Key matters for 2022/23 reports and accounts

Introduction

Welcome to the FRC's summary of key matters for the 2022/23 financial reporting season. This document sets out the key findings and expectations of the Corporate Reporting Review (CRR) team of the FRC for the coming year and provides links to other relevant documents. This summary is primarily targeted at CEOs, CFOs and Audit Committee Chairs but will be helpful to all those involved in the preparation or auditing of annual reports and accounts. We encourage all reporting teams and relevant committees to consider both the outcomes of our reviews and our key expectations of future reporting when preparing their annual reports. We would welcome any feedback on this document to help us improve the effectiveness of our communications.

We are living in times of heightened uncertainty. Russia's invasion of Ukraine sent geopolitical shockwaves around the globe and exacerbated the economic damage caused by the Covid-19 pandemic. Rising inflation, slowing economic growth, an energy crisis, increasing interest rates, stresses in supply chains, labour shortages, and changes in consumer behaviour are just some of the challenges businesses are currently facing. And in the background, the effects of climate change around the world present an increasingly concerning and urgent issue.

At these times of increased uncertainty, some areas of financial reporting may pose particular challenges, for example, disclosures of judgements and estimation uncertainty, measurement of the impairment of assets, going concern and viability assessments, and measurement of provisions. CRR plays an important role in this regard by working to ensure that annual reports and accounts comply with the relevant financial and narrative reporting requirements and deliver high quality decision-useful information for investors and other stakeholders.

We are pleased to note that, despite the challenging environment, the quality of corporate reporting among the FTSE 350 has been maintained. We saw improvements in the reporting of judgements and estimation uncertainty, impairment of non-financial assets, alternative performance measures and revenue. However, there is considerable scope for improvement in some areas, in particular, financial instruments, deferred tax and cash flow statements.

In the coming year, our monitoring work will take account of the risks and uncertainty in the challenging economic environment, including those relating to climate change. Companies need to assess and clearly articulate the impact of these risks on their strategy, business model, viability and going concern assessments, ensuring consistency across the annual report and accounts.

We explain below where our detailed monitoring work identified shortcomings and our expectations for the next reporting season.

1. Summary of key messages from recent FRC publications

1.1 Annual Review of Corporate Reporting

Our Annual Review of Corporate Reporting (the Annual Review) provides detailed findings from our corporate reporting review activities during the year. A short Corporate Reporting Highlights document is specifically designed for readers who may find a high-level summary more helpful.

Financial and narrative reporting
Reporting of judgements and estimation uncertainty, impairment of non-financial assets and revenue are particularly critical to users in an uncertain environment. The CRR has been driving enhancements in these areas over a number of years. We are pleased to see improvements in the reporting of these matters, and we expect the quality to be maintained.

There is considerable scope for improvement in some other areas of financial reporting and we are disappointed that the number of restatements prompted by our reviews nearly doubled this year compared with last year. Over half of these restatements relate to cash flow statements. Many of these errors could have been picked up by robust pre-issuance reviews. We present these restatements in section 6.2 of the Annual Review.

- **Cash flow statements**
  Cash flow statements remain an area of considerable concern, with the number of errors found in this review cycle almost doubling compared with last year. Companies and their auditors can and must do better. To help drive the necessary improvements, cash flow statements have been identified as an area of focus for audit quality inspections in the 2022/23 review cycle. Our thematic review of cash flow and liquidity disclosures highlights the questions we raise most frequently. The simple consistency checks that are an integral part of our review process, and which commonly identify cash flow statement errors, are included in the appendix to the thematic review.

- **Financial instruments**
  We asked more questions about financial instruments this year – in many instances, our queries could have been avoided by clearer accounting policies and disclosures. We continued to raise questions about non-banking companies' disclosures of expected credit loss provisions, which will remain an area of focus in view of the current economic climate. We also raised queries related to liquidity risk disclosures, in particular, around financing arrangements and covenants.

