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Financial Reporting Council

**Bulletin on Review of Annual Reports for the six months ended 30 June 2016**

**I Introduction**

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In view of promoting high quality reporting, FRC reviews the annual reports of Public Interest Entities (PIEs) to ensure that they comply with IFRS and the requirements of the Code of Corporate Governance (Code).

For the year 2016, subsequent to the BAI Scandal, FRC modified the way of conducting the review of the annual reports of PIEs. In this regard, FRC carried out the reviews as follows:

**(a) Group Reviews**

Group reviews were mainly based on focus areas of IFRSs significant to the business of the respective PIEs and liquidity risks within a group of companies. The objectives of the Group reviews are:

1. To assess the financial situation of the group and its subsidiaries (liquidity and financial performance of the group and its subsidiaries);
2. To evaluate the accounting policies adopted by the group and its subsidiaries (eg, exemption for consolidation (IFRS 10), Fair value (IFRS 13), Revenue Recognition (IAS 18), etc);
3. To focus on risky sectors such as construction, leisure and hotels, textile, insurance, and banking within the group; and
4. To assess key IFRSs relevant to the activities of the Group.

**(b) Review of other entities**

Apart from the PIEs reviewed as per (a) above, FRC also selected for review the following PIEs:

* entities listed on the Stock Exchange of Mauritius;
* entities that scored a grade 3 in its previous review;
* PIEs for which complaints were received; and
* State Owned Enterprises (SOEs) listed in the First Schedule of the Financial Reporting Act 2004.

For the six months ended 30 June 2016, FRC carried out the review of a group which has 14 PIEs. Also, FRC reviewed the annual reports of 13 other PIEs.

The annual reports reviewed had year ends December 2014 (4), March 2015 (1), June 2015 (21) and December 2015 (1).

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** | **Sectors** | | | | | | |
| **BIF** | **Commerce** | **Industry** | **Investment** | **Leisure & Hotels** | **Others** | **Total** |
| Listed on SEM | - | 1 | 2 | 4 | 1 | 2 | 10 |
| Financial institutions regulated by BOM (excluding cash dealers) | 1 | - | - | - | - | - | 1 |
| Financial institutions regulated by FSC | 2 | - | - | - | - | - | 2 |
| Category 4 PIEs as per the FRA | - | 2 | 8 | - | 1 | - | 11 |
| SOEs as per the First Schedule of FRA | 1 | 1 | - |  | 1 |  | 3 |
| **Total** | **4** | **4** | **10** | **4** | **3** | **2** | **27** |

*Note:*

‘*Category 4 PIEs’ comprises 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.*

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**PART A - Full reviews**

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**1. Main findings from Group Reviews**

FRC carried out the review of a group with 14 PIEs. The holding company of the group of companies, is listed on the Stock Exchange of Mauritius and its main activity is to provide long term growth and dividend income for distribution to investors. It has invested in a diversified portfolio of equity and equity related investments and has the following five distinct clusters:

* Agro & Property
* Finance
* Hotels & Resorts
* Textile
* Healthcare

The PIEs within the group were from the diverse categories as illustrated in the table below:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** | **Sectors** | | | | | |
| **BIF** | **Industry** | **Investment** | **Leisure & Hotels** | **Others** | **Total** |
| Listed on SEM | - | - | 2 | 1 | 2 | 5 |
| Financial institutions regulated by FSC | 2 | - | - | - | - | 2 |
| Category 4 PIEs as per the FRA | - | 6 | - | 1 | - | 7 |
| **Total** | **2** | **6** | **2** | **2** | **2** | **14** |

As part of its annual report review, FRC had also focused on the following areas and IFRSs relevant to the group’s businesses:

* New accounting standards
* Business combinations
* Related parties Transactions
* Asset valuations
* Estimates/judgment – reasonableness
* Operating Segments
* Retirement benefit obligations (Pension schemes)
* Accounting policy revenue
* Disclosure Initiative (IAS1) –relevancy of accounting policies
* Any other material issues affecting the PIEs

Based on these focused areas, the following main non-compliances had been identified from the group review:

* 1. **Compliances with regard to International Financial Reporting Standards (IFRSs)**

1. IAS 1, Presentation of Financial Statements

**FRC informed 7 PIEs** [2 listed in Others, 1 regulated by FSC and 4 PIEs in Category 4] **within the group** **of non-compliances in respect of the following requirements of IAS 1:**

* Accounting policies on borrowing costs, revenue, redemption of shares and interest income;
* Detailed information on rental income, other income and subordinated loan;
* Description of the nature and purpose of each reserve within equity; and
* Description of items grouped under items that will not be reclassified to P&L.

