or **trgordon@deloitte.co.uk**
Corinne Sheriff – 020 7007 8368 or **csheriff@deloitte.co.uk**
William Touche – 020 7007 3352 or **wtouche@deloitte.co.uk**

Notes

Notes

Deloitte.