- **Income taxes**
  We raised an increased number of queries in respect of accounting for income taxes. In several cases, there was only boilerplate disclosure of the evidence supporting the recognition of deferred tax assets by entities with recent losses, despite this being highlighted as a matter requiring improvement in our 2021 Annual Review. This will remain an important area of disclosure in the current economic environment.

Further information about these matters (and other frequently raised issues) and how to address them is provided on pages 5 to 8 of the Corporate Reporting Highlights document.

Climate-related reporting
This year saw a significant advance in climate-related reporting, with the introduction into the Listing Rules of reporting based on the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations for premium listed entities on a comply-or-explain basis.

As part of the FRC's ongoing programme of work on environmental, social and governance (ESG) and climate-related reporting, more details of which can be found in our Statement of Intent, CRR undertook a thematic review of companies' climate-related reporting, including a review of the Listing Rules' requirements in collaboration with the Financial Conduct Authority (FCA). Our review focused on larger companies that are significantly affected by climate change. We found that these companies had generally risen to the challenge of mandatory TCFD reporting and were able, in most cases, to provide the disclosures 'particularly expected', as identified by the Listing Rule. There was, however, a range of maturity in these companies' disclosures, and our report highlighted five main areas for companies to consider in future reporting. In addition, we were pleased that a significant number of companies referred to the impact of climate change and the climate transition in their financial statements, although these disclosures were often quite generic in nature.

The FCA's broader review found that some companies claimed compliance with the TCFD's recommended disclosures when it appeared that they had not complied; we and the FCA may take action as appropriate in such cases.

The FRC Transformation Programme
Section 6.4 of our Annual Review also includes an update of the impact of the FRC's transformation programme on the work of CRR.

The UK Government plans to amend the definition of public interest entities to include only companies and LLPs with more than 750 employees and an annual turnover of more than £750 million. Once implemented, UK quoted AIM companies that do not meet this threshold will fall out of CRR's remit.

This is the third year in which CRR raised matters on areas outside its current statutory enforcement powers on a number of routine reviews. Where appropriate, we highlight opportunities for companies to improve their reporting against the UK Corporate Governance Code 2018 (the Code) (see section 1.5 below). This year, we will extend our review work to include remuneration reporting on a pilot basis. Our findings from this work will help inform our regulatory approach once we have statutory powers over the whole annual report and accounts.

1.2 CRR thematic reviews

During the year, CRR published the following thematic reports:

- Discount Rates The use of discount rates is common in IFRS. However, determining an appropriate discount rate can be complex and prone to error. It may also be an area of significant estimation uncertainty, requiring enhanced disclosures. We identified opportunities for companies to improve their disclosures in relation to discount rates, in particular, by explaining how discount rates are determined. We were pleased to find some good examples where companies had clearly explained what factors had been incorporated into the discount rate, for example, explaining if risk and inflation were included in the cash flows or the discount rate.
- TCFD disclosures and climate in the financial statements We found that the premium listed companies in our review had generally risen to the challenge of mandatory TCFD reporting and were able, in most cases, to provide the TCFD disclosures that are 'particularly expected' by the FCA's Listing Rule. The increased information will go some way to meeting calls from investors for more information on the potential effects of climate change and the climate transition on companies' businesses. However, companies could significantly enhance the usefulness of their reporting by improving the granularity and specificity of disclosures about different sectors, geographies and businesses. Companies need to ensure a fair balance between risks and opportunities, an appropriate connectivity between TCFD disclosures and other narrative reporting, consider consistency between TCFD disclosures and the financial statements, and provide explanations where necessary. We also expect companies to explain how materiality has been reflected.
- Deferred tax assets We considered the basis for recognition of, and disclosure in relation to, deferred tax assets in the light of the effect of the Covid-19 pandemic on companies' recent profitability. We saw some examples of good practice, including disclosure of why forecasts supported the recovery of deferred tax assets, disclosure of the expected period of recovery, and geographical analysis of tax disclosures. The most significant areas for improvement are to provide entity-specific disclosure of the nature of evidence supporting the recognition of net deferred tax assets by companies with recent losses, and to explain the specific nature of key judgements and major sources of estimation uncertainty related to deferred tax assets.
- Business combinations We considered companies' compliance with the requirements of IFRS 3 'Business Combinations', to highlight areas of better practice and identify where improvements are required. Despite accounting for business combinations regularly featuring within our most common findings for a number of years, we were pleased with the overall

