Financial Reporting Council

October 2015

Corporate Reporting Review

Annual Report 2015

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.

Under the Companies Act 2006, the Conduct Committee of the FRC reviews the reports and accounts of public and large private companies to determine whether they comply with the Act and other reporting requirements. Where it appears that those requirements have not been complied with, the Conduct Committee investigates the position and determines the action to be taken to address any non-compliance. In practice, and as agreed with BIS, the Committee normally exercises its authority only in connection with public limited companies and large private companies. When discharging these statutory responsibilities, the Conduct Committee aims to improve the quality of financial reporting in the UK.

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1 FRRP Chairman's Statement

I was delighted to be asked by David Childs, Chairman of the Financial Reporting Council's ('FRC') Conduct Committee, to take on the role of Chairman of the Financial Reporting Review Panel ('FRRP') on 1 April 2015, in succession to Richard Fleck. Richard has given many years of committed and distinguished service to the FRC community, as a former Chairman of the Conduct Committee, member of the FRC Board, as well as Chairman of the FRRP and, previously, the Auditing Practices Board. We are very grateful to him and I'm pleased to say that his dedication and experience will not be lost to us, since he's agreed to become a member of the Panel.

The work of Corporate Reporting Review ('CRR'), supported by the FRRP, promotes improvements to the quality of corporate reporting in the UK which, in turn, increases investor confidence.

It is vital to the CRR activities of the FRC that we can call on the experience and judgement of our Panel members in providing peer review, and I would like to thank them for their continued support. I firmly believe that, alongside our statutory remit to ensure compliance with the financial reporting requirements of the Companies Act, we can best serve the objectives of the FRC as a whole by ensuring that we engage with those who are affected by the legislation, whether as issuers of reports and accounts, investors or commentators. And so I would like to make use of the experience of our Panel members as much as we can – and as they are able, given their other commitments.

The FRC has recently engaged external consultants to look at the operations of CRR and Audit Quality Review ('AQR'). The feedback from their discussions with users has provided valuable insights on our operations and some very helpful recommendations for improvement, both in communications and processes. We are looking forward to implementing these in ways that we think will benefit investors and help issuers. It was good to learn that the quality of the work done by the CRR team was widely agreed to be of high quality and, whatever changes we may introduce, I'm very keen that this remains the case. Our team is small and consistently stretched – it nevertheless deals very ably with complex and demanding issues and matters of judgement, and I'm very grateful for their continued efforts to realise our objectives.

Geoffrey Green

Chairman, Financial Reporting Review Panel

Member, Conduct Committee

22 October 2015

2 Summary

The overall quality of corporate reporting is generally good but:

- We have a potential concern about how some Boards assess materiality
- Materiality assessments should not be used to conceal errors or achieve a particular presentation
- Boards need to look at issues through the 'right lens' - what do investors expect to see?
- We will continue to monitor this by liaising with the FRC's and other audit regulators

Some smaller companies fail to explain their story and comply fully with the relevant standards, so:

- We have issued a consultation paper to support a step change in the quality of their reporting
- We will continue to question smaller companies proportionately

Boards made appropriate effort to implement the new consolidation, joint venture and associate accounting standards, and to produce the new strategic report and:

- The implementation of 'de facto' consolidation requirements was generally succesful
- Most companies effectively explained their strategy and described their business model

Investor interest and diversity in accounting for pension deficit funding commitments means that Boards need to:

- Explain judgements made around pension assets or excess deficit funding liabilities and
- Disclose the amount of deficit funding obligations

We concluded our enquiries into the reports and accounts of Quindell Plc, blur Group plc and fastjet Plc, which:

- Made material restatements to their reports and accounts
- Six additional companies agreed to refer to FRC enquiries in their accounts, following significant changes

There was good response to our call for improved disclosures about complex supplier arrangements and:

- We identified improved narrative disclosures
- But remind Boards that they need to discuss the effect of changes in estimates

3 Key Messages

3.1 Introduction

This report provides an overview of the CRR activities of the FRC for the year ended 31 March 2015. It is written primarily for those with Board-level responsibility for preparing company reports and accounts. The report:

- includes our assessment of the quality of corporate reporting in the UK, based on the results of our work;
- sets out our findings;
- explains how we approached the year's focus areas;
- identifies our current and likely future focus areas;
- includes case studies illustrating our approach to selected areas of focus; and
- highlights those areas where we most often challenged companies during the year.

3.2 Quality of Corporate Reporting

3.2.1 Findings

We saw a good level of corporate reporting by the larger public companies, particularly those in the FTSE 350. This continued a trend seen over several years, as we would expect during a period in which there have been limited changes to IFRS for companies to implement. FTSE 350 Boards generally have a good knowledge of IFRS and how to apply it to their businesses. Our questions to these companies were more often in relation to unfamiliar or complex transactions where the Boards may already have spent significant time considering the relevant accounting judgements and disclosures and are, therefore, able to explain their approach. We have, however, identified a potential concern about how Boards assess materiality when deciding whether, and, if so, how they should correct identified errors.

Boards generally responded well to the new strategic report requirements. They took the time to restructure their annual reports and move forward from the previous requirement for a business review, for example, by adding succinct descriptions of their business models and strategy.

3.2.2 Smaller Listed and AIM-quoted Companies

We saw examples of good reporting by some smaller listed and AIM-quoted companies but also saw more straightforward errors in how they applied IFRS. Inadequate explanation of their results and descriptions of principal risks in their strategic report was also more likely from the Boards of smaller companies.

Similar findings in earlier years were persuasive in prompting a three-year project by the FRC to drive a step-change in the quality of smaller companies' financial reporting. In June 2015, the FRC issued a consultation paper[1], reporting on the first phase of the project, which considered the results of research into root causes and proposed actions to facilitate improvement.

The FRC found that directors often believe that investors place little value on smaller companies' annual reports and accounts, which can lead to Boards doing the minimum

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1 https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b.aspx

required to comply with relevant standards. In contrast, it heard from investors that they do consider the quality of corporate reporting when deciding whether to invest in smaller companies, partly because there is less information available about them. The FRC identified a number of areas that should help in improving the quality of their reporting, including facilitating greater dialogue between preparers and investors and encouraging investors to give more feedback to Boards on the quality of their financial information.

3.3 Focus Areas

In 2014/15 we focused on the following matters:

- **Exceptional items –** we monitored how companies responded to the FRC Press Notice issued in December 2013 and wrote to them where their disclosures appeared to depart from IFRS principles (See Section 5).

