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Looking ahead: What you need to know Spring 2018

The 100 Group briefing

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Dear members of The 100 Group,

Welcome to the second edition of The 100 Group briefing for 2018. It's been a relatively quiet start to the year, but there are still a few developments in reporting, assurance, corporate governance and investor engagement you may wish to review.

With the UK's departure from the EU approaching, there still seems to be quite a lot of uncertainty about how events will play out. One such area is a fundamental aspect of reporting: what form IFRS should take going forward. Listed groups have been required by EU Regulation to prepare their consolidated financial statements in accordance with EU-adopted IFRS since 2005, but following Brexit this could of course change. We've laid out in this briefing a few possible scenarios, and would encourage Group members to lobby for the one they think is best when the FRC consults later this year.

One other topic that Group members may wish to review if they're not already familiar is the first report from the FRC's Audit & Assurance Lab. It looks at audit committee reporting and feedback from a number of Audit Committee Chairs who have used the Lab report has been positive - it can be a useful tool to help with drafting the chair's personal introduction to the audit committee report in particular.

We've set out in the Executive summary the other topics included in this edition. I hope you find the briefing useful – please do let me know what you'd like to see more of and how we can improve the publication.

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Looking ahead

The 100 Group briefing, *Looking ahead*, is a quarterly briefing commissioned by the 100 Group of Finance Directors. Its aim is to brief the Group on key developments in the capital markets and proposed changes in regulation and standards that might require response, lobbying, or which are important for general awareness.

For further information, please contact Gilly Lord.

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Key: M – Monitor R – Respond/React L – Lobby

Reporting

The use of IFRS after Brexit

With the UK's departure from the EU approaching, PwC's Peter Hogarth looks at what form IFRS should take going forward.

Listed groups have been required by EU Regulation to prepare their consolidated financial statements in accordance with EU-adopted IFRS since 2005. It seems likely that, at the point of the UK's exit from the EU next year, the EU (Withdrawal) Bill will transpose this requirement, and the extant body of endorsed standards, into UK law. But what happens after that? Setting aside any arrangements that may be negotiated for the period of transition, decisions need to be made about the reporting regime for UK listed companies from 2019 and beyond. If there are existing standards not yet endorsed in March 2019 (and IFRS 17 on insurance contracts seems a likely candidate), or the IASB issues new standards, what happens to them?

The first, and most obvious, question is whether UK listed groups will continue to prepare their consolidated financial statements in accordance with IFRS. The answer seems equally obvious. Almost all of the world's major capital markets permit or require reporting under IFRS. Fifteen members of the G20 have adopted IFRS for use by all or most companies listed on their principal capital markets. Of the remainder, three (China, India and Indonesia) have adopted national standards that are substantially consistent with IFRS, one (Japan) permits the use of IFRS and one (the USA) permits foreign registrants to use IFRS. All members of the G20 have made a public commitment to a single set of high quality global accounting standards. Given the UK's position as a major financial centre, it seems inconceivable that the UK might revert to some form of UK standards, notwithstanding the criticism of IFRS that we sometimes read about in the press. This is especially the case as the only current body of UK standards (FRS 102) is written with simpler, unlisted businesses in mind.

But to say that UK listed groups should continue to use IFRS is not the whole answer. We need to look at the next question: what form should IFRS take going forward?

Currently, the standards used within the EU are subject to formal adoption ('endorsement') following a process involving expert groups and the European Parliament. The UK could go down a much easier road, which would be to accept standards as soon as they are issued by the IASB. But surprisingly few countries do this (although companies filing accounts in the US do need to apply IFRS as issued by the IASB). It is more common for standards to be subject to some sort of national endorsement mechanism (e.g. Canada, Australia and, of course, the EU).

The EU's endorsement process is tried and tested so could form the basis for a similar exercise in the UK. But the process takes a considerable amount of time, so maybe there is an opportunity for the UK to develop its own means for adopting standards. The FRC seems to be readying itself for such an approach as it refers in its draft three

year strategy to "preparing the framework for any UK endorsement process"[1]. While the EU ultimately puts responsibility for endorsement in the hands of Parliament, the UK Government could delegate responsibility to the FRC or another body. After all, UK standards were set by the FRC and its predecessor bodies without Government intervention for many years prior to 2005.

