**Financial Reporting Council**

**Bulletin on Review of Annual Reports**

**for the six months ended 30 June 2015**

**I Overview**

FRC has the responsibility to ensure that the annual reports of Public Interest Entities (PIEs) comply with IFRS and the requirements of the Code of Corporate Governance (Code), with the objective of promoting quality of financial and non-financial reporting.

This would assist in improving good governance among PIEs by ensuring that annual reports present a comprehensive and objective assessment of the activities of the company, to allow the stakeholders to understand how the entity is managed.

For the six months ended 30 June 2015, FRC had reviewed the annual reports of 102 PIEs consisting of 72 full reviews and 30 follow-up reviews. Annual reports of PIEs from various sectors of the economy were reviewed.

The annual reports reviewed had year ends, December 2013 (3), March 2014 (6), June 2014 (58), July 2014 (1), September 2014 (7), October 2014 (1), December 2014 (25) and March 2015 (1).

**II The bulletin is in four parts:**

Part A – Full reviews

Part B – Follow up reviews

Part C – Grading

Part D – Conclusion

The table below indicates the categories of PIEs and their corresponding sectors for full annual report reviews:

|  |  |
| --- | --- |
| **Types of reviews** | **Sectors** |
| **BIF** | **Commerce** | **Industry** | **Information technology** | **Investment** | **Leisure & Hotels** | **Others** | **Sugar** | **Total** |
| Listed on SEM | 2 | 3 | 5 | - | 7 | 3 | - | 2 | 22 |
| Financial institutions regulated by BOM (excluding cash dealers) | 10 | - | - | - | - | - | - | - | 10 |
| Financial institutions regulated by FSC | 17 | - | - | - | - | - | - | - | 17 |
| Category 4 PIEs as per the FRA | 1 | 6 | 4 | 1 | 3 | 4 | 2 | 2 | 23 |
| **Total** | **30** | **9** | **9** | **1** | **10** | **7** | **2** | **4** | **72** |

*Note:*

‘*Category 4 PIEs’ comprise any company or group of companies having, during 2 consecutive preceding years, at least 2 of the following –*

* *an annual revenue exceeding 200 million rupees;*
* *total assets value exceeding 500 million rupees;*
* *a number of employees exceeding 50.*

This bulletin sets out the main findings as per the following sections:

[**PART A - Full reviews**](#_Hlk395610325)

1. [IFRS Findings](#IFRS1)

2. [Corporate Governance Findings](#_Hlk395611879)

3. [Liquidity](#_Hlk395611358) risk

4. [Audit and non-audit fees](#AFees)

5. [Non-financial information](#_Hlk395611487)

6. [Market Capitalisation](#_Hlk395611558)

7. [Categories of Auditors](#_Hlk395611800)

**[PART B - Follow up reviews of annual reports](#_Hlk395610500" \s "1,36264,36309,0,,PART B - Follow up reviews of an)**

 **[PART C - Grading of Annual Report Reviews](#_Hlk395610623" \s "1,41350,41393,0,,PART C - Grading of Annual Repor)**

**[PART D - Conclusion](#_Hlk395610793" \s "1,43050,43070,0,,PART D - Conclusion)**

**PART A - Full reviews**

**I.** **IFRS Findings**

Compliance with IFRS is a means of ensuring transparency and completeness of financial information. FRC has identified weaknesses in compliance with the following IFRSs:

**1.1 IAS 1, Presentation of Financial Statements**

IAS 1 prescribes the basis for presentation of general purpose financial statements to ensure comparability both with a company’s previous financial reporting and with the financial statements of other entities.

The main non-disclosures identified in respect of IAS 1 were as follows:

1. **Description of reserves**

Entities are required to provide a description of the nature and purpose of each reserve within equity (IAS 1 paragraph 79(b)).

**4 PIEs** [1 listed PIE in Commerce sector, 1 entity regulated by BOM and 2 PIEs in Category 4] **had not provided a description of the nature and purpose of each reserve within equity.**

1. **Nature of items of financial statements**

The standard specifies that additional information on the nature of expenses and other information that is of relevance to an understanding of the financial statements should be disclosed (IAS 1 paragraphs 104 and 112). *Such information assists in understanding the financial performance achieved and is useful in predicting future cash flows.*

**11 PIEs** [3 entities (2 BIF and 1 Insurance) regulated by FSC and 8 PIEs in Category 4] **had not provided separate disclosures on the following, although the amounts were material:**

* **Operating and administrative expenses**
* **Cost of sales**
* **Other receivables and prepayments**
* **Operating and other income**
1. **Accounting policies**

IAS 1 requires companies to provide a summary of their significant accounting policies that are *relevant to an understanding of the financial statements. Appropriate accounting policies supported by reasonable and prudent judgments must be used consistently by the PIEs.*

**8 PIEs** [4 listed (1 BIF, 1 Industry, and 2 Investments), 2 entities regulated by FSC and 2PIEs in Category 4] **had not adequately disclosed their accounting policies in respect of the following items:**

* **Leases**
* **Intangible assets**
* **Investment property**
1. **Capital risk management**

IAS 1 requires an entity to disclose information that enables users of its financial statements to evaluate the entity’s objectives, policies and processes for managing capital (IAS 1 paragraphs 134 & 135).

**3 PIEs**in Category 4*,* **had not disclosed quantitative data about what the Company manages as capital.**

**1.2 IAS 16, Property, Plant and Equipment**

IAS 16 prescribes the treatment and disclosures applying to the accounting for an entity’s tangible fixed assets. Property, plant and equipment may be carried at cost or at revalued amount.