- **New accounting standards** – we considered application of the new suite of consolidation and joint arrangement accounting standards[2]. We identified only isolated issues in their application. The additional guidance provided on whether 'de facto' control of a subsidiary exists did not appear to have a notable effect. As expected, given the uncertainties surrounding its implementation date and final requirements, we did not see any discussions of the likely effect of the new revenue standard[3].

- **Business combinations –** we wrote to companies that identified fewer separate intangible assets than we may have expected following a business acquisition. We emphasised the importance of having available sufficient, robust technical expertise to assist with identification and valuation of intangible assets (See Section 5).

- **Enhanced Audit Committee reporting –** we welcomed the enhanced disclosures of the significant accounting judgements made by Audit Committees during the year. We wrote to companies where descriptions of significant estimates and judgements in their accounts were not as tailored or as informative as those in their Audit Committee reports.

- **Companies Act 2006 compliance –** we wrote to companies that did not comply with corporate reporting requirements, such as the requirement to disclose certain greenhouse gas emission information.

- **Pension structuring** – we are pleased to note that, following our 2013 Press Notice[4], we identified no further examples of pension structures designed to achieve an accounting effect, such as reducing apparent pension obligations.

3.3.1 Areas of Future Focus

We are currently in a relatively mature corporate reporting environment, where UK Boards are generally familiar with the requirements of IFRS and can apply them appropriately in most circumstances. We spend an increasing proportion of our time evaluating the significant accounting judgements that Boards make and the quality of their conclusions, as we know

2 IFRS 10, 'Consolidated Financial Statements', IFRS 11, 'Joint Arrangements' and IFRS 12, 'Disclosure of Interests in Other Entities'

3 IFRS 15, 'Revenue from Contracts with Customers'

4 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/January/FRC-challenges-the-reporting-of-companies-classify.aspx

that these areas are important to investors. These significant judgements involve the consideration of materiality.

Boards should consider both the quantitative and qualitative aspects of materiality when making judgements. We may challenge these conclusions, particularly if we believe the Board may be using a quantitative materiality argument to achieve a particular accounting treatment, to justify giving insufficient prominence to relevant information or to avoid the transparency surrounding an error correction. We remind Boards that an error can be less than a previously calculated quantitative threshold for materiality but still be material in nature when the issue is relevant to investors. If we were to identify any widespread concerns regarding the application of materiality we would need to consider additional action.

The case study in Section 5 illustrates how we evaluated the process a Board went through when considering whether an identified error was material.

We will continue to make good use of information received from the FRC's and other audit regulators, which can identify certain reporting issues, including materiality considerations, that are not evident from a desk top review. We also encourage investors to raise their concerns about companies' accounts to us.

Our 2015/16 reviews will be influenced by macro-economic factors that may affect corporate reporting in the UK:

- Volatility in commodity prices and in equity and bond markets may affect asset valuations. Disclosures of measurement sensitivity will be particularly important, including short-term estimation uncertainty for assets directly affected and whether reasonably possible changes in sensitivities would result in goodwill impairment.

- Tax uncertainties may be increasing given recent challenges by global and European institutions and national governments. Disclosures of tax risks, accounting policies, judgements and estimates will be increasingly important.

3.3.2 Clear & Concise Reporting

Our reviews are influenced by the FRC's Clear & Concise initiative. Our letters highlight opportunities to make reports and accounts more clear and concise; for example, by removing accounting policy disclosures that do not appear relevant.

Our work also supports the initiative more broadly as we consider other aspects of companies' reports and accounts that affect their clarity, such as:

- their internal consistency;
- whether narrative is sufficiently tailored to be relevant, yet still comprehensive; and
- whether important issues are given due prominence.

An objective and wide-ranging assessment of what is material to investors is key to clear and concise reporting.

Our letters may be accompanied by an appendix of more minor points identified by our reviews, usually relating to disclosures that do not appear to have been provided. We draw attention to these potential omissions but leave Boards to assess whether they are material. All our opening letters emphasise that we only expect items to be reflected in a company's accounts where they are material or relevant. During the year, we checked a sample of accounts that we had reviewed in the previous year to assess whether our practice of including appendix points had encouraged companies to include immaterial information in their accounts. This check confirmed that, in our sample, immaterial information was not included as a result of our approach.

3.4 Company Responses

In our 2013/14 Report, we identified the good practices that we encourage companies to demonstrate when they receive an FRC letter and during the subsequent exchanges of information. Further guidance on how a company should respond to a letter from us is available on our website[5].

We identified further good practices from our 2014/15 cases:

- We encourage Boards to volunteer all information that is directly relevant to an issue early in our correspondence. For example, if we ask about goodwill impairment and a detailed Board paper had been prepared on the subject, volunteering this information early in our correspondence is likely to reduce the duration of our enquiry.

- We encourage audit firm representatives to accompany their clients when they are invited to meet us. This is because auditors can be helpful in facilitating the discussion and in understanding the sometimes very technical nature of our concerns. Meetings usually conclude with the Conduct Committee and the company agreeing certain changes to their future reporting. The auditor's support for that resolution is important as any subsequent disagreement would be problematic for all concerned. Firms also benefit from understanding the reasons for our concerns and are able to pass on the benefits of this knowledge to other clients.

- A company's Board is responsible for all information included in its report and accounts, including items that have been prepared by external service providers. The Board needs to take responsibility for the explanations that it subsequently provides to us. All letters to us should be signed by a Board member.

- Some overseas-based companies experienced delays in receiving our initial letters because they were not forwarded promptly by their UK-registered office. We expect UK listed companies to have a process for ensuring prompt correspondence with regulators.

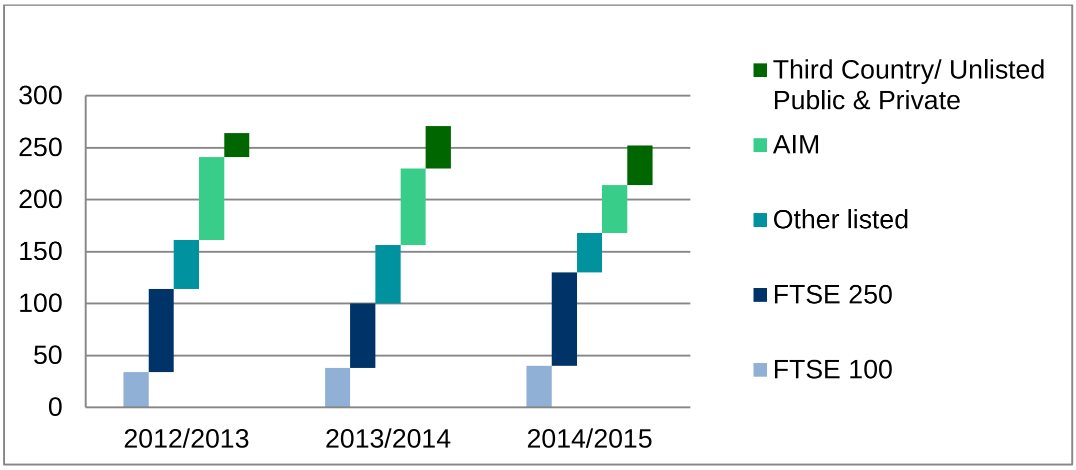
[5] https://www.frc.org.uk/Our-Work/Conduct/Corporate-Reporting-Review/FAQs/FAQs-My-company-has-received-a-corporate-reporting.aspx