1. IAS 17, Leases

**FRC raised IAS 17 issues for 3 PIEs** [1 listed in Investment and 2 PIEs in Category 4] **within the group, with regard to the following:**

* Description of the lessor’s material leasing arrangements; and
* Breakdown of the future minimum lease payments under non-cancellable operating leases.

1. IAS 19, Employee Benefits

**With regard to IAS 19, FRC queried 6 PIEs** [2 listed in Investment and 4 PIEs in Category 4] **reviewed within the group** **in respect of the following:**

* The significant risks to which the entity was exposed through its defined benefit plan;
* Explanation of amounts in the financial statements for present value of the defined benefit obligation;
* Description of any funding arrangements and funding policy that affect future contributions and the expected contributions to the plan for the next annual reporting period; and
* Sensitivity analysis for actuarial assumption.

1. IAS 24, Related Parties

**FRC informed 5 PIEs in the group** [2 listed (1 Investment and 1 Others) and 3 PIEs in Category 4] **of issues relating to IAS 24 requirements:**

* Classification of key management compensation; and
* Nature and purpose of management fees.

1. IFRS 3, Business Combinations

**FRC observed that 2 listed PIEs** involved in the Investment sector **within the group, had not complied with IFRS 3, in respect of the following:**

* Primary reasons for the business combination; and
* Qualitative description of the factors that make up the goodwill recognised.

1. IFRS 7, Financial Instruments: Disclosures

**FRC informed 5 PIEs** [2 listed (1 Investment and 1 Others) and 3 PIEs in Category 4] **within the group, of their non-compliances with the following IFRS 7 requirements**:

* Fair value of the collateral held, sold or repledged and the terms and conditions associated with its use of the collateral;
* Policies and processes for managing interest rate risk; and
* Information on cash flow hedge.

1. [IFRS 13, Fair Value Measurement](file:///\\frcdatasrv01\Guidancenotes\Bulletin\2014\Bulletin%20(July%20to%20Dec%202014)\Methodology%20Manual\IFRS%2013%20-%20Fair%20Value%20Measurement.doc)

**From the annual reports of 4 PIEs** [1 listed involved in Others and 3 PIEs in Category 4] **of the group, FRC identified issues, which related to the following requirements of IFRS 13:**

* The level of the fair value hierarchy within which the fair value measurements of assets and liabilities are categorised in their entirety; and
* Description of the valuation technique(s) and the inputs used in fair value measurement.
  1. **Other issues**

The following differences were noted in respect of the accounting policies and accounting estimates of the company as compared to that of the ultimate holding company for **4 PIEs within the group** [2 listed involved in Others and 2 PIEs in Category 4]:

1. Depreciation rates of the entity were not in the same range as that of the ultimate holding company; and
2. IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) had been adopted by the entity while this had not been early applied by its ultimate holding company.
   1. **Issues raised with auditors**

FRC also monitored the services provided by the auditors as well as other issues involving the work of the auditor.

**During the course of its review, FRC informed the auditors of 4 PIEs** **within the group** [3 listed (1 Investment, 1 Leisure & Hotels and 1 Others) and 1 Category 4 PIE] **of the following issues noted from their audit reports:**

1. Provision of other services

FRC noted that the auditors of 4 PIEs of the group had provided other services such as internal audit fees, independent advisory fees and tax advisory services.

1. Going concern risk

From the review of the Annual Report of 1 Category 4 PIE in the group, FRC observed that there were indicators of going concern risks that may cast doubt on the entity’s ability to continue as a going concern.

1. Date of auditor’s report

FRC informed the holding company of the group of companies (a listed company engaged in Investment), that the date of its Audit Report was earlier than that of its subsidiary companies.