**5 PIEs** [1 listed in Sugar sector, 1 entity regulated by BOM and 3 PIEs in Category 4] **had not complied with IAS 16 in respect of the following:**

* Subsequent measurement for property, plant and equipment (IAS 16 paragraph 73).
* Accounting policy on recognition of increase/decrease in the asset’s carrying amount as a result of revaluation (IAS 16 paragraphs 39 & 40).
* Effective date of revaluation and whether an independent valuer was involved (IAS 16 paragraph 77).
* The carrying amount that would have been recognised had the assets been carried under the cost model (IAS 16 paragraph 77).
* Assets recognised under the revaluation model had not been revalued with sufficient regularity (IAS 16 paragraph 34).
* Reconciliation of the carrying amount at the beginning and end of the period (IAS 16 paragraph 73).

*Application of this standard would improve the transparency of fair value measurements and ensure that the carrying amounts of property plant and equipment do not differ materially from their fair values and may give rise to better financial reporting quality and governance among PIEs. It also provides useful information to users which allow them to compare the carrying amount and the revalued amount of property, plant and equipment.*

**1.3 IAS 17, Leases**

IAS 17 prescribes, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to leases.

**The annual report reviews carried out indicate that 15 PIEs**[5 listed (1 BIF, 2 Investment, 1 Leisure and Hotels and 1 Sugar), 3 regulated by BOM (including 1 public), 1 public entity regulated by FSC and 6 PIEs in category 4]**had not complied with the following disclosure requirements of IAS 17 Leases**:

* The total of future [minimum lease payments](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS17c_2005-08-18_en-3.html#SL145300) under [non-cancellable](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS17c_2005-08-18_en-3.html#SL145282) operating leases for each of the following periods:
* not later than one year;
* later than one year and not later than five years
* later than five years (IAS 17 paragraph 31).
* The total of future minimum sublease payments expected to be received under [non-cancellable](http://eifrs.iasb.org/eifrs/stdcontent/eIFRSs_at_30th_June_2008/IAS17c_2005-08-18_en-3.html#SL145282) subleases at the end of the reporting period (IAS 17 paragraph 35).
* Reconciliation between the [gross investment in the lease](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS17c_2005-08-18_en-3.html#SL145330) at the end of the reporting period, and the present value of [minimum lease payments](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS17c_2005-08-18_en-3.html#SL145300) receivable at the end of the reporting period (IAS 17 paragraph 47).
* A general description of the lessor’s material leasing arrangements and the lessee’s significant leasing arrangements (IAS 17 paragraphs 35 & 47).

*Disclosures relating to leases enable users of financial statements to understand the amount of any associated liabilities and also help users to understand whether the finance and operating leases had any special conditions attached to them.*

**1.4 IAS 19, Employee Benefits**

IAS 19 prescribes the accounting to be adopted in respect of employee benefits, requiring:

(i) A liability to be recognised when services have been provided in exchange for future employee benefit; and

(ii) An expense when the company consumes the economic benefit arising from the service.

Employee benefits consist of short term benefits, post employment benefits, other long term employee benefits and termination benefits.

Post employment benefit plans are classified as either defined contribution plans or defined benefit plans. The nature of the defined benefit plans varies significantly from relatively straightforward provisions for severance pay to complex pension plans of groups.

**From the annual reports, FRC noted the following:**

* **52 PIEs** [14 listed (1 BIF, 3 Commerce, 3 Industry, 4 Investment, 2 Leisure and Hotels and 1 Sugar), 8 regulated by BOM (including 3 public), 15 PIEs regulated by FSC (including 4 public) and 15 PIEs in Category 4] **had fully complied with the requirements of IAS 19.**
* **18 PIEs** [6 listed (1 BIF, 2 Industry, 1 Investment, 1 Leisure and hotels and 1 Sugar), 1 regulated by BOM, 3 regulated by FSC (including 2 public) and 8PIEs in Category 4 (including 1 public)]**had partly complied with IAS 19.**
* **1 listed** entity in Investment sector **had not complied at all with the requirements of IAS 19.**

The PIE undertook to make appropriate disclosures in its next financial statements with respect to the defined contribution as per IAS 19.

* **1 listed PIE did not apply IAS 19 as it did not have any employee.**

With regard to the 18 PIEs which had partly complied with IAS 19, the following common non-compliances were notedfor defined benefit plans:

* Amount recognised as an expense for defined contribution plans (IAS 19 paragraph 53).
* Characteristics of the defined benefit plans and their associated risks (IAS 19 paragraph 139).
* Explanation of amounts in the financial statements such as disaggregation of the fair value of the plan assets into classes that distinguish the nature and risks of those assets (IAS 19 paragraph 142).
* Fair value of the entity’s own transferable financial instruments held as plan assets, and the fair value of plan assets that are property occupied by, or other assets used by, the entity (IAS 19 paragraph 143).
* A sensitivity analysis for each significant actuarial assumption (IAS 19 paragraph 145).
* A description of any funding arrangements and funding policy that affect future contributions, the expected contributions to the plan for the next annual reporting period and information about the maturity profile of the defined benefit obligation (IAS 19 paragraph 147).

*Information about post employment benefits is particularly important to users of financial statements because other information published by an entity will not only allow users to estimate the nature and extent of defined benefit obligations and to assess the risks associated with those obligations, it will also assist users of financial statements in understanding the financial effect of the plan during the period and the future liability of the entity.*

**1.5 IAS 24, Related Party Disclosures**

IAS 24 applies to identification and disclosures of related party transactions. The disclosure of such information is necessary for an understanding of the potential effect of the related party relationship and transactions on the financial statements. Related Party Transactions is a sensitive issue. In order to meet rational economic demand, the PIEs must also have an established corporate governance mechanism that assists in ensuring that complex related party transactions are sufficiently monitored.

The following non-disclosures were noted with respect to IAS 24:

1. **Key Management Personnel**

Key management personnel is categorised as related parties and are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

IAS 24 paragraph 17 states that an entity shall disclose [key management personnel](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS24c_2004-12-16_en-3.html#SL146739)[compensation](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS24c_2004-12-16_en-3.html#SL146725) in total and for each of the following categories:

1. short-term employee benefits;
2. post-employment benefits;
3. other long-term benefits;
4. termination benefits; and
5. share-based payment.

**During the course of its annual report review, FRC noted that6 PIEs** [2 PIEs regulated by FSC (including in public) and 4PIEs in Category 4] **had not classified key management compensation in accordance with the above requirement of IAS 24.**

1. **Related Party Transactions**

**From the review exercise, FRC observed that 8PIEs** [1 listed entity in Investment sector, 3 entities regulated by BOM,2 PIEs regulated by FSC (including 1 public) and2 PIEs in Category 4]**had not disclosed details of the terms and conditions of their related party transactions including whether they are secured, the nature of the consideration to be provided in settlement and details of any guarantees given or received** (IAS 24 paragraph 18).

**1.6 IAS 36, Impairment of assets**

IAS 36 sets out the procedures for impairment that a company should apply to ensure that its assets are carried at no more than their recoverable amount and the disclosures required in specific circumstances.

When the carrying amount exceeds its recoverable amount, the asset is described as impaired and the company must recognise an impairment loss.

With respect to goodwill, PIEs are required under IAS 36 to test for impairment of a cash-generating unit to which goodwill has been allocated annually and whenever, there is an indication that the unit may be impaired (IAS 36 paragraph 90).

**4 PIES** [2 listed (1 Investment and 1 Leisure and Hotels), 1 public entity regulated by FSC and 1 PIE in Category 4]**had not fully complied with IAS 36** as they had not disclosed the following:

* The events and circumstances that led to the recognition of impairment loss (IAS 36 paragraph 130).
* The main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses and the main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses (IAS 36 paragraph 131).
* In respect of goodwill allocated to cash-generating units (CGUs) for the purpose of impairment testing, there were no disclosures regarding (IAS 36 paragraph 134).
* Estimates used to measure recoverable amounts of CGUs (IAS 36 paragraph 134).

*The disclosures as per IAS 36 provide users of accounts with useful information in assessing future cash flows and the risks specific to an asset in determining whether an asset may be impaired.*

**1.7 IFRS 4, Insurance Contracts**

IFRS 4 requires an insurer to disclose information that identifies and explains the amounts in the financial statements arising from insurance contracts.

**4 PIEs engaged in Insurance** (including 1 listed) **had not disclosed the following with respect to insurance contracts:**

* Reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs (IFRS 4 paragraph 37(e)).
* Sensitivity to insurance risk (IFRS 4 paragraph 39A(a)).

*Information about insurance contracts is particularly important to users of financial statements because it allows users to assess the risks associated with those insurance contracts and assists them in understanding the financial effect of the insurance contracts and the impact of changes in risk variables.*

**1.8 IFRS 7, Financial Instruments: Disclosures**

IFRS 7 applies to all entities that deal with and have financial instruments. *The requirements of IFRS 7 would enable users to evaluate:*

1. *the significance of financial instruments for the company’s financial position and performance;*
2. *the nature and extent of risks arising from the financial instruments to which the company is exposed; and*
3. *how the company manages those risks.*

*Identification of risks by the Board and audit committee also is primordial. This would enable the firm to generate economic profit and enhances shareholder value in the long term.*

**From the review exercise, FRC observed that 22 PIEs** [7 listed entities(2 BIF, 1 Commerce, 2 Investment , 1 Leisure & Hotels and 1 Sugar), 2 regulated by BOM (including 1 public), 4 PIEs regulated by FSC (including 2 public) and 9 PIEs in Category 4]**had partly complied with IFRS 7.**

The following disclosures as per IFRS 7 were found missing:

* Disclosures related to cash flow hedge (IFRS 7 paragraphs 23 & 24).
* Management of financial risks and maturity analysis for non-derivative financial liabilities (IFRS 7 paragraphs 33 & 39).
* Information on credit risk such as (IFRS 7 paragraph 36).
* An analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired (IFRS 7 paragraph 37).
* Description, carrying amount, fair value and terms and conditions of collaterals (IFRS 7 paragraph 36).
* Sensitivity analysis for each type of market risk to which the company is exposed and the methods and assumptions used in preparing the sensitivity analysis (IFRS 7 paragraph 40).

**1.9 IFRS 8, Operating Segments**

IFRS 8 *Operating Segments* is applicable to listed entities. It requires that operating segment information be disclosed on the same basis as information used by management to assess operating performance and make decisions about the allocation of resources, to identify segments of the company.

The following observations were made in respect of the**22 listed entities:**

* **18 entities** [2 BIF, 3 Commerce, 4 Industry, 6 Investment, 2 Leisure and Hotels and 1 Sugar] **had fully complied with the requirements of IFRS 8.**
* **2 PIEs [**1 Investment and 1 Leisure and Hotels**] had not disclosed the requirements of IFRS 8 as this IFRS was not applicable given that the entities did not have more than one operating segment due to the nature of their businesses.**
* **1 PIE in the Industry sector had not disclosed the requirements of IFRS 8 as the company had only one significant business segment.**
* **1 PIE in the Sugar sector had not disclosed the following with regards to operating segments:**
* Factors used to identify the entity’s reportable segments, including the basis of organisation (IFRS 8 paragraph 22(a)).
* Revenues from external customers for each product and service, or each group of similar products and services (IFRS 8 paragraph 32).

*Segmental disclosures provide sufficient explanation of the basis on which the information was prepared and assist users of financial statements in understanding segmental performance.*

**1.10** [**IFRS 13, Fair Value Measurement**](Methodology%20Manual/IFRS%2013%20-%20Fair%20Value%20Measurement.doc)

IFRS 13 defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. To increase consistency and comparability in fair value measurements and related disclosures, IFRS 13 establishes a fair value hierarchy that categorises into three levels the inputs to valuation techniques used to measure fair value.