4 Activities and Outcomes

4.1 Summary of Activities

In 2014/15 we reviewed 252 sets of reports and accounts (2013/14: 271; 2012/13: 264).

4.1.1 Table A: Reviews by Market

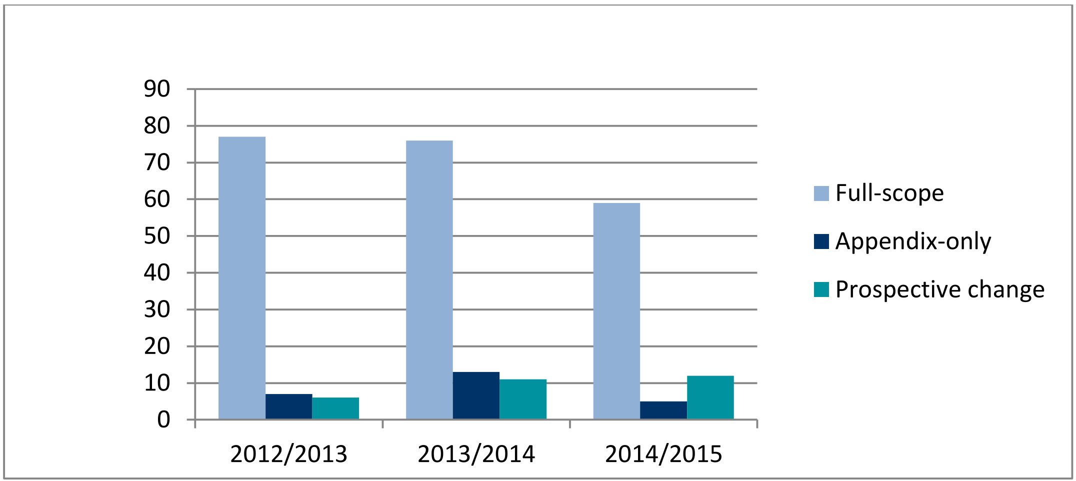


While our work covers all listed, AIM-quoted and large private companies, we direct most resource towards the largest companies, where a material error can have implications for confidence in the market as a whole. We currently review these companies' accounts on a rotational basis. FTSE 100 companies are reviewed at least once every three years and FTSE 250 companies at least once every four years. Our continued prioritisation of the larger and more complex organisations does impact the total number of companies we can review and write to, which we have under consideration.

We aim to complete our reviews before the publication of the companies' next accounts so that matters identified can be publicly addressed as soon as possible. We have previously acknowledged that our focus on the FTSE 350 may mean that matters on smaller company accounts may not be resolved until the next reporting cycle. The effect of this brought-forward work-in-progress affects the timeliness of the subsequent year's reviews. We are considering possible ways to address this issue, subject to our resource constraints.

We have completed 93% of our 2014/15 reviews by the date of publication of this report (2013/14: 90%); the rest are in correspondence.

4.1.2 *Table B: Approaches to Companies*



This year we wrote to 76 companies (2013/14: 100; 2012/13: 91), which is 30% (2013/14: 37%; 2012/13: 34%) of the total number of companies whose reports were reviewed.

We only write to companies if our review identifies potential matters that are significant enough to request additional explanation or information. In selecting areas to question, we consider matters that investors tell us are material and information in the press and investor blogs.

The different types of letters are discussed in detail on our website[6]. We ask for written responses to our full scope and prospective change letters, the latter once the company has published its next annual report and accounts. We may write a prospective change letter if a matter comes to our attention close to a company's year-end and we expect the company to be able to resolve the matter satisfactorily based on our initial enquiries. We write a small number of appendix-only letters each year, where we do not request a written response.

We ask companies to respond to our initial letter within 28 days so that matters raised can be addressed promptly. We expect the questions we raise on significant accounting judgements to have already been considered by companies and their auditors and that the relevant information and explanations should be readily available. We acknowledge that companies will occasionally need additional time in which to respond and we consider reasonable requests for time extensions favourably. Only 46% (2013/14: 45%) of companies responded to initial letters sent in 2014/15 within 28 days, although most of the remainder were received shortly afterwards. The average response time for all letters was 36 days (2013/14: 40 days).

We also aim to respond to companies' letters within 28 days. In 2014/15 our average response time was 34 days (2013/14: 35 days). This average was affected by a small number of complex cases where the matters at issue required more extensive deliberation.

Our operating procedures allow us to set up a Review Group[7] of FRRP members if we believe a formal inquiry into a company's annual report and accounts is required. Last year, all matters we raised with companies were successfully resolved without progressing to a Review Group (2013/14: none opened).

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6 https://www.frc.org.uk/Our-Work/Conduct/Corporate-Reporting-Review/FAQs/FAQs-My-company-has-received-a-corporate-reporting.aspx

7 See Glossary

A greater proportion of our reviews were prompted by complaints and referrals. We received 24 complaints and referrals in 2014/15 (2013/14: 16, 2012/13: 8), nine of which were referred from other regulators. As we are required to keep company information confidential we cannot enter into extended correspondence with complainants about the basis for our conclusions, however, we do inform them of the outcome of their cases and explain our decision if we decide not to pursue a matter. We consider complaints thoroughly and can address them best when we receive a full explanation of the corporate reporting or accounting issue and why it is of concern. We encourage well-informed complaints as they can provide an additional insight into issues that may not be identifiable from a desk top review of the report and accounts.

4.2 Outcomes

It is rare for our letters to companies not to result in any improvement to their future reports and accounts. Where, as a result of our engagement, a company makes a material correction, for example to a primary statement, the market is informed either through a Press Notice[8] or a Committee Reference[9]. In the majority of cases, however, where we raise a question because a disclosure is unclear, Boards undertake to clarify the information in the following year's reports and accounts.