1. **Main findings from review of other entities**

For the six months ended 30 June 2016, FRC reviewed the annual reports of 13 other PIEs. The table below illustrates this type of PIEs per sector:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** | **Sectors** | | | | | |
| **BIF** | **Commerce** | **Industry** | **Investment** | **Leisure & Hotels** | **Total** |
| Listed on SEM | - | 1 | 2 | 2 | - | **5** |
| Financial institutions regulated by BOM | 1 | - | - | - | - | **1** |
| Category 4 PIEs as per the FRA | - | 2 | 2 | - | - | **4** |
| SOEs as per the First Schedule of FRA | 1 | 1 | - | - | 1 | **3** |
| **Total** | **2** | **4** | **4** | **2** | **1** | **13** |

With respect to these PIEs, FRC identified issues relating to the following areas of corporate reporting during the six months ended 30 June 2016:

* 1. **Compliances with International Financial Reporting Standards (IFRSs)**

1. IAS 1, Presentation of Financial Statements

**7 other entities** [2 listed (1 Industry and 1 Investment), 3 PIEs in Category 4 and 2 State Owned Enterprises as per the First Schedule of FRA] **had not disclosed the following in their annual reports:**

* Accounting policies for land and buildings, investments, assets repossessed, foreign currency translation, joint ventures and cash and cash equivalents;
* Information on capital risk management;
* Disclosures regarding judgements, estimates and assumptions;
* Disclosure regarding classification of investments;
* Presentation of third statement of financial position;
* Comparative information on motor vehicles under leases, administrative expenses and trade payables;
* Description of items grouped under items that will not be reclassified to P&L;
* Disclosure of the par value per share; and
* Information on dividend per share.

1. IAS 2, Inventories

**FRC noted that 3 PIEs** [2 PIEs in Category 4 and 1 State Owned Enterprise as per the First Schedule of FRA] **had not complied with IAS 2, as detailed below:**

* Inadequate disclosures in respect of:
* amount of inventories recognised as an expense for the period under review;
* the cost formula used; and
* the carrying amount in classification appropriate to the entity;
* Work in progress arising under construction contracts had been wrongly classified under inventories.

1. IAS 17, Leases

**The annual report reviews carried out indicate that 5 PIEs** [1 listed entity in Investment sector, 3 PIEs in Category 4 and 1 State Owned Enterprise as per the First Schedule of FRA] **had not complied with the following 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.
* A general description of the lessor’s material leasing arrangements and the lessee’s significant leasing arrangements; and
* Lease and sublease payments recognized as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments.

1. IAS 24, Related Party Disclosures

**For 6 PIEs** [2 listed entities (1 Industry and 1 Investment), 1 regulated by BOM and 3 PIEs in category 4], **FRC noted the following with regard to IAS 24:**

1. Key Management Personnel

FRC observed that [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) had not been categorised into 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.
6. Related Party Transactions

From the review exercise, there were no disclosures regarding the terms and conditions of the PIEs’ 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.

1. IFRS 7, Financial Instruments: Disclosures

**From the review exercise, FRC observed that 4 PIEs** [2 listed entities (1 Industry and 1 Investment), 1 PIE in Category 4 and 1 State Owned Enterprise as per the First Schedule of FRA] **had partly complied with IFRS 7.**

The following disclosures as per IFRS 7 were found missing:

* Management of financial risks;
* Description of collaterals;
* Information on credit risk such as:
* information regarding maximum exposure to credit risk;
* information about the credit quality of financial assets that are neither past due nor impaired;
* an analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired; and
* an analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired.
* Maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

1. IFRS 8, Operating Segments

IFRS 8 *Operating Segments* is applicable to listed entities. With respect to the 5 listed other entities reviewed, the following observations were made**:**

* **3 entities** [1 Commerce, 1 Industry and 1 Investment] **had fully complied with the requirements of IFRS 8.**
* **1 PIE** involved in Industry **had not disclosed the requirements of IFRS 8 as this IFRS was not applicable given that the entity did not have more than one operating segment due to the nature of its businesses.**
  + - **1 PIE** in Investment **had not disclosed the basis of accounting for its inter-segment transactions.**
  1. **Compliances with corporate governance**

The National Code of Corporate Governance aims at establishing principles for good corporate governance leading to transparency, accountability and a long-term perspective.

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.

It is commendable to note that all of the 13 other entities had reported on corporate governance and that 9 out of these 13 PIEs had partly complied with the Code.

FRC has identified that in most cases, amongst others, the PIEs had not complied fully with the following requirements of the code of corporate governance:

* Composition of the Board (section 2 of the code);
* Information on board committees (section 3 of the code);
* Details of risk management policies (section 5 of the code);
* Description of internal control (section 5 of the code); and
* Details of internal audit function (section 5 of the code).