From the annual report review, FRC noted that **10 PIEs had not fully complied with the requirements of IFRS 13.**

The following disclosures as per IFRS 13 were found missing:

* The levels of fair value hierarchy under which these investments had been classified (IFRS 13 paragraph 93(b)).
* Valuation techniques used in this fair value measurement (IFRS 13 paragraph 93(d)).
* A description of the valuation processes used by the entity (IFRS 13 paragraph 93(g)).

*The above disclosures would improve the transparency of fair value measurements and enables users to assess reliability and relevance of the methods and assumptions used in valuation of financial instruments.*

**2. Corporate Governance Findings**

The national code of corporate governance aims at establishing principles for good corporate governance leading to transparency, accountability and a long-term perspective.

**2.1 Level of compliance with Corporate Governance (Full Reviews)**

Section 75(2) of the FRA stipulates that every PIE shall adopt corporate governance in accordance with the Code of Corporate Governance (‘Code”). The ‘comply or explain’ principle forms the basis of this Code. Through this principle, companies that depart from the relevant corporate Governance Code are required to explain in their corporate governance statement which parts of the Code they depart from and the reasons for doing so.

The table below shows the number of annual reports reviewed and level of compliance by the respective PIEs.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **PIEs** | **Total** | **Reported on CG** | **Not Reported on CG, but explanations provided** | **Not Reported on CG and no explanations provided** |
| Listed on SEM | 22 | 22 | - | - |
| Regulated by BOM | 10 | 10 | - | - |
| Regulated by FSC | 17 | 16 | 1 | - |
| Category 4 PIEs as per the FRA | 23 | 20 | 2 | 1 |
| **Total**  | **72** | **68** | **3** | **1** |

It is commendable to note that 68 PIEs out of 72 had reported on corporate governance. However, there are critical areas where non-compliance is still a concern such as:

* Board composition – Only 41 out of the 68 PIEs had the appropriate number of independent directors; and
* Board committees – 50 out of the 68 PIEs had audit and corporate governance committees;
* Board remuneration – 26 out of 68 PIEs reported on individual remuneration.

Details are provided below:

**2.2 Corporate governance findings**

**(a) Reporting on corporate governance**

* For the 68 PIEs that had submitted a corporate governance report, FRC noted that the common non-compliances raised from the annual report reviews of these PIEs were as follows:
1. **Information on the Board of Directors**

 As per the code of corporate governance of Mauritius, a company should have appropriate balance of executive, non-executive and independent directors. This enables the company to make sound decision making with competent board members with proper level of qualifications and experience.

 During the course of the annual report reviews, FRC noted major non-compliances relating to the composition of the board – the minimum requirement of executive and independent directors was not met.

* Minimum requirement of having at least 2 independent directors on the board of directors

As depicted in figure below, out of 68 PIEs 41 entities had at least 2 independent directors on their boards in line with section 2.2.2 of the code of the corporate governance. The rest either explained the reason for not having independent directors or did not comply at all with this requirement.

|  |  |
| --- | --- |
| **PIEs** | **Section 2.2.2** |
| **Reported on the requirement that all companies should have at least two independent directors on their boards**  | **Explanations provided** | **Not Reported on the requirement that all companies should have at least two independent directors on their boards, and no explanations provided** | **Total**  |
| Listed on SEM | 19 | 3 | 0 | **22** |
| Regulated by FSC | 7 | 8 | 1 | **16** |
| Regulated by BOM | 7 | 3 | 0 | **10** |
| Category 4 PIEs as per the FRA | 8 | 10 | 2 | **20** |
| **Total**  | **41** | **24** | **3** | **68** |

The explanations provided for not complying with this section of the code of corporate governance included the following:

* The entity was taking all the necessary steps to appoint additional independent directors.
* The appointment of the directors was done by minister’s prerogative.
* The entity did not consider it appropriate to appoint independent directors to the Board taking into consideration the current directors’ appropriate skills and experience and the shareholding structure of the company.
* The board considered that the appointment of independent directors was not necessary as the entity was a private family owned business.
* The minimum requirement of having 2 executive directors in the board of directors

The figure below indicates the level of compliance with the minimum requirement of having 2 executive directors in their boards.

|  |  |
| --- | --- |
| **PIEs** | **Section 2.2.3** |
| **Reported on the requirement that all boards should have at least two executives as members**  | **Explanations provided** | **Not Reported on the requirement that all boards should have at least two executives as members** | **Total**  |
| Listed on SEM | 16 | 5 | 1 | **22** |
| Regulated by FSC | 7 | 7 | 2 | **16** |
| Regulated by BOM | 5 | 5 | 0 | **10** |
| Category 4 PIEs as per the FRA | 15 | 4 | 1 | **20** |
| **Total**  | **43** | **21** | **4** | **68** |

43 out of 68 PIEs met the minimum requirement of the code of corporate governance. The rest explained the reasons for not having executive directors on its board.

The explanations provided by the PIEs were described below:

* + In view of the business scope and activities of the company, the board was of the opinion that one executive director, working in close collaboration with the chairman was sufficient.
	+ The Board was of the view that the attendance and participation of senior executives during the board deliberations met the spirit of the Code.
	+ It was the prerogative of the minister to appoint directors.
	+ The Company was in the process of appointing additional executive directors.
	+ The Board was satisfied that given the size of the Company, that having the Managing Director on the Board and the Finance Manager attending Board meetings was in accordance with the Code’s spirit regarding executive’s presence on the Board.
	+ Based on the size and structure of the company, it was not considered necessary to appoint additional executive directors.
1. **Information on Board Committees**

Board committees are a mechanism to assist the board and its directors in discharging their duties through a more comprehensive evaluation of specific issues.As per the code of corporate governance, all companies should have, at a minimum, an audit committee and a corporate governance committee except for, subsidiary companies which would not be expected to have separate sets of board committees.

From the table below, 18 PIEs had not disclosed information on committees, but explanations provided in this regard. The PIEs explained the following:

* All matters were taken up at board level. As such no sub committees were established.
* No board committees had been set up as the Company's core business was that of investment holding and its main investee companies had fully fledged systems of corporate governance on their own.
* All corporate governance issues were considered by the committees formed by the holding company.
* The Company was in the process of appointing potential candidates as non-executive directors,thus enabling the board to establish committees.
* Given the size, shareholding complexity and structure of the company, establishment of the board committees were not considered necessary.
* The Board was of view that it would not bring additional benefits at this stage to set up any Board Committees.

|  |  |
| --- | --- |
| **PIEs** | **Section 3.5** |
| **Reported on the requirement that all companies should have, at a minimum, an audit committee and a corporate governance committee** | **Explanations provided** | **Total**  |
| Listed on SEM | 21 | 1 | **22** |
| Regulated by FSC | 9 | 7 | **16** |
| Regulated by BOM | 8 | 2 | **10** |
| Category 4 PIEs as per the FRA | 12 | 8 | **20** |
| **Total**  | **50** | **18** | **68** |

1. **Detailed directors’ remuneration**

Disclosures on directors’ remuneration provide a control mechanism that seeks to ensure that there is alignment of directors’ interests with that of shareholders. The table below indicates details of individual remuneration of directors.

|  |  |
| --- | --- |
| **PIEs** | **Section 2.8.2** |
| **Reported on the disclosure requirement of remuneration paid to each director on an individual basis** | **Explanations provided** | **Not Reported on the disclosure requirement of remuneration paid to each director on an individual basis** | **Total**  |
| Listed on SEM | 7 | 15 |   | **22** |
| Regulated by FSC | 6 | 10 |   | **16** |
| Regulated by BOM | 3 | 7 |   | **10** |
| Category 4 PIEs as per the FRA | 10 | 9 | 1 | **20** |
| **Total**  | **26** | **41** | **1** | **68** |

From the above, it is noted that the majority of PIEs either disclose individual remuneration of directors or explain the reason for not disclosing information on individual remuneration of directors.

The explanations given for not disclosing detailed remuneration of directors on an individual basis were that the PIEs considered Directors' fees and remuneration as being sensitive information in the competitive market.

1. **Risk management**

Risk management reduces the probability that the attainment of an organisation’s objectives are jeopardised by unforeseen events. It ensures that management is capable of identifying circumstances which represent an opportunity or can be turned to competitive advantage.The operation of controls and internal audit form part of the process of risk management

The table below shows details of the PIEs complying with this section of the code of corporate governance.

|  |  |
| --- | --- |
| **PIEs** | **Sections 5.1.7 / 8.4** |
| **Reported on the requirement that risk consideration and management in key risk areas** | **Explanations provided** | **Not Reported on the requirement that risk consideration and management in key risk areas** | **Total**  |
| Listed on SEM | 22 |   |   | **22** |
| Regulated by FSC | 14 | 1 | 1 | **16** |
| Regulated by BOM | 10 |   |   | **10** |
| Category 4 PIEs as per the FRA | 16 | 2 | 2 | **20** |
| **Total**  | **62** | **3** | **3** | **68** |

As shown in the table above, FRC noted that 62 out of the 68 PIEs reviewed, had reported on consideration and management in key risks. 3 PIEs explained that no disclosures had been made regarding risk management as these requirements had been made at group level.

1. **Internal Audit**

The internal audit function is responsible for providing assurance to the board regarding the implementation, operation and effectiveness of internal control and risk management. Information on this function provides a better understanding of the level of internal audit processes implemented by the PIEs.

|  |  |
| --- | --- |
| **PIEs** | **Section 5.3** |
| **Reported on internal audit** | **Explanations provided** | **Not reported on internal audit and explanation not provided** | **Total**  |
| Listed on SEM | 22 |  |  | 22 |
| Regulated by FSC | 10 |  |  | 10 |
| Regulated by BOM | 10 | 5 | 1 | 16 |
| Category 4 PIEs as per the FRA | 16 | 3 | 1 | 20 |
| Total  | 58 | 8 | 2 | 68 |

 The table above shows that 10 PIEs had not provided information on their internal audit function in their annual reports. Out of these 10 PIEs, 8 had explained the following:

* Internal audit function was being discharged at group level.
* Due to the size and complexity of the business, there was no internal audit function within the company.
* The Board is committed with the highest standards of business integrity and had set its proper internal control framework.
* Oversight of the financial reporting process was made by the board of directors.
* **Other corporate governance issues**

During the course of its annual report reviews, FRC identified some uncommon non-compliances issues with respect to the following:

* Details and amount paid for non-audit services (section 6 Accounting and Auditing);
* Policies and practices as regards social, ethical, safety, health and environmental issues (section 8 Communication and Disclosure);
* Detailed time table specifying important events (section 8 Communication and Disclosure); and
* Profile of each member of the senior management team (Section 8 Communication and Disclosure).

 **(b) Explanations provided for non-submission of a corporate governance report**

FRC observed that 3 PIEs had provided explanations for not submitting a corporate governance report. These PIEs were reminded to henceforth adopt the code of corporate governance and comply with section 75 of the Financial Reporting Act (“FRA”).

The explanations provided for non-submission of a corporate governance report were as follows:

* The Company was a family enterprise and its shareholding was made up exclusively of family members, all of whom were represented on the Board of Directors. Given the special nature of the Company some members of the Board of Directors, who are also the key management personnel, assume all tasks of compliance and the tasks of governance.
* In view of the smallness of the Company and the volume of transactions within the actual business context, the entity was unable to justify the extra costs of implementing the Code of Corporate Governance as intended. However the requirements of the Code of Corporate Governance would be considered in the event that there is an improvement in the entity’s business activity.
* Being a family business, the Company did not have the structure to comply with the requirements of the Code of Corporate Governance. The requirements as per the Code would be catered for in the next financial year.