We follow up all specific undertakings given by Boards. In the unusual situation where the company's next annual report and accounts do not provide the agreed improvements, we would re-open our correspondence. We did this on one occasion this year (2013/14: nil).

We issued three company-specific Press Notices during the year (2013/14: two). The first[10] accompanied fastjet Plc's restatement of its accounts after failing to identify a reverse acquisition.

The second[11] related to a number of restatements announced by Quindell Plc. These included:

- delaying the recognition of revenue in relation to income from pursuing legal claims on behalf of customers until the uncertainty about the receipt of cash is removed, for example, on settlement of the claim;
- failing to identify a reverse acquisition; and
- incorrectly accounting for historical share transactions.

Certain matters in respect of Quindell Plc are also being considered by the FRC's Professional Discipline team.

The third[12] accompanied blur Group plc's 2015 interim report. The company corrected its revenue recognition policy to recognise revenue only when there was sufficient evidence to conclude that the stage of completion could be assessed reliably and that it was probable that

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8 See Glossary
9 See Glossary
10 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/June/Findings-of-the-FRC-in-respect-of-the-accounts-of.aspx
11 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/July/Quindell-Plc.aspx
12 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/September/Findings-of-the-FRC-in-respect-of-the-accounts-of.aspx

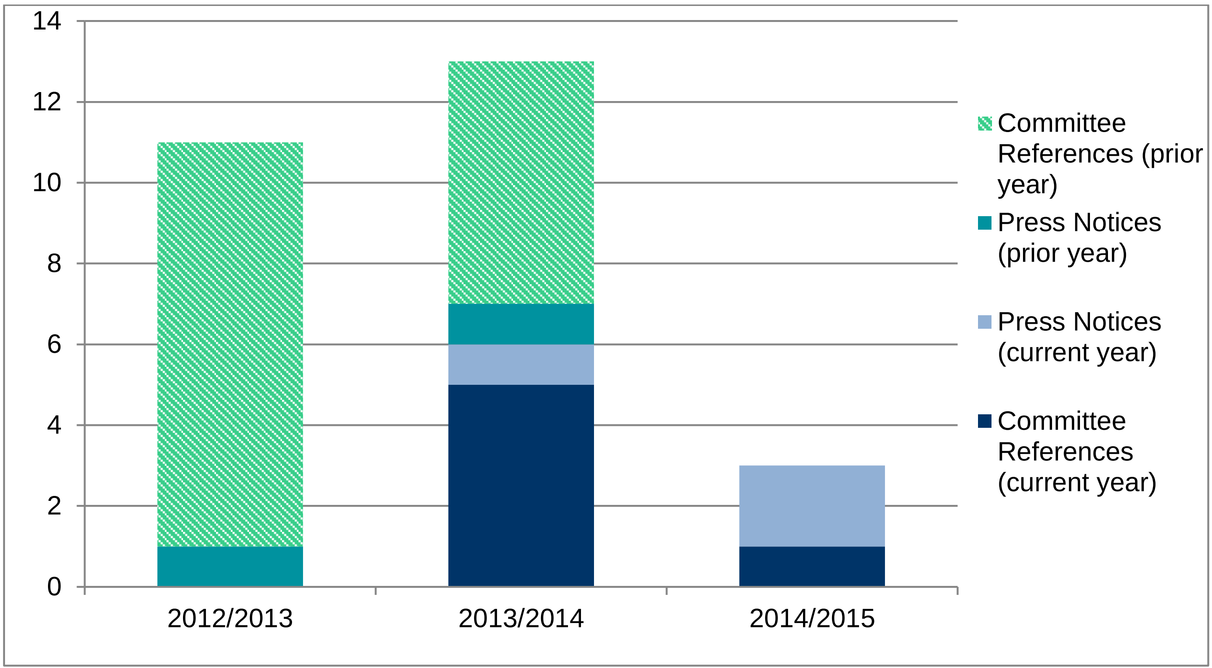
economic benefit would be received. This resulted in a restatement of the cumulative revenue recognised.

We also questioned whether the company was principal or agent in relation to the outsourcing services it provided and whether the strategic report gave a fair and balanced analysis of the company's performance.

Six companies (2013/14: nine) have agreed to our request and made a Committee Reference in the report and accounts in which they made a change following our intervention.

Table C shows the number of FRC Press Notices and Committee References that have been published relating to reviews starting between 2012 and 2014. They are categorised by the year in which our review of the annual report and accounts commenced. Further details of current-year Press Notices and Committee References are included in Appendix B.

4.2.1 *Table C: Press Notices and Committee References*



In exceptional cases, we write to the senior partner or chairman of an audit firm, where we identify an unusually high number of corrections to the audited accounts, or where their effect is significant. We did not issue any such letters in 2014/15 (2013/14: two).

4.2.2 *Exercising our Powers*

Almost all companies provide us with information and explanations voluntarily. Where we experience problems obtaining this information, we write to companies explaining that our statutory powers allow us to apply to the court for information and explanations that we have requested but with which we have not been provided. We wrote such letters to two companies in 2014/15 (2013/14: one), which resulted in the information being provided. Further details of our powers are provided on our website[13].

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[13] https://www.frc.org.uk/Our-Work/Conduct/Corporate-Reporting-Review/FAQs/FAQs-My-company-has-received-a-corporate-reporting.aspx

4.3 Complex Supplier Arrangements

We issued one generic FRC Press Notice[14] during the year, relating to complex supplier arrangements. The issue had gained publicity in the retail sector but it also affected some manufacturing and financial services businesses. The Press Notice explained the importance of users having access to transparent information on the relevant accounting judgements and associated amounts, such as period-end accruals and the effect of changes to estimates on profit.

We have performed an initial review of how FTSE 350 companies responded to our Press Notice. We focused on retailers and their suppliers. Our review found that most companies had responded positively to the Press Notice and the heightened interest in the issue. The most subjective area was the period-end accrual relating to complex or retrospective discounts and rebates.

Whilst we were pleased with the general improvement in disclosures, we would like to see more discussion of how complex supplier arrangements relate to companies' business models and greater transparency regarding the changes in estimates between interim and annual reports. We have written to three retailers where we have identified particular issues relating to their disclosures and will keep the area under review during the interim reporting season.

We remind companies that if there has been a significant change in an estimate made in the second interim period, IAS 34[15] requires the annual report and accounts to disclose the nature and amount of that change unless a separate second half or fourth quarter report is published.

14 https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/December/FRC-urges-clarity-in-the-reporting-of-complex-supp.aspx

15 IAS 34, 'Interim Financial Reporting'

5 Most Frequently Raised Issues

We identified the following 10 areas of corporate reporting that were most frequently raised with companies during the year:

- Strategic Reports
- Accounting Policies
- Critical Judgements
- Clear & Concise Reporting
- Business Combinations
- Exceptional and Similar Items
- Revenue
- Pensions
- Taxation
- Cash Flow Statements

5.1 Strategic Reports

2014/15 was the first full year in which all company accounts had to include a strategic report. The report incorporates the previous Companies Act requirements to prepare a business review and disclose principal risks and uncertainties with new requirements for listed companies to discuss their strategy and describe their business model.

The review should be fair, balanced and comprehensive. We challenged companies where undue prominence given to alternative performance measures meant that the review was not sufficiently balanced, for example, where an adjusted profit measure was discussed but not the IFRS loss. Supporting the Clear & Concise initiative, we encouraged Boards to focus on disclosures that are relevant to investors and not include extraneous material in their reports. However, coverage must be comprehensive; the business review must cover not just the year's performance but also the position at the end of the year. For example, disclosures should include discussions of significant balance sheet and cash flow amounts, not just items that impact the income statement.

Disclosures in the strategic report should be consistent with a company's business model. For example, if a company is reliant on long-term contracts then we would expect information on the company's ability to turn profits into cash over the period of the contracts to be relevant. We also challenged companies where unusual or non-recurring items were inadequately explained.

We continued to raise questions on the disclosure of key performance indicators, where these could not be reconciled to the relevant amounts or where trends were not explained.

As in previous years, we continued to see poorer quality reporting in this area by private, small listed and AIM-quoted companies. We wrote to companies whose strategic reports were disappointingly brief and lacked, for example: a discussion of revenue trends, a description of unusual items or any balance sheet information.

5.2 Accounting Policies

Investors rely on accounting policy disclosures to understand the amounts presented elsewhere in the financial statements. When we assess the completeness of a company's accounting policies we consider other disclosures in the accounts, such as the business model. For example, if the model includes distinct and significant revenue streams, we would expect to see accounting policies relevant to each stream.

Where necessary, we reminded companies of the requirement to include accounting policies for all material transactions, particularly where they were unusual or non-recurring. Examples of missing policies identified included:

- discontinued operations;
- capitalisation of assets under development and software development costs;
- treatment of minimum funding requirements for pensions;
- supplier rebates and discounts;
- debt modification; and
- bid costs.

We queried instances where companies had general accounting policies but it appeared that they should have had more specific policies for certain significant transactions; for example, whether a general policy on provisions should have explained specifically the policies for tax or redundancy provisions.

We challenged a company's policies on cost capitalisation where the point at which it started capitalising development costs was unclear. We are particularly interested if a company capitalises all or none of its development costs and where the reason is not apparent from the business model or explanations of judgements or estimates.

Where a company has industry-specific accounting policies we expect these to be disclosed clearly and without the use of industry jargon.

5.3 Critical Judgements

Investors benefit from disclosure of the specific judgements that Boards make in applying their accounting policies. For these disclosures to be meaningful they should state explicitly what those judgements are and identify them separately from disclosures around accounting estimates. Where our correspondence involves a detailed discussion of the judgements made by a Board in applying an accounting policy, we often conclude our enquiries by asking for these judgements also to be provided to investors by including them in future reports and accounts.

We observed from their reports that Audit Committees generally invested time in carefully describing the significant accounting judgements made during the year. These often contrasted with the more 'boilerplate' discussions of significant judgments in the accounts. We wrote to companies where there was opportunity for the narrative in the accounts to match the higher quality of discussion in the Audit Committee report.

Case Study: Materiality

Background

During the finalisation of its 2014 annual report and accounts, a company identified an error in the prior year's accounts. The error was approximately five times the level of materiality disclosed by the auditors in their 2013 opinion.

The error arose because a pension prepayment had been double-counted as a pension asset in the report prepared for the trustees, resulting in the overstatement of net assets on the closing balance sheet. The increase in assets had resulted in an erroneous gain in other comprehensive income ('OCI') in 2013. As the error had not recurred in the current year, the apparent reduction in net pension assets had resulted in a compensating loss being erroneously recognised in OCI in 2014.

The issue was added to the Audit Committee agenda shortly before the approval of the company's accounts. Despite the fact the error substantially exceeded the level of materiality for the 2013 accounts and was approximately equal in size to the company's total movement in OCI in 2014, the Audit Committee and auditors concluded that the error was not material because the materiality level did not apply to OCI.

The error was not, therefore, corrected by way of an adjustment to the comparative amounts. Nor was it separately disclosed. It was included with other actuarial gains and losses arising from changes in the valuation of pension assets and liabilities.

Company's initial view

The company acknowledged that the error was significantly larger than the auditor's disclosed level of materiality. It claimed, however, that this materiality was relevant only to the income statement and profit for the year and not to OCI.

It argued that OCI was not relevant to the materiality assessment because investors only focus on the profit component of performance. As evidence, it noted that it did not receive questions from investors or business analysts on the components of OCI. It believed that an error in the net pension asset would be more appropriately compared against net assets or equity, against which it was not quantitatively material.

FRC's view

We did not think that a company should base a decision on whether to correct an acknowledged and significant error on its view that investors only focus on the profit component of performance because:

(i) A company and its directors would be in breach of their responsibilities when preparing accounts if they fail to correct a known, material error.

(ii) Investors are not the only users of financial statements whose interests should be considered. For example, a material overstatement of the assets of a pension scheme could potentially affect any levy payable to the Pension Protection Fund.

(iii) A failure to correct an error of this nature and magnitude may be interpreted by an investor as relevant to its assessment of the culture and integrity of a company.

We would have expected the Audit Committee to have informed the Board and to have considered how the correction to net assets would be viewed from the investors' perspective had it been disclosed publicly, that is, it should have looked at the error through a 'different lens'. We believe that investors understand that mistakes are sometimes made but that when identified, they expect them to be corrected appropriately given their nature, and that one of this magnitude deserved to be fully disclosed and explained.

We do not agree that the company should construct an analysis based on carefully selected ratios in order to discount the impact on a specific primary statement, as investors are entitled to rely on the fairness of all of a company's primary financial statements.

Company's amended view

The Company's Chairman appreciated the need for transparent reporting and the need to look at the error through a 'different lens', consistent with the FRC's concerns.

As a result, the company reconsidered its approach. It agreed that it should have considered the wider qualitative aspects, as well as the quantitative effect, of the error on all of its primary financial statements.

FRC focus points

We acknowledge that, even in a company with robust internal controls, errors may occur and directors may have to assess materiality while managing strict reporting deadlines. In these situations, it is particularly important for directors to take a step back and consider the wider qualitative aspects of materiality and the need for transparent reporting to maintain users' trust in financial statements.

Directors should not approach the question of materiality by reference to whether or not restating financial statements for a prior year error could be justifiably avoided. They should instead consider the wider relevance of the error to investors and other users of financial statements and whether they are providing them with the most reliable and transparent information.

5.4 Clear & Concise Reporting

Preparers should be in no doubt that we take cutting clutter seriously. It is vital that important messages in the report and accounts are not obscured by extraneous material. Boards should not include irrelevant information in their reports and accounts on the false premise that it will avoid regulatory enquiry. If a company believes that a potential disclosure is not material or relevant we would expect them to easily be able to explain the reason for its omission to us. Often our consideration of a company's response leads us to agree that no further disclosure is necessary.

The following case study demonstrates our approach to companies that have undertaken specific projects to make their reports and accounts more clear and concise. While an increasing number of companies have initiated 'Clear & Concise' reviews, we continue to see reports and accounts that would benefit from this approach.

Case Study: Clear & Concise Reporting

Background

A company has an ongoing project to make its annual report and accounts more clear and concise through, for example, removal of immaterial disclosures. It has also improved clarity by increasing the use of pictures and diagrams where these convey information more concisely than text.

In its December 2013 accounts it removed its share-based payment note and did not present the detailed disclosures required by IFRS 2[16]. It did, however, disclose the charge for the year and the dilutive effect of share-based payments.

Company's initial view

The share-based payment charge for the year was less than 1% of profit before tax and approximately 70% of the group materiality disclosed in the auditor's report. The company had removed the detailed information because it believed that it was immaterial.

FRC's view

As the FRC has an objective of making company accounts more clear and concise, we welcome the work companies do in reviewing accounting policies and disclosures to remove immaterial items.

When considering materiality, companies should consider both the size and nature of items. We may, therefore, ask how a company concluded that information removed from accounts was immaterial.

We considered the information provided by the company together with the three principles of disclosure in IFRS 2. The company had addressed two of the principles; the only missing information identified related to the company's approach to valuation. We asked the company whether high-level disclosure of the approach to the valuation of share-based payments would benefit users of the accounts.

We emphasised that our question did not mean that we wanted all the company's previous share-based payments disclosures to be reinstated.

Company's amended view

On reflection, the company concluded that including a brief description of its methodology for estimating the fair value of share-based payments would be helpful to users of the accounts and a proportionate disclosure. The FRC had not questioned the non-disclosure of the other IFRS 2 disclosures and, as the company had concluded that they were immaterial, it did not intend to reinstate them.

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16 IFRS 2, 'Share-based Payment'

FRC focus points

We accept that detailed disclosures are not necessary when the amounts involved are immaterial. This case study demonstrates that we will not ask companies to reinstate such disclosures following a 'cutting clutter' exercise. However, we believe it is important for companies to consider the overall disclosure principles of a standard and assess whether including certain disclosures would be appropriate.

5.5 Business Combinations

An area of focus this year was whether companies had identified all separate intangible assets arising from business combinations. We looked for consistency between discussions in a company's press notices and strategic report and the intangible assets identified in the accounts. For example, if a driver for an acquisition was the quality of the acquired company's customer relationships then we would expect to see customer-related intangible assets on the balance sheet. We will challenge companies where we cannot identify the intangible assets we would expect to see, given other relevant information.

Boards need to have the right resources and expertise to identify and measure intangible assets arising from business combinations. We expect them to consider the use of external advisors to support their company's accounting function in producing high quality, robust analyses.

The findings supporting our company-specific Press Notices emphasise the importance of correctly identifying which party is the acquirer before accounting for a business combination.

5.6 Exceptional and Similar Items

We monitored companies' presentation of exceptional and similar items and considered the extent to which they reflected the principles set out in our December 2013 Press Notice[17]. This year, we wrote to companies on:

- Inconsistent presentation of non-recurring debits and credits. Examples included non-recurring tax credits and the unwinding of unused provisions when the charge to recognise the provision was originally disclosed as an exceptional item.
- Missing accounting policies for exceptional items, or policies that listed the company's exceptional items but which did not explain what made them exceptional.
- Items that were described as non-recurring but had also occurred in the previous year.

5.7 Revenue

Revenue and its associated accounting policies are one of the key areas of focus for investors[18]. We continued to challenge companies where their accounting policies were 'boilerplate' and insufficiently tailored to all the material revenue streams implied by the company's business model; for example, royalty or licence fee income.

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17 https://frc.org.uk/News-and-Events/FRC-Press/Press/2013/December/FRC-seeks-consistency-in-the-reporting-of-exceptio.aspx

18 https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b.aspx

Our most common challenge was to Boards that did not adequately explain how they estimated the stage of completion of long-term contracts. IAS 18[19] requires use of a method that measures reliably the services performed. One method suggested by IAS 18 that may be appropriate for calculating the proportion of revenue to recognise is to compare the percentage of costs incurred to date with total estimated contract costs. We identified some companies that had applied this ‘cost to cost’ methodology but where it did not appear to result in a pattern of revenue recognition consistent with their pattern of service delivery. We will continue to focus on this area.

5.8 Pensions

We have now seen a full-year of results under the accounting and disclosure requirements of the revised version of IAS 19[20]. We were disappointed to note that some companies’ accounting policies still referred to the requirements of the previous version of IAS 19, which implied that their accounts preparation process was not as thorough as it should have been.

IAS 19 requires companies to disclose the applicable regulatory framework for their pension schemes and to describe the level of minimum funding requirements. This is particularly relevant where a company is not able to recover any pension surplus and an onerous contract provision is required. We wrote to a number of companies that had not provided appropriate disclosures in their accounts.

Given the level of investor interest in near-term deficit funding obligations, we expect companies to include comprehensive quantitative information regarding their minimum funding requirements in order to give a complete picture of their pension arrangements. However, we did not identify this information in accounts as often as we would expect.

We reminded companies that they should give sensitivity analyses for all significant actuarial assumptions; for example, future pension increases.

In the light of the diversity in practice in the UK, the IFRS Interpretations Committee is currently considering how companies should assess the rights of pension fund trustees when considering whether they have an unconditional right to a pension surplus. This issue affects the recognition of assets for pension surpluses and whether additional liabilities are required for deficit funding requirements. It has issued an Exposure Draft (‘ED’) for consultation. Until the ED is finalised and effective, and IAS 19 and IFRIC 14[21] are amended, we would expect companies to disclose any significant accounting judgements made when assessing trustees’ rights, including the extent to which their policies are consistent with the ED.