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 13 PIEs, 5 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 remaining 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 | 2 | 3 | - | **5** |
| Regulated by BOM | 1 | - | - | **1** |
| Category 4 PIEs as per the FRA | 1 | 2 | 1 | **4** |
| SOEs as per the First Schedule of FRA | 1 | 2 | **-** | **3** |
| **Total** | **5** | **7** | **1** | **13** |

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

* The Board of Directors was of the view that the composition of the board was adequately balanced given the scale and size of the entity.
* Board composition did not affect the effectiveness of the Board given the size of the Company and the experience of the other Directors. It was also composed of professionals having the right mix of experience to enable it to function in full independence The entity would consider the appointment of additional independent directors.
* The appointment of the directors was specified in the PIEs’ dedicated laws.
* The Company believed that the board composition was adequate due to the presence of independent and executive directors on the board of its principal operating subsidiary.
* Having given due consideration to its business, its ownership and governance structures, the Board was of the view that it would not bring additional benefits of having at least two independent directors.
* 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 requirement that all companies should have at least two executive 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 | - | 4 | 1 | **5** |
| Regulated by BOM | - | 1 | - | **1** |
| Other PIEs | 1 | 2 | 1 | **4** |
| SOEs as per the First Schedule of FRA | 1 | 2 | **-** | **3** |
| **Total** | **2** | **9** | **2** | **13** |

2 out of 13 PIEs met the minimum requirement of the code of corporate governance. The rest either explained the reasons for not having executive directors on its board or did not comply at all with this requirement.

The explanations provided by the PIEs were described below:

* Board composition did not affect the effectiveness of the Board given the size of the Company and the experience of the other Directors. It was also composed of professionals having the right mix of experience to enable it to function in full independence The entity would consider the appointment of additional independent directors.
* The appointment of the directors was specified in the PIEs’ dedicated laws.
* The Board currently had 1 executive director due to the scale and size of the Company.
* The Nomination Committee had already started procedures in identifying a suitable qualified person with the requisite competencies to replace the CEO of the Bank.
* Having given due consideration to its business, its ownership and governance structures, the Board was of the view that it would not bring additional benefits of having at least two independent and two 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, 6 PIEs had not disclosed information on committees, but explanations provided in this regard. The PIEs explained the following:

* The Company did not have any board committee due to the scale and size of the company.
* A monitoring committee had been put in place to ensure objectives and targets were implemented as per milestone agreed.
* As regards the setting of other committees such as the Audit Committee, this was not warranted at the moment due to the small size of the organisation and that the internal control procedure was in-built in the operating system;
* Given the nature and size of the business, all Board Committee functions including Corporate Governance and Audit Committee functions were discharged by the Board as a unit.
* As the entity is a subsidiary it had not established a corporate governance committee as per section 1.3 of the code of corporate governance.

|  |  |  |  |
| --- | --- | --- | --- |
| **PIEs** | **Section 3** | | |
| **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 | 3 | 2 | **5** |
| Regulated by BOM | 1 | - | **1** |
| Category 4 PIEs as per the FRA | 1 | 3 | **4** |
| SOEs as per the First Schedule of FRA | 2 | 1 | **3** |
| **Total** | **7** | **6** | **13** |

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** | **Section 5.1.7** | | |
| **Reported on the requirement of risk consideration and management in key risk areas** | **Not Reported on the requirement of risk consideration and management in key risk areas** | **Total** |
| Listed on SEM | 4 | 1 | **5** |
| Regulated by BOM | 1 | - | **1** |
| Category 4 PIEs as per the FRA | 3 | 1 | **4** |
| SOEs as per the First Schedule of FRA | 1 | 2 | **3** |
| **Total** | **9** | **4** | **13** |

As shown in the table above, FRC noted that 4 out of the 13 PIEs reviewed, had not reported on consideration and management of key risks.

1. Internal controls

An effective internal control system ensures that the processes and systems used by the entity is operating effectively. It enables the board of director to report any lack of, or breach of internal controls and any unethical or irregular behaviour concerning the company. It also provides assurance that the system manages risk in the manner approved by the board.

