

Lab reminders for the 2014 reporting season

The Financial Reporting Lab (the Lab) published two reports in 2014, on accounting policies and on clear and concise reporting. They add to reports covering investor and company views on various governance and financial reporting areas.

With the reporting cycle approaching, companies may wish to consider their reporting in light of the key areas highlighted in each of the Lab's reports to date. Copies of all reports can be found at <https://frc.org.uk/Lab/published-project-reports>.

Accounting policies and integration of related financial information

In July, the Lab published a report on company and investor views on the content and placement of accounting policies; ordering, grouping and combining of notes to the financial statements; and integration of the financial review with the primary financial statements.

Investors have some clear messages for companies in relation to improving the prominence of significant accounting policies, and enhancing the quality of disclosures.

Investors indicate the following attributes which, alone or together, may indicate significant policies:

- materiality of the transactions, classes and amounts;
- importance to the nature of the business;
- distinct revenue streams (revenue policies are always seen to be significant);
- choice of policy in IFRS, or significant judgement in selecting a policy; and
- significant levels of estimation or judgement in applying the policy.

On the content of significant policy disclosure, investors suggest that companies do the following to improve quality:

- write using plain, understandable language;
- describe any judgements made in selecting the policy applied and the rationale for them;
- describe the company's application of policies (not only a summary of IFRS), including the estimation/judgements made and their significance to reported amounts; and
- describe new IFRS requirements only if they significantly, or are likely to significantly impact the financial statements, and present the changes in tabular format.

Retail and institutional investor views differ on the presentation of any additional, non-significant policies. However, moving these policies to an appendix within the annual report may be a helpful compromise. Further best practice examples are available in the Lab's full report.

Although the combining of tax expense and balance sheet notes is considered logical by investors, the case for other changes in ordering of notes has not been made. Additionally, investors prefer the traditional approach of placing management commentary and the financial statement information in separate sections of the annual report.

Towards Clear & Concise Reporting

In June, the FRC announced a programme of work to support [Clear & Concise](#) reporting by companies. As part of this programme, in August the Lab published a report that examines what companies have done to aid clarity and conciseness, based on observations that the Lab made on how companies dealt with the significant changes in corporate reporting requirements introduced in 2013.

Companies made improvements by:

- thinking about the communication channels and matching users' needs with the level of detail presented;
- focusing disclosure on content that was most important to investors;
- considering materiality criteria and removing immaterial disclosures; and
- using layout to improve clarity, and cross-references to reduce duplication.

The report includes practical steps companies can consider in relation to the process of improvement. Key steps in a process of continual improvement include:

- planning the change: building momentum, getting leadership from the top of the organisation and deciding on the scope of change;
- managing the process: identifying who will make the changes, setting targets and getting board agreement;
- doing what is needed: starting with a blank piece of paper, ensuring that changes in business and regulation are reflected and making sure that the auditors have bought into the changes; and
- evaluating the process: debriefing early, asking for feedback from investors, and reflecting how to make improvements continuous.

The Lab's full report provides further examples from companies and gives additional guidance on characteristics of good reporting from the Financial Reporting Review Panel.

Companies may also wish to consider the recent [Annual Report](#) of the FRC's Corporate Reporting Review (CRR) activities. The report summarises the FRC's findings for the year and emphasises areas of reporting focus for Boards in the next reporting season.

Audit Committee reporting

Last year the Lab published a report on Audit Committee reporting. Investors believe that high-quality reporting from Audit Committees, which meets their needs, helps to promote long-term commitment. When drafting their reports, Audit Committee Chairs should ensure that they are:

- demonstrating ownership and accountability by personalising the reporting;
- being specific to the company and to the current year;
- saying what was actually done. Reports should depict the specific activities during the year and their purpose, using active, descriptive language;
- disclosing judgement calls made for the year, and the sources of assurance and other evidence drawn upon to satisfy the committee of the appropriateness of the conclusion;
- considering the audience when describing issues, their context, policies, processes, conclusions and their consequences for the company and its reporting; and
- considering where in the annual report information should be best placed, avoiding repetition.

Presentation of market risk disclosures

This Lab report considers changes implemented by HSBC in risk disclosures. Investors want disclosures that are tailored to be concise and relevant to current results and exposures, and they focus on material assumptions and changes to policy when analysing key metrics. They felt that splitting policy and standing information can aid focus, but is not essential.

Providing basic information on debt and cash flows

A company's debt and cash flows remain key areas that investors want to understand. The Lab published three reports designed to explore what information investors wanted in this area. The following is a selection of approaches identified in the reports which could be adopted by companies to better provide investors with the information they need. In our experience, careful attention to these points may be needed to avoid missing these basics.

Debt terms and maturity tables

Companies should consider if the following questions are being addressed clearly in their reports:

How much debt is owed? - Listing debt terms by obligation allows investors to consider underlying currency risk and understand how closely the carrying amount on the balance sheet approximates the amount to be repaid. Disclosure should show for each significant borrowing the: principal borrowed, currency of denomination, and carrying amount on the balance sheet. A contractual maturity table that shows a total for principal payments and reconciles this to the carrying

amount in the balance sheet, helps investors assess how close the carrying amount is to the repayment amount.

When is it due? - Listing maturity month and year for each significant obligation, or providing contractual maturity tables that split out maturity amounts for at least each of the first five years, both help answer this question.

Net debt reconciliations

Companies could provide a net debt reconciliation and / or a reconciliation of net cash flows to changes in net debt, to explain cash and non cash movements in net debt. Providing clarity in this area is particularly important when there is any complexity to changes in the period, such as acquisitions, disposals, fair value hedges, or foreign currency fluctuations.

Operating and investing cash flows

Investors want to better understand the link between cash generated, related profit and loss, and amounts on the balance sheet. Specifically, they prefer:

- the reconciliation of profit or loss to operating cash flows to be at the top of the statement of cash flows (not in the notes);
- the statement of cash flows to start with operating income or loss. If starting from another figure, it could be reconciled first to a subtotal for operating income or loss; and
- the reconciliation to show the separate changes in the individual components of working capital, and other differences between operating income or loss and operating cash flows that are specific to the business. Companies should use descriptions that link easily to relevant items on the balance sheet and explain the nature of the differences that convert profits to cash.

The Lab is undertaking an implementation study of cash and debt reporting that will look at some of the challenges companies may face in reporting in this area. We are interested in hearing from companies about their use of the Lab's reports; email us at financialreportinglab@frc.org.uk

Keeping up with the Lab's activities

Next year the Lab will be publishing reports on 'Corporate Reporting in a Digital World' and on 'Disclosure of Dividend Policy and Capacity', as well as a number of case studies supporting companies' efforts on Clear & Concise Reporting.

If you would like to keep up to date with the Lab's activities:

- subscribe to updates <http://frc.org.uk/Subscribe> ; or
- follow us on LinkedIn uk.linkedin.com/in/financialreportinglab