5.9 Taxation

The reconciliation between a company’s notional and effective tax rate provides investors with useful information about the drivers of its ongoing tax obligations. We raised queries when we were unable to understand the nature or amounts of reconciling items. For example, we challenged when:

- reconciling items had been aggregated at a level that did not provide sufficient information for investors to understand the sustainable tax rate;

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19 IAS 18, ‘Revenue’
20 IAS 19, ‘Employee Benefits’
21 IFRIC 14, ‘IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction’

- the description of reconciling items was inconsistent with the strategic report and unclear; and
- only current, and not total, tax had been reconciled.

We reminded Boards that the nature of evidence supporting a deferred tax asset is required to be disclosed when its recovery depends on future profits and the company is loss-making. We wrote to companies when the deferred tax asset would be recovered over an extended period but which had not been disclosed as a significant judgement enabling users to understand its impact.

We challenged one company's accounting for tax on share-based payments when it was unclear whether the company had properly allocated the tax credit arising on option exercise between equity and the income statement.

Boards often delegate responsibility for the preparation of tax disclosures and calculations to external service providers. We reminded Boards that they retain ultimate responsibility for this information, so they need to have robust procedures in place to assess the quality of the outputs they receive. This year, our challenge of its disclosures led to a company identifying errors in externally prepared information.

5.10 Cash Flow Statements

Operating cash flow disclosures are particularly relevant to investors when assessing the quality of a company's profits. We continued to challenge companies on their classification of cash flows as operating, financing or investing. Companies should pay particular attention to the classification of unusual or non-recurring cash flows as they may still meet the definition of cash flows from operating activities.

We continued to identify examples of cash flows that had been inappropriately netted, for example payments to, and receipts from, different banks.

5.11 Detailed Technical Observations

A more detailed technical presentation, summarising the resolution of certain issues that arose from reviews undertaken in the past year, is available on our website. We expect this presentation to be particularly relevant to those involved in the detailed preparation of financial statements.

6 Processes and Collaboration with Others

6.1 Review of CRR Processes

In 2015, the FRC engaged external consultants to perform an independent review of the processes, outcomes and external communications of its CRR and AQR activities. The consultancy interviewed a number of stakeholders who had experience of our work, including preparers, investors and auditors, who confirmed that the review started from a position of strength. We are currently considering several of the recommendations, including the level of transparency surrounding our reviews and decisions, our communications and internal processes. Any consequential changes to our operating procedures will be subject to a public consultation.

6.2 Collaboration with Others

6.2.1 Liaison with Audit Regulators

Members of the CRR and AQR teams collaborate when they are able to assist each other's reviews. CRR advises AQR if it has concerns around the quality of the audit work performed. Where AQR reviews an audit and identifies potential issues with a set of accounts, CRR will then consider whether to open correspondence with the company.

During the year, CRR worked closely with AQR on ten joint reviews where CRR reviewed the annual report and accounts and AQR reviewed the related audit file. CRR team members advised on the corporate reporting issues considered by the auditors and the AQR team drew CRR's attention to matters on the audit file that affected corporate reporting. The same degree of co-operative working is being maintained on all CRR and AQR reviews, although formal joint reviews have been discontinued partly to avoid the unintended consequence of delays in writing to companies.

We also receive complaints regarding company accounts stemming from audits inspected by the ICAEW's Quality Assurance Division. We value the insights into companies' accounts that other regulators can bring and welcome their referrals.

6.2.2 Interaction with Codes and Standards Division

Anonymised observations from our CRR activities are shared with the FRC's Codes and Standards division and inform their standard setting and IFRS influencing activities. These may include examples where we think a standard is unclear or its quality or effectiveness could be improved. We also contribute to the Financial Reporting Lab's projects on potential improvements to UK corporate reporting, based on our enforcement experiences.

6.2.3 Working with the European Securities Market Authority ('ESMA')

CRR is an active participant in the European Enforcers' Coordination Session ('EECS'), the committee established by ESMA for European National Enforcers to deliver its mandate in strengthening European Supervisory convergence. We discuss significant enforcement decisions and emerging issues when these are relevant across the broader European market. ESMA publishes a selection of these decisions twice a year.

Each year, after discussion with National Competent Authorities, ESMA issues European Common Enforcement Priorities. We consider these priorities when performing our work and report the results to ESMA. For reviews undertaken in 2014/15, the priorities include: impairment of non-financial assets, fair value measurement and forbearance disclosures in financial institutions. We identified no significant concerns in these areas and noted that the forbearance disclosures in the sample of UK financial institutions reviewed were amongst the most comprehensive in Europe.

From time to time, ESMA organises working groups and sub-committees of European enforcers to discuss topical issues. We participated in two such ESMA groups during the year, which are ongoing, on accounting by financial institutions and disclosures. We co-ordinate the work of the group on disclosures, which has provided us with the opportunity to share the principles of our Clear & Concise initiative with European colleagues.

In December 2014, ESMA published its Enforcement Guidelines for European enforcers, which we are required to implement on a ‘comply or explain’ basis. The FRC has, together with the Financial Conduct Authority (‘FCA’), confirmed to ESMA that it complies. As the working practices of our CRR team were broadly consistent with the Guidelines, their implementation did not have a significant effect.

In June 2015, ESMA published Guidelines on alternative performance measures (‘APMs’) presented in companies’ Annual Report and Accounts (other than financial statements), and other information such as press releases and prospectuses. It applies to companies from July 2016 and guides them on how to present, explain and reconcile APMs. We will consider its requirements during our reviews.

6.2.4 Coordination with Other Regulators

We also liaise with other UK regulators. We have regular meetings with the FCA, where we share the outcomes of our work on listed companies and discuss ongoing matters of mutual interest. We refer financial service companies that are regulated by the FCA to the authority when we have concerns about their corporate reporting. The FCA may refer corporate reporting matters to us when we are the most appropriate authority to investigate possible shortcomings.

We liaise with the Prudential Regulation Authority on areas of common interest involving corporate reporting by financial institutions. We will contact other authorities, such as the London Stock Exchange, when we are aware of matters that could be of significance to them in the discharge of their responsibilities.