**(c) No explanations provided for non-submission of corporate governance report**

1 PIE had not submitted a corporate governance report and had not provided explanations in this respect.

The PIE was reminded of the requirement of section 75(2) of the FRA and that of the need to comply with each requirement of the code of corporate governance on a ‘comply or explain principle.’

**2.3 Reporting by Auditors in compliance with Section 39(3) of the FR Act**

Section 39(3) of the FRA requires an auditor to report whether the disclosures made in the corporate governance report are consistent with the Code. The format of this report on corporate governance by auditors is laid out in the Guidelines on compliance with corporate governance – Government Gazette No. 64 of 20 July 2013, General Notice No. 1819.

From the 72 Annual Reports reviewed, FRC observed that the **auditors** of:

**70 PIEs [**22 listed (2 BIF, 3 Commerce, 5 Industry, 7 Investments, 3 Leisure & Hotels and 2 Sugar), 10 regulated by BOM, 17 PIEs regulated by FSC (including 5 public) and 21 in Category 4 of the FRA (including 1 public] **had reported on the consistency of the requirements of the Code; and**

**2 PIEs** in Category 4 of the Financial Reporting Act **had not reported on the consistency of the requirements of the Code.**

The auditors who had not complied with Section 39 (3) of the FRA and the guidelines, were requested to provide explanations to the FRC.

**3. Liquidity risk**

During the annual report review exercise, FRC noted that **12 PIEs** [5 listed (1 Commerce, 2 Industry, 1 Leisure and Hotels and 1 Sugar), 1 PIE regulated by FSC and 6 PIEs in Category 4**]had indicators of potential going concern problem such as loss for the year, revenue deficit, negative cash flows and net current liabilities.**

The companies were requested to submit the remedial actions that they would take to enhance its profitability and liquidity situation.

**4.** **Audit and non-audit fees**

From the annual report review, FRC observed that some licensed auditors had provided non-audit services to PIEs such as tax services.

1. **Legal requirements for PIEs**

In accordance with legal requirements and under the code of corporate governance, PIEs are required to disclose the following information for the non-audit services rendered by their external auditors in their annual reports:

* Separate disclosure of the amount paid for non-audit services as opposed to audit services (section 221 of the Companies Act 2001 *Contents of annual report* refers).
* Description of non-audit services rendered by the external auditor in their annual reports stating particulars of the nature of the services and amounts paid for each nature of services.

With respect to audit and non-audit fees, the following observations were made following the 72 reviews:

* **36 PIEs** [12 listed (2 Commerce, 2 Industry, 4 Investment, 2 Leisure and Hotels and 2 Sugar), 5 regulated by BOM (including 2 public), 7 regulated by FSC (including 1 public) and 12 PIEs in Category 4 (including 1 public)] **had paid fees for audit services only.**
* **28 PIEs** [10 listed (2 BIF, 1 Commerce, 3 Industry, 3 Investment and 1 Leisure and Hotels), 5 PIE regulated by BOM, (including 2 public), 8 PIEs regulated by FSC (including 4 public) and 5 PIEs in Category 4] **had disclosed fees paid for audit services as well as ‘other services’ provided by the same firms of external auditors. The ‘other services’ rendered by the auditors consisted mainly of taxation services.**
* Out of the above 28 PIEs, **7 PIEs** [3 listed (2 Industry and 1 Investment), 3 PIEs regulated by FSC (including 1 public) and 1 PIE in Category 4] **had not disclosed the nature of non audit services provided by the auditor.**
* **5 PIEs** [2 PIEs regulated by FSC and 3 PIEs in Category 4] **had not disclosed the audit and/or non-audit fees after having complied with sections 218(2) and 221(4) of the Companies Act 2001.**
* **3 PIEs in Category 4had not disclosed fees paid for audit and non audit services.**

FRC had requested these entities to report on fees paid for audit and non-audit services. A description of the nature of non-audit services provided shall also be reported.

1. **Independence of auditors in respect of non-audit services**

The concern is that there are certain provision of other services which may impair auditor’s independence and objectivity. The importance of external auditor independence is a vital pre-condition for the workings of efficient capital markets that would undoubtedly promote investor’s confidence.

Whenever non-audit services are provided by the engagement partner, the PIEs have to assess the significance of any threats to independence and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level in accordance with the IFAC code of Ethics. Also, the allowable non-audit services as per the IFAC Code of Ethics shall be adhered to by auditors.

FRC drew the attention of these auditors that these services may create a self-review threat and that this may affect matters to be reflected in the financial statements. The auditors were also advised not to prepare tax calculations for the purpose of preparing accounting entries except in emergency situations.

Also, FRC informed the Board of Directors and/or the Audit Committees that they should make sure that the “other services” provided did not conflict with the audit work being provided. Where the auditors supply non-audit services to the company, the audit committee should review the nature and extent of such services, seeking to balance the maintenance of objectivity and independence of the auditor.

**5. Non-financial information**

A good annual report always addresses all the required relevant information in respect of the entities’ activities, objectives and strategic plans, firms’ values and principles, factors affecting its environment and its performance.

From the 72 annual reports reviewed, FRC made the following observations:

* 40% of companies discussed their corporate strategies and business objectives;
* 31% of firms discussed values and principles;
* 93% of the PIEs provided a description of their businesses and scope; and
* 24% mentioned the external forces affecting the entities such as customer, suppliers and competitors.

**6. Market Capitalisation**

Market capitalisation is calculated by multiplying a company's shares outstanding by the current market price of one share. This figure is used to determine a company's size, provides an indication of its value and its net worth.

For the six months ended 30 June 2015, FRC reviewed the annual reports of 22 listed companies and noted that their market capitalisation approximately totalled Rs 76 billion.

4 PIEs that were the most capitalised were involved in investment and leisure and hotels. The entities that were least capitalised were engaged in industry.

**7.** **Categories of Auditors**

As per section 33 of the FRA, any person who holds any appointment or offers any services for remuneration, as an auditor, has to hold a licence under the FRA. This licence issued under section 33 is valid for a calendar year of for such period as the FRC may determine. The table below provides a description of the type of PIEs reviewed and their categories of auditors.

|  |  |
| --- | --- |
| **Types of reviews** | **Type of audit firm** |
| **Big Audit Firms** | **More than two partners Audit firm** | **Two Partners Audit Firm** | **One Partner Audit Firm** | **Sole Practitioner** | **Total** |
| Listed on SEM | 22 | - | - | - | - | **22** |
| Financial institutions regulated by BOM (excluding cash dealers) | 9 | - | 1 | - | - | **10** |
| Financial institutions regulated by FSC | 12 | 1 | 2 | 2 | - | **17** |
| Category 4 PIEs as per the FRA | 16 | 3 | 3 | 1 | - | **23** |
| **Total** | **59** | **4** | **6** | **3** | **-** | **72** |

From the above table, FRC noted the following from the 72 PIEs reviewed:

* 59 representing 82% of the PIEs (22 listed, 9 BOM, 12 FSC and 16PIEs in Category 4) are audited by Big Audit Firms (namely PWC, Deloitte, BDO, Ernst and Young, KPMG and Grant Thornton);
* 4 PIEs are audited by more than two partners audit firm;
* 6 PIEs had a two-partners firm as auditor; and
* 3 PIEs had as auditors a one partner firm.

**PART** **B - Follow up reviews of annual reports**

FRC undertook follow-up reviews to assess the extent to which findings raised on previous reviews had been satisfactorily addressed by the PIEs. New issues such as the application of new standards, amendments to standards and regulations arising during the course of the follow-up reviews of the annual reports were also considered.

During the period under review, 30 follow up reviews were undertaken. The selected PIEs reviewed were those who obtained Grade 2B during the previous reviews.

The following table analyses the follow up reviews of PIEs by sectors:

|  |  |
| --- | --- |
| **Types of reviews** | **Sectors** |
| **BIF** | **Commerce** | **Industry** | **Investment** | **Leisure & Hotels** | **Others** | **Property development** | **Total** |
| Listed on SEM | - | 1 | 2 | 3 | - | - | 2 | **8** |
| Financial institutions regulated by BOM | 3 | - | - | - | - | - | - | **3** |
| Financial institutions regulated by FSC | 7 | - | - | - | - | - | - | **7** |
| Category 4 PIEs as per the FRA | 1 | 1 | 3 | 4 | 1 | 1 | 1 | **12** |
| **Total** | **11** | **2** | **5** | **7** | **1** | **1** | **3** | **30** |

1. **Findings of Follow-up Review**

**IFRS compliance**

During the follow-up reviews carried out for the six months ended 30 June 2015, FRC considered whether the issues previously raised in previous full annual report reviews had been properly addressed in the PIEs’ latest annual reports and whether there are still recurrent issues from previous reviews. This would ensure that PIEs had taken corrective actions subsequent to FRC’s previous letters of observations.

FRC noted an overall improvement in the reporting of most entities. **There were certain non-compliances which were reiterated as they were not properly addressed in the current annual reports:**

**11 PIEs** [3 listed (1 Industry and 2 Investment), 1 public company regulated by FSC and 7PIEs in Category 4] **had again not complied with the following IFRSs:**

* **IAS 1, Presentation of Financial Statements (paragraphs 97, 112and 138)**
	+ Additional information on the nature of expenses and other information that is of relevance to an understanding of the financial statements.
	+ Accounting policies used that are relevant to an understanding of the financial statements.
	+ Nature of the company's operations and principal activities.
* **IAS 16, Property, Plant and Equipment (paragraph 34)**
	+ Frequency of revaluations of property, plant and equipment.
* **IAS 19, Employee Benefits (paragraphs139 (b) and 147(b))**
	+ A description of the risks to which the plan exposes the entity.
	+ The expected contributions to the plan for the next annual reporting period.
* **IAS 24,** [**Related Party Disclosures**](file://frcdatasrv01/Guidancenotes/Bulletin/2014/Bulletin%20%28July%20to%20Dec%202014%29/Methodology%20Manual/IAS%2024%20-%20Related%20Party%20disclosures.doc) **(paragraphs 17 and 18(b))**
	+ [Key](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS24c_2004-12-16_en-3.html#SL146739) [compensation](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS24c_2004-12-16_en-3.html#SL146725) in total and in its different categories.
	+ Details of the terms and conditions of their related party transactions including whether they are secured, the nature of the consideration to be provided in settlement and details of any guarantees given or received.
* **IFRS 5, Non-current Assets Held for Sale & Discontinued Operations (paragraph 41(b))**
	+ Description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal.
* **IFRS 7, Financial Instruments: Disclosures (paragraph 33(b))**
	+ Management of financial risks.
* **IFRS 13, Fair Value Measurement (paragraph 93(d))**
	+ A description of the valuation technique(s) and the inputs used in the fair value measurement
1. **Other non-compliances arising from the follow-up reviews**

As part of its follow-up review exercise, FRC considered whether the PIEs had undertaken new business activities and/or material transactions, and whether they had adopted the new IFRSs and/or amendments to IFRSs which were relevant to them.