quality of the disclosures provided by the companies in our sample. Where acquisitions had a transformational effect on the acquirer's operations, companies explained how their strategy had evolved to incorporate the new additions. For all business combinations, companies explained the reasons for the combination and the impact on performance of the acquired entity. However, we found some basic errors as well as opportunities for better disclosures, for example, explanations for the reasons why goodwill had arisen were often generic and not specific to the company's circumstances.

- Earnings per share The findings of CRR's routine reviews show that some of the main requirements of IAS 33 'Earnings per Share' (EPS) are not always well understood or applied correctly, even in relatively straightforward circumstances. The report highlights some of the more common errors we have found, explains the issues involved and shows how companies might improve their compliance with IAS 33 through more accurate EPS calculations and more helpful disclosures.
- Judgements and estimates We identified improvement in the quality of judgement and estimate disclosures. Examples of good practice included detailed, granular explanations of judgements and uncertainties; quantification of assumptions and/or the amount at risk of material adjustment; and sensitivity analysis. However, companies should make a clear distinction between estimation uncertainty disclosures required under IAS 1 'Presentation of Financial Statements', where there is significant risk of a material adjustment in the following year, and other estimation uncertainty disclosures and associated sensitivities.

The individual thematic reports provide more detail on the main findings as well as our key reporting and disclosure expectations for the next year in each of the areas covered.

1.3 What Makes a Good Annual Report and Accounts

Our *What Makes a Good Annual Report and Accounts* report is due to be published later this year. It will form part of our 'What Makes a Good ...' series[1] and will identify a number of characteristics that we, as a regulator, associate with a good annual report and accounts.

1.4 FRC Lab reports

The reports produced by the FRC Lab (the Lab) this year are outlined below. They comment on current practice and highlight the information that investors consider most important.

- Digital security risk disclosures Digital security is fundamental to business continuity, resilience and the ability of companies to generate value. However, reporting in this area currently falls short of stakeholder expectations. The report provides recommendations for

[1] FRC What Makes a Good Audit? report was published in November 2021.

audit committees to help them provide disclosures that meet investor needs. The report also identifies best practice examples.

- ESG data – production The Lab report explores the processes and systems used to generate and collect ESG data for internal decision-making and external reporting, which are predominantly still manual. It highlights the challenges companies face in terms of time and resource constraints to meet changing requirements and demands for ESG disclosures across different frameworks. The report also includes actions for better practice, including collaboration across the organisation on ESG matters to avoid siloed thinking and better embed ESG data in decision-making. The next phase of the ESG data project will explore distribution and consumption.
- Net zero Companies are increasingly referencing net zero commitments in their ESG disclosures. However, explanation on what these commitments mean for the business, as well as how they will be met in practice, often falls short of investor needs. This report explores investor preferences to reporting in a number of areas, including how companies explain what is in and outside the scope of a commitment, how the commitment may impact the company's strategy and business model, and how companies measure performance. It highlights questions for preparers to consider and provides some good practice examples.
- European Single Electronic Format (ESEF) The Lab has recently completed a review of the implementation of ESEF in the UK.[2] The Lab's review shows that while there have been some positive steps on design, there remain significant issues with process and data quality. The report outlines areas of focus for companies. The Lab also highlights some areas to consider regarding the tagging of notes (mandatory this year). The FRC and the FCA have jointly written to companies and have stressed the need for companies and boards to give due care and attention to the structured digital report.

1.5 Corporate Governance and Stewardship team (CG&S)

Joint reviews of corporate governance

In April 2020, we launched a pilot as part of our response to the Government's consultation into restoring trust in audit and corporate governance. For a selection of companies, in parallel with the CRR review of corporate reporting, our colleagues in CG&S reviewed the corporate governance disclosures against the requirements of the Code. We drew companies' attention to non-compliance that had not been declared or where the explanation was insufficient. We also highlighted where it was not clear whether companies had applied the Code's Principles. We were pleased to note from follow-up reviews that a high proportion of companies responded satisfactorily to the matters raised.

[2] DTR 4.1.14.R

We are extending the pilot to a third year and are analysing a larger sample of companies. We will write to companies that fail to provide specific details relevant to the company, including information about actual actions and outcomes during the year.

The CG&S team conducted the following projects during the year:

- Risk management and internal controls The Government has now published its response to its consultation 'Restoring trust in audit and corporate governance', which sets out the next steps to reform the UK's audit and corporate governance framework. One of the more significant changes likely to result from this paper would be a requirement for companies to publish a statement on the effectiveness of their risk management and internal control systems. Last year, as part of the joint work between CRR and CG&S, we wrote to some companies noting the lack of explanation against Provision 29, which requires companies to report on how they have reviewed the effectiveness of their risk management and internal control systems. This year, the CG&S team will again evaluate companies' reporting on the Code's risk management and internal controls requirements. This will help us formulate potential policy options to be included in the future consultation on the update to the Code.

- Wates Principles The FRC contracted the University of Essex to conduct an in-depth assessment of the quality of reporting by large private and unlisted public companies that had chosen to adopt the Wates Principles to guide their corporate governance arrangements. The review found that some companies provided good levels of disclosure in terms of their general policies. However, overall, reporting by companies lacked specific details as to how the Wates Principles had been applied in practice. There is a broad scope for improvement, and while the FRC is mindful that this was the first year of reporting under the Wates Principles, we expect more detailed and specific reporting on how companies have applied these Principles.

- Significant votes against project The FRC is currently undertaking an in-depth assessment of how companies have complied with the requirements of Provision 4 of the Code, considering the level of engagement with shareholders and the quality of reporting following a significant vote against a board-recommended resolution. In addition to the reporting found in annual reports, the review will cover announcements of voting results following general/annual meetings and update statements, as required by the Code. The aim of this research project is to determine the level of compliance with the provision, the extent of engagement with shareholders and the quality of reporting on such engagement. It will also support the broader aims of the work of the CG&S team in encouraging good governance and best practice reporting.

- Annual Review of Corporate Governance Reporting In November 2021, we issued our second review of corporate governance reporting. We assessed the application of the Code's Principles and compliance with the Provisions based on a random sample of 100 FTSE 350 and Small Cap companies. Our second review highlighted areas where reporting could be improved, including diversity and succession planning, increased transparency of disclosures citing non-compliance with the Code and the alignment of remuneration policies with a company's purpose and values.

We plan to issue our 2022 review of corporate governance reporting in autumn 2022, addressing the importance of reporting on outcomes, rather than processes, and emphasising the importance of a clear, detailed and meaningful explanation for a departure from the Code. Our reviews will continue to promote the highest standards of practice and reporting. We advise companies to move away from boilerplate statements of intent and demonstrate clearly the impact of their actions.

2. Year-end developments

2.1 Financial reporting

Please see pages 50 to 55 of the Annual Review for the developments in corporate reporting.

2.2 Climate-related disclosures

For accounting periods beginning on or after 1 January 2022, companies with a standard listing on the Main Market of the London Stock Exchange must include a statement in their annual financial report explaining the extent of their compliance with the TCFD's recommendations and recommended disclosures on a comply-or-explain basis.

For all listed companies, TCFD disclosures given for accounting periods beginning on or after 1 January 2022 will need to be consistent with the revised TCFD guidance published in 2021.

For periods beginning on or after 6 April 2022, mandatory climate-related financial disclosures apply under the Companies Act 2006 to qualifying companies and LLPs. Please see page 54 of the Annual Review.

3. Keep in touch

Contact us

We would welcome feedback on the scope and format of this new publication.

Contact us at enquiries@frc.org.uk

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