Appendix A: FRRP Members

Chairman

Geoffrey Green[22]	Former Senior Partner Ashurst LLP and former Managing Partner Asia Ashurst LLP. Non-executive Director, Vedanta Resources Plc. Chairman of FRC's Monitoring Committee
Richard Fleck CBE[23]	Former Chairman, Conduct Committee; Former Director, FRC; and consultant, Herbert Smith Freehills LLP

Deputy Chairs

Joanna Osborne	Former Partner, KPMG, specialising in financial reporting
Ian Wright	Former Director, Corporate Reporting, FRC

Members

Daniel Abrams	Former Finance Director, Volex plc and Non-Executive Director, BioCity Group Limited
James Coyle	Former Group Financial Controller, Lloyds Banking Group. Non-Executive Director, HSBC Bank plc and the Scottish Building Society. Member of FRC's Monitoring Committee[24]
Jimmy Daboo	Partner, KPMG. Vice Chairman of KPMG's Global Energy and Natural Resources Practice
Graeme Dacomb	Partner, Ernst & Young LLP
Mary Dolson	Member of PricewaterhouseCoopers Accounting Consulting Services IFRS Central Team, located in London
Stephen Edlmann	Partner, Ashurst LLP
Eric Hutchinson	Chief Executive, Spirent Communications plc
Vanessa Knapp, OBE	Former Partner, Freshfields Bruckhaus Deringer LLP
Iain Lowson	Head of Risk and Quality, BDO LLP
David Mabb QC	Member of Erskine Chambers
Andrew McIntyre	Partner, Ernst & Young LLP
Richard Meddings	Former Group Finance Director, Standard Chartered plc

22 Appointed 1 April 2015
23 Retired as Chairman 31 March 2015 (continuing member)
24 Appointed 1 May 2015

Chris Moulder	Director of General Insurance, Prudential Regulation Authority
Brendan Nelson	Non-Executive Director and Audit Committee Chairman, Royal Bank of Scotland plc and BP plc. Former President of the Institute of Chartered Accountants of Scotland
John Nicholas[25]	Non-Executive Director and Audit Committee Chairman, Rotork plc, Hunting Plc and Mondi Group. Non-Executive Director of Diploma PLC
Andrew Palmer	Non-Executive Director and Audit Committee Chairman, Direct Line Group and Royal London Group. Formerly Group Finance Director, Legal and General Group
Richard Pinckard	Partner, KPMG
Richard Piper	Partner at Restoration Partners Limited and Chairman and NED of a number of main listed and AIM businesses
Alan Trotter	Former Chief Financial Officer, Alliance Trust PLC, a FTSE 250 company. Member, Technical Committee of the Association of Investment Companies, the Hundred Group of Finance Directors and the FCA Practitioner Panel
Richard Wilson	Partner, Ernst & Young LLP
John Worby	Non-Executive Director and Chairman of Audit Committee, Fidessa plc, Connect Group PLC and Carr's Group PLC

25 Retired 30 April 2015

Appendix B: FRC Press Notices and Committee References

Unless otherwise stated, the Press Notices and Committee References referred to below relate to accounts reviewed in the 2014/15 FRC year. All the cases are now closed. Where a Press Notice or Committee Reference relates to a review commenced in an earlier reporting period, the year that was under review is indicated on the schedule; this year six cases relate to reviews commenced prior to 2014/15. This table excludes companies that disclosed that correspondence with the FRC was closed with no adjustments required. The identification in this Appendix of companies that published Committee References is in accordance with our operating procedures.

Company	Status	Issues	Publicity
fastjet Plc	AIM	Business combination should have been treated as a reverse acquisition	Press Notice
Quindell Plc 31/12/2011 31/12/2012	AIM	The recognition of revenue in relation to income from pursuing legal claims on behalf of customers should have been delayed until the uncertainty about the receipt of cash was removed, for example, on settlement of the claim Business combination should have been treated as a reverse acquisition Wrongly accounted for historical share transactions	Press Notice
blur Group plc	AIM	The recognition of revenue from outsourcing arrangements should have been delayed until there was sufficient evidence to conclude that the stage of completion could be assessed reliably and that it was probable that economic benefit would be received	Press Notice
Lombard Risk Management plc 31/03/2013	AIM	Assets under construction – amortisation commenced when costs incurred rather than when assets ready for use	Reference
Aquarius Platinum Ltd 30/06/2013	FTSE Small Cap	Cash flow misclassification of payment to cancel a foreign currency swap as financing rather than operating cash flow	Reference
Workspace Group PLC 31/03/2013	FTSE 250	Discretionary distribution attributable to a non-controlling interest (‘NCI’) was incorrectly recognised as a provision rather than being accounted for as NCI	Reference

Company	Status	Issues	Publicity
Penna Consulting Plc	AIM	Tax on discontinued operations incorrectly included as tax on continuing operations	Reference
Telford Homes plc 31/03/2013	AIM	Reversal of inventory provisions should have been separately disclosed	Reference
Regal Petroleum Plc 31/12/2012	AIM	Cash flow statement misclassification of: (1) sales taxes and (2) PP&E acquired, as inventory	Reference

Glossary

Item	Definitions
Committee Reference	In some cases, we may ask a company to refer to its discussions with the Conduct Committee in the report and accounts in which it makes a change to a significant aspect of its reporting following our intervention. This is known as a '**Committee Reference**' and may be requested, for example, in respect of an error affecting classification in one of the primary statements, an omission of disclosure with a material impact, or multiple omissions of relevant information and / or the provision of poor quality information. The Conduct Committee asks for a Committee Reference where it considers that investors and other preparers ought to be aware of the correction or changes in the extent of disclosures provided by a company but that it is not necessary to inform the market at large.
Press Notice	**Press Notices** are usually only issued where a significant change to published accounts is being made and which may include an agreed significant change to future accounts. When the Conduct Committee considers, for example, that the change is sufficiently material to the annual report and accounts taken as a whole, or is a material error, which investors, other preparers and their advisors or the public ought to be aware of, a press notice would generally be issued. Sometimes the matter is such that dissemination cannot wait until the publication of the company's next report and accounts, for example because it is an emerging trend or setting a precedent. In those instances the press notice would be issued at the same time as the company announces the change, for example when restating or issuing its preliminary results announcement.
Review Group	Initially, the Conduct Committee raises questions with a company where there is, or may be, a question as to whether the accounts comply with relevant accounting and reporting requirements. Most matters are resolved through correspondence. If, after considering additional information and explanations, the Conduct Committee believes that there is still a possibility of a significant breach of accounting or disclosure requirements, then it will open a **Review Group** enquiry in order to investigate the matter in more detail. A Review Group of FRRP members will be established to consider the matters.

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