**FRC observed that 8 PIEs** [3 listed (1 Industry and 2 Investment) and 5PIEs in Category 4] **had not adequately disclosed the following in accordance with IFRSs:**

* **IAS 1, Presentation of Financial Statements (paragraphs 79(b) and 117)**
	+ A description of the nature and purpose of each reserve within equity.
	+ Accounting policies used that are relevant to an understanding of the financial statements.
* **IAS 19, Employee Benefits (paragraphs 139(b), 142, 143, 145 and 147)**
	+ Description of the risks to which the defined benefit plan exposes the entity.
	+ Disaggregation of the fair value of the plan assets into classes that distinguish the nature and risks of those assets.
	+ The fair value of the entity’s own transferable financial instruments held as plan assets, and the fair value of plan assets that are property occupied by, or other assets used by, the entity.
	+ Sensitivity analysis for each significant actuarial assumption as of the end of the reporting period.
	+ Description of any funding arrangements and funding policy that affect future contributions, the expected contributions to the plan for the next annual reporting period and information about the maturity profile of the defined benefit obligation.
* **IAS 36, Impairment of assets (paragraph 130(a))**
	+ The events and circumstances that led to the recognition or reversal of the impairment loss.
* **IFRS 12, Disclosure of Interests in Other Entities (paragraphs 12(g) and B 10(b))**
	+ Summarised financial information about the entity’s subsidiary.
	+ Summarised financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that non-controlling interests have in the group’s activities and cash flows.
* [**IFRS 13, Fair Value Measurement**](file://frcdatasrv01/Guidancenotes/Bulletin/2014/Bulletin%20%28July%20to%20Dec%202014%29/Methodology%20Manual/IFRS%2013%20-%20Fair%20Value%20Measurement.doc) **(paragraph 93(b))**
	+ The level of the fair value hierarchy within which the fair value measurements of assets and liabilities are categorised in their entirety
1. **Compliance with the code of corporate governance**

 **• Explanations for non-submission of Corporate Governance Report**

3 PIEs [1 regulated by FSC and 2 Category 4] provided the following explanations for not having submitted a Corporate Governance Report:

* The company was a private company held by only two shareholders. All the required disclosures were reported in the corporate governance report of the company's operating subsidiary.
* The company had not started any operations since inception. However, it would comply with Section 75 of the FRA in respect of the inclusion of a Corporate Governance Report in its annual report as soon as it starts operating.
* As the company was a family owned/managed business, the board of directors had not deemed it necessary to abide with the code of corporate governance. The board undertook to take necessary measures to ensure compliance as soon as possible.

**• Part-compliance with corporate governance**

With respect to the Code, the following were not properly addressed in the current annual reports of 6 PIEs [2 regulated by FSC and 4 Category 4]:

o Composition of the Board of Directors (Section 2 paragraph 2.5.5 of the code of corporate governance (code))

* Information on remuneration of directors (section 8.4 of the code)
* Exposure and management of key risks (section 8.4 of the code)
* Profile of senior management team(section 8.4 of the code)
* Submission of statement of compliance (section 75(3) of the FRA)

**PART C** **- Grading of Annual Report Reviews**

FRC had graded the quality of the 102 annual reports reviewed (72 full reviews and 30 follow up reviews) for the six months ended 30 June 2015.

The grading allocated to the PIEs was based on the following four levels:

• Good (Grade 1)

• Acceptable with limited improvements required (Grade 2A)

• Acceptable overall with improvements required (Grade 2B)

• Significant improvements required (Grade 3)

The grades of the annual report review were determined mainly by the nature of non-compliances raised with respect to IFRS, auditors’ report, corporate governance and other issues arising such as non-compliances with regulations, going concern problem and independence of auditors amongst others. This would highlight areas in which there is room for improvement and helps drive quality reporting.

FRC noted that 8 PIEs had received a grade of 1, 66 PIEs a grade of 2A while 27 PIEs had obtained grade 2B. Only 1 PIE had received a grade of 3. Those with grade 2A have no significant non-compliances whilst those having grade 2B had various non-compliances.

The table below shows an analysis of the grading obtained by types of PIEs.

|  |  |  |  |
| --- | --- | --- | --- |
| **Types of PIEs** | **Full Review** | **Follow-up Review** | **Total** |
| **Grade 1** | **Grade 2A** | **Grade 2B** | **Grade 3** | **Grade 1** | **Grade 2A** | **Grade 2B** | **Grade 3** |  |
| Listed on SEM | - | 16 | 6 | - | 2 | 6 |  - | - | **30** |
| Financial institutions regulated by BOM (excluding cash dealers) | 2 | 7 | 1 | - | 1 | 2 | - | - | **12** |
| Financial institutions regulated by FSC | 1 | 10 | 6 | - | 1 | 6 | - | - | **25** |
| Category 4 PIEs as per the FRA | - | 12 | 10 | 1 | 1 | 7 | 4 | - | **35** |
| **Total** | **3** | **45** | **23** | **1** | **5** | **21** | **4** | **-** | **102** |

A follow up review was carried out with respect to the 30 entities who had received grade 2B in their previous reviews and FRC observed the following during the follow up exercise:

* 4 PIEs still obtained the same grade (2B) as compared to last year;
* 21 PIEs had been granted grade 2A; and
* 5 PIEs obtained grade 1.

From the 4 PIEs that had still obtained grade 2B as in previous year, FRC noted the following:

* 1 PIE had not submitted a corporate governance report in last year review but has reported on corporate governance in the year under review. In that respect, non-compliances were raised with respect to board composition, remuneration of directors and senior management profile.
* 1 PIE stated the board was taking action to ensure compliance with the code of corporate governance as soon as possible.
* For the remaining 2 other PIEs, FRC noted various non compliances in respect of the following IASs:
* IAS 1 Presentation of Financial Statement
* IAS 19 Employee Benefits
* IAS 24 Related Party Disclosures
* IAS 36 Impairment of Assets
* IFRS 12 Disclosure of Interests in Other Entities

It was good to note that there had been an improvement in corporate reporting asthere had been an improvement in the grading of 25 PIEs which had moved from grade 2B to grades 2A and 1.

**PART D -****Conclusion**

FRC noted that there was a good level of compliance with the International Financial Reporting Standards and corporate governance among PIEs in general. This was reflected by the grades scored by the PIEs wherein a majority of the PIEs scored grade 2A.

FRC will continue to carry out its follow up exercise to ensure that the non-compliances raised in previous reviews are being considered. The annual report reviews performed would also take into account new developments in IFRS and regulations to ensure quality reporting.

**Financial Reporting Council**

**15 July 2015**