Having some form of endorsement process does lend legitimacy to the standards that result. But one of the most significant benefits of reporting under IFRS by companies throughout the world is consistency. So there would clearly be a need for robust criteria against which an endorsement decision could be based. Currently, in the EU, the criteria are:

- Consistent with a true and fair view.
- Meet basic quality criteria (for example, understandable, relevant, reliable and comparable).
- Conducive to the European public good.

The UK could adopt similar criteria (substituting UK public good) or could develop a new suite. Either way, given the extensive due process followed by the IASB and the desirability of UK listed companies continuing to report in a way that is consistent with other countries, the hurdle for any decision not to adopt a standard would surely need to be high.

There are many decisions that need to be made over the coming months. The FRC stated recently that we should expect a consultation later this year. Members should engage, either with the FRC or with Government, when the time arises.

European Regulator issues guidance on accounting for US tax law changes

In January 2018, the European Securities and Markets Authority ("ESMA") released a public statement to assist European public companies in applying a consistent approach to accounting for changes to tax balances arising from the US Tax Cuts and Jobs Act ("the Act"), which was passed in December 2017. PwC's Dave Walters has more.

This was in response to concerns raised by companies highlighting the short time frame available to assess the accounting consequences of the Act, and the emergence of guidance in the US from the SEC (primarily for US GAAP reporters) under Staff Accounting Bulletin 118, which gave US issuers some relief from adopting the consequences of the Act in their December year-end financial statements.

The ESMA statement highlights that there is no relief under IFRS from the requirements to measure tax balances using tax laws enacted at the end of the reporting period, even to deal with the circumstances where complex legislation is enacted shortly before the year end.

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[1] https://frc.org.uk/getattachment/142a578c-be85-4298-af21-244ebc292724/FRC-Strategy-2018-21-Draft-Budget-and-Levy-Proposals-2018-19-(December-2017).pdf

However, particularly in respect of companies with a calendar year end, ESMA highlighted that due to the short time frame within which companies have to prepare their estimates, taking account of the complex changes in tax law, it expects that those estimates will be subject to a higher than usual degree of uncertainty than is usually the case. Furthermore, it noted that measurement adjustments may be needed in subsequent periods as issuers get more accurate information. Nevertheless, ESMA expects that issuers will be able to make a reasonable estimate of the material impacts of the Act.

Given the potential impact of the changes and the degree of estimation uncertainty, ESMA highlighted the importance of good disclosure. The themes here are similar to those highlighted by the FRC in their thematic reviews of tax disclosure (October 2016) and judgements and estimates (November 2017).

Furthermore, taking account of the fact that information on the application of the Act may become available only prospectively, there is an expectation that adjustments to estimates arising from this would be reflected as a change in estimate in future periods. This is the case where an issuer takes account of all information it could reasonably have been expected to obtain for its prior period estimates. This doesn't remove the need to consider whether a future adjustment might represent the correction of an error.

Group members should think carefully about whether this may affect them and their disclosure – ESMA will be monitoring the level of transparency issuers provide.

FRC issues guidance for construction & business support services companies

Following the collapse of Carillion, the Financial Reporting Council (FRC) has issued guidance reminding Boards of companies in the construction and business support service sectors of their reporting obligations. PwC's Peter Hogarth looks at what it includes.

The FRC has reminded companies of a few fundamental aspects of reporting. These include that the annual report and accounts must provide sufficient, clear and relevant information, segmented between business lines where necessary.

Users must be able to:

- understand the company's performance, financial position and prospects;
- assess its going concern status; and
- assess its longer term viability.

The accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss. The analysis presented in the strategic report must be fair, balanced and comprehensive. Boards of companies applying the UK Corporate Governance Code must ensure the annual report and accounts are fair, balanced and understandable.

In November 2017, the FRC announced its priority sectors for 2018/19, which included construction and business support services. As a result, it's regular audit quality review, corporate reporting review and thematic activities for the period will encompass companies in this sector.

The FRC also included more detailed guidance on the following areas:

- Going concern basis of accounting.
- The Strategic report and risk & viability reporting.
- Judgements and estimates applied in preparing the financial statements.
- Cash flow and net debt indicators.
- Complex employee pension arrangements.
- The role of the audit committee.

Though targeted primarily at those in the construction and business support services sectors, this guidance will also be relevant to other companies. We'd advise Group members to review their own reporting – given the high-profile nature of the Carillion collapse, it's likely the FRC will be paying particular attention to the areas mentioned.

Corporate governance

Audit committee reporting

The FRC has published the first report from its Audit & Assurance Lab, "Audit committee reporting". PwC's John Patterson looks at what's included.

This is the first part of a planned two-stage project and relates to the audit committee section of the annual report: the second part will focus on auditor reporting to audit committees. Like the Reporting Lab, the Audit & Assurance Lab brings together investors, corporates, audit committees and auditors to discuss how audit-related issues, including how they are reported on, can be moved forward.

Key findings

- The report emphasises the importance of the audit committee's role in the view of many investors.
- Investors value the role played by the audit committee and place reliance on its work.
- Both Audit Committee Chairs and investors recognise that there is scope for further engagement (this is also encouraged in the proposed new UK Corporate Governance Code).
- The audit committee report can be seen as an indicator of the quality of the committee's work, so has the potential to build trust and confidence among users.
- Audit Committee Chairs and investors overwhelmingly agree that audit quality should be a key factor in the audit tendering selection process.
- Investors would like to see more explanation around an audit committee's non-audit services assessment.

The report also includes a number of questions for audit committees to ask and good practice examples in areas including auditor appointment and tendering, independence and effectiveness, significant issues and risk management and internal control.

Feedback from a number of Audit Committee Chairs who have used the Lab report has been positive - it can be a useful tool to help with drafting the Chair's personal introduction to the audit committee report in particular.

Group members may wish to see if their audit committee members may want to get involved in phase 2 of the project when it starts to express their views on what is useful in audit committee documents provided by auditors to audit committees.

Investor engagement

Investor Association publishes register of shareholder dissent

The Investment Association has published its register of resolutions with 20% votes or more votes against. PwC's Marie Claire Tabone explains.

In December 2017, the Investment Association (IA) published its first Public Register ('the register') of listed companies on the FTSE-All Share which received shareholder opposition of 20% or more on any resolution, considered to be significant opposition, during AGMs and other general meetings held in 2017. The register, which can be found here, continues to be updated on an ongoing basis, and also includes withdrawn resolutions.

Till the last update on 13 February, the register included 148 companies with 238 resolutions with 20% or more shareholder dissent, and 29 resolutions which were withdrawn. The most common type of resolution included in the register was that relating to reappointment of directors, with 84 resolutions facing significant opposition. 14 companies had both their remuneration report and policy voted against by 20% or more, while shareholders found issue with the remuneration report of an additional 30 companies, and the remuneration policy of another 11 companies. There were 7 resolutions which related to the reappointment of auditors and another 2 to the approval of the auditor's remuneration. The register did not include any resolutions relating to a company's accounts, the strategic report and the reports of the directors and auditor.

There are currently 21 FTSE 100 companies included in the register, with 28 resolutions in total, of which 3 were withdrawn. The number of resolutions by type were as follows:

Type of resolution	Number of instances in register
Re-election of director	11
Approval of directors' remuneration report	8
Approval of directors' remuneration policy	3
Authority to disapply pre-emption rights	2
Authority to allot shares	2
Re-appointment of auditor	1
Removal of director	1

This register has been developed in response to the Government's Green Paper on Corporate Governance Reform. Companies included in the register will have received a letter from the IA to notify them of their inclusion on the register, and also to provide them with the opportunity to provide a response (whether interim or final) to the vote against, which can be included on the register. This response would be a public statement in addition to any comments made at the time of the AGM/GM results announcement in connection with provision E.2.2 of the Corporate Governance Code (which are also included in the register). The IA suggests the response provides an overview of the views heard from shareholders on the reasons

for the voting result, and the outcome of the actions taken or to be taken by the Board subsequently to the vote in question.

It is worth noting the proposed revisions by the Financial Reporting Council (FRC) to the Corporate Governance Code also include reference to when more than 20% of votes have been cast against a resolution, and the actions that the company should take, including publishing an update within six months of the vote, and possibly in the subsequent annual report. The FRC's aim is to ensure that a company fully understands the reasons for shareholders voting against a resolution and that it can enter into dialogue with shareholders to discuss these matters further. The FRC noted that it will be adding a footnote to the revised Corporate Governance Code to highlight that the IA register will be available for reviewing these updates.

Group members should remain mindful that if they receive 20% or more votes against a resolution at any of their general meetings, they will need to consider engagement with shareholders and what public statements they need to make. However, we recommend that companies and their shareholders engage in dialogue before significant dissent against a general meeting resolution arises, and that even if there is less than 20% opposition, the situation may still necessitate engagement.

Assurance

Possible reform of the global audit, assurance and ethics standard setting model

The Monitoring Group of global regulators and financial institutions who oversee the development of international audit, assurance and ethics standards recently consulted on proposed reform of the global standard-setting model. One option would be an independent Foundation similar to the IFRS Foundation model.

A debate is underway on possible significant reforms of the standard setting model for global audit, assurance and ethics standards, led by IOSCO, IFIAR and other key global audit and financial institution regulators comprising the Monitoring Group (MG). A consultation was released in November 2017 that set out various options to enhance the governance, accountability and oversight of the international audit standard-setting process.

At the time of the release of the consultation in November 2017, Gerben Everts, Chair of the Monitoring Group said: '*We envisage key reforms to enhance the public interest responsiveness of audit standards in order to promote the quality of audits. Removing the audit related standard setting activities from the profession and entering into a multi-stakeholder, geographically representative and independent governance structure would address concerns vis-á-vis the independence of standard setting*.'

The current model, which operates under the auspices of IFAC, is a public-private collaboration, and has significantly contributed to promoting audit quality globally since it was established in 2003. Confidence in the model led to the adoption of the International Standards on Auditing in more than 120 jurisdictions around the world – including the UK. However, there has been some criticism that the profession has the ability to have undue influence in the process, and concerns from others about how the governance operates.

The debate has attracted a lot of attention. During the consultation period, four roundtables were held – London, Washington, Singapore and Johannesburg. Over 275 people participated from national accountancy bodies, audit firms (both small and medium-sized firms and the global networks), investors, financial institutions, regulators, and academia. Over 180 responses were submitted to the MG.

In a recent press release, the Monitoring Group said it considered the number and diversity of responses as representative of the importance to stakeholders of sound governance over audit-related standard setting boards.

The UK FRC expressed its strong support for the objectives of the reform proposals issued by the Monitoring Group, and urged that momentum be maintained. The FRC considers that reform should be extended throughout the standard setting framework, and that the Monitoring Group should articulate its reform proposals for both the Public Interest Oversight Board and the Monitoring Group itself as well as

for the standard setting board. This should include an implementation timetable, which should be provided when it sets out its final reform proposals later in the year.

Similarly, the larger accountancy networks expressed support for reform, but raised concerns about a number of the proposals in the MG's consultation, including similar points to those raised by the FRC. The networks support a multi-stakeholder standard-setting board and governance model, similar to the IFRS Trustees – a view shared by many in the roundtables and in the responses to the consultation.

However, the proposals are controversial. IFAC and many of the national accountancy bodies believe the case for such significant reform has not been made and worry that some of the strengths of the current model could be lost. They urge caution.

The MG's stated aim is to establish a more independent, sustainable and effective governance structure, widen the experience and professional background of the boards, reduce the undue influence of the profession over audit standards and strengthen the process by which the public interest is considered throughout the standard setting process. The consultation was a first step. The Monitoring Group will carefully review the responses and work towards the publication of a feedback statement over the course of next month. The Monitoring Group expects to engage in a second consultation in the fall of 2018.

The corporate sector has not contributed significantly to the debate. Few preparers participated in the roundtables and only a few of the responses are from corporates. However, the sector has an important voice with a relevant point of view. There will be a second consultation on a White Paper later in the year and it is worth following the debate so that the 100 Group can consider contributing.

Feedback Statement and Impact assessment: Auditors and Preliminary Announcements

The FRC has published the results of a consultation on the role of the auditor in preliminary announcements. PwC's Diana Hillier looks at what's included.

Current FRC guidance for auditors who are engaged to agree to the publication of preliminary results under UK Listing Authority rules is contained in Bulletin 2008/2. Bulletins have the status of 'guidance' rather than standards, and are therefore 'persuasive rather than prescriptive' and are 'indicative of good practice'. Bulletins do not deal with the application of auditing standards to specific sectors or types of transaction, but are designed to provide 'timely guidance on new or emerging issues'.

Bulletin 2008/2 was last revised in 2008. Following some initial stakeholder outreach the FRC issued a discussion paper in April 2017 which considered various options for bringing the material up to date. These included converting the guidance to an engagement standard, consulting with the UK Listings Authority to require auditors to follow FRC guidance and mandating that statutory financial statement audits should be complete before auditors agree to the release of preliminary announcements. A number of other more detailed options were also presented, including proposals to revise the guidance on materiality, the review of 'other information' and of alternative performance measures.

Responses to the consultation

The FRC received 14 written responses: 7 from audit firms, 2 from professional bodies, 3 from groups representing issuers of preliminary announcements and 2 from investors.

The majority of those who responded stated that they believe the current regime for preliminaries is fit for purpose and does not require significant change. Many also commented that the role of auditors should be considered in the context of the primary role of company Directors in producing accurate and reliable financial information. This is consistent with the feedback the FRC has received in its separate investor outreach exercise. There was also general acknowledgment that Bulletin 2008/2 should be revised, even if only to update references and reflect changes in financial reporting and listing rules.

As a result, the FRC is only proposing minor changes to current auditor guidance, and will consult with the FCA/Listing Authority on specific matters where these are within their scope as the regulator:

- It is not proposing to convert the current guidance into an engagement standard;
- It does not propose to require auditors to have completed the statutory financial statement audit and sign the auditor's report before agreeing to the publication of preliminary announcements – although it will continue to highlight the fact that this is best practice and consistent with most current market practice;
- It will include a draft report in the revised bulletin setting out the status of the financial statement audit, and the procedures performed by the auditor on the preliminary announcement to be prepared and published on a voluntary basis
- It will coordinate with colleagues in the Corporate Reporting Team as they conclude their work on the format and structure of preliminary announcements in combination with the UK Listing Authority.

The input received in the consultation is a good basis for a conversation between companies, audit committees and auditors about the auditor's involvement with preliminary announcements, in light of the identified best practices.

IAASB sets up a Project Advisory Panel to support project on assurance on emerging forms of external reporting

The International Auditing and Assurance Standards Board recently established a Project Advisory Panel ("PAP") to support its recently approved project to develop guidance on key challenges in assurance engagements over Emerging Forms of External Reporting ("EER"). PwC's Diana Hillier has more.

The IAASB established an Integrated Reporting Working Group (IRWG) in 2014, to monitor developing interest in EER and related demand for assurance over EER. In August 2016, the IRWG made available a discussion paper, *Supporting Credibility and Trust in Emerging Forms of External Reporting: Ten Key Challenges for Assurance Engagements*, to which 39 stakeholders responded. In response to the input received on the discussion paper, the IAASB commenced a project in October 2017 to develop non-authoritative guidance to go a step further to address the key

challenges arising in applying ISAE 3000 (Revised) in the performance of assurance engagements over EER.

Many respondents felt that ISAE 3000 (Revised) remained fit for purpose, but sought guidance on its application. The key objective of the project is to enable more consistent and appropriate application of ISAE 3000 (Revised) to EER and greater trust in the resulting assurance reports by users of EER.

Project Advisory Panel

In order to develop relevant guidance, the IAASB decided to create a PAP so that it could engage directly with subject matter experts and other interested parties.

The PAP for EER is expected to consist of between 15 to 20 individuals with diverse experiences of EER and related assurance engagements from relevant stakeholder perspectives and various geographic locations, including:

- National Standard Setters with experience of developing guidance or standards for assurance engagements relating to EER.
- Practitioners, whether who have experience of undertaking assurance engagements relating to EER under ISAE 3000 (Revised), other ISAEs or other similar standards.
- Preparers of EER reports with experience of addressing challenges in preparing EER reports using commonly applied international reporting frameworks, including internal auditors.
- Users and potential users of EER reports and of related external assurance and other reports intended to enhance confidence and trust.

The IAASB hopes that the PAP will provide insights into current practice across different jurisdictions and contexts to inform the IAASB's work on assurance engagements related to EER.

With stakeholder interest increasing in non-financial performance information and other forms of emerging external reporting, this project will be of interest to companies looking to build trust in their broader corporate reporting.

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