The table below illustrates the level of the PIEs’ compliance with this section of the code of corporate governance.

|  |  |  |  |
| --- | --- | --- | --- |
| **PIEs** | **Reported on the methods by which the directors' responsibilities for internal control** | **Not Reported on the methods by which the directors' responsibilities for internal control has been disclosed** | **Total** |
| Listed on SEM | 4 | 1 | **5** |
| Regulated by BOM | 1 | - | **1** |
| Category 4 PIEs as per the FRA | 4 | - | **4** |
| SOEs as per the First Schedule of FRA | 2 | 1 | **3** |
| **Total** | **11** | **2** | **13** |

From the above table, FRC noted that 2 PIEs had not provided information on internal control. These PIEs were informed of the requirement of **Section 5 of the code of Corporate Governance.**

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 | 2 | 2 | 1 | 5 |
| Regulated by BOM | 1 | - | - | 1 |
| Category 4 PIEs as per the FRA | 3 | 1 | - | 4 |
| SOEs as per the First Schedule of FRA | 2 | - | 1 | 3 |
| Total | 8 | 3 | 2 | 13 |

The table above shows that out of the 13 PIEs, 5 PIEs had not made disclosures in the annual report for their internal audit function, as per the requirement of the code. Out of these 5 PIEs, 3 had explained the following:

* Oversight of the financial reporting process was made by the Board of Directors.
* The board of directors believes that the managerial and supervisory control put in place are sufficient to protect the company’s income and assets.

With respect to the 2 PIEs that had not provided information on internal audit function, FRC draws their attention to **Section 5 of the Code of Corporate Governance** which requires that ‘*the Statement of Directors’ Responsibilities for Internal Control shall state whether or not the board has established an internal audit function.’*

1. Other corporate governance issues

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

* Details and amount paid for non-audit services (section 6 of the code);
* Detailed time table specifying important events (section 8 of the code);
* Material clauses of the company’s constitution (section 8 of the code);
* Description of non-audit services (section 6 of the code);
* Policies and procedures as regards ethics, environment, health and safety and social issues (section 8 of the code); and
* Dividend policy (section 8 of the code).
  1. **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 13 Annual Reports reviewed, FRC observed that the **auditors** of:

* **12 PIEs** [4 listed (2 Industry and 2 Investment), 1 regulated by BOM, 4 in Category 4 and 3 State Owned Enterprises as per the First Schedule of FRA] **had reported on the consistency of the requirements of the Code;** and
* **1 PIE** in Category 4 of the Financial Reporting Act reported on the extent of compliance by the entity with the requirements of the Code of Corporate Governance as follows:

*“The disclosure on Corporate Governance Report is in line with Section 2.5 of Governance Practice Guidance for unlisted and family companies.”*

FRC was of the view that the auditor had made reference to the new Code of Corporate Governance, which will be effective as from 01 July 2016 rather than the prevailing Code of Corporate Governance.

* 1. **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 for the 13 reviews:

* **6 PIEs** [1 listed in Industry sector, 3 PIEs in Category 4 and 2 State Owned Enterprises as per the First Schedule of FRA] **had paid fees for audit services only.**
* **6 PIEs** [4 listed (1 Commerce, 1 Industry and 2 Investment), 1 PIE regulated by BOM and 1 PIE 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.**
* **1 Stated Owned Enterprise as per the First Schedule of FRA had not disclosed the audit fees payable to its external auditor as it was not required to comply with the requirements of the Companies Act 2001.**

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.

* 1. **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 13 annual reports reviewed, FRC made the following observations:

* 54% of companies discussed their corporate strategies
* 77% of the entities made disclosures regarding their business objectives;
* 31% of firms discussed values and principles;
* 100% of the PIEs provided a description of their businesses and scope; and
* 23% mentioned the external forces affecting the entities such as customer, suppliers and competitors.

FRC encourages PIEs to report on relevant non-financial information which will help users of accounts to interpret the financial information provided in the annual reports.

* 1. **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 2016, FRC reviewed the annual reports of 5 listed companies and noted that their market capitalisation approximately totalled Rs 3,661,505,126.

3 PIEs that were the most capitalised were involved in investment and commerce. The PIEs that were least capitalised were engaged in industry.

**PART** **B - Follow up reviews of Annual Reports**

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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.

For the period under review, 5 follow up reviews were undertaken. These consisted of PIEs in Category 4 which had obtained Grade 2B or had liquidity issues during the previous reviews. They were from the following sectors:

* Commerce (2)
* Industry (2)
* Investment (1)

During the follow-up reviews carried out for the six months ended 31 December 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.

From the follow up review exercise, FRC observed the following issues with respect to corporate governance:

1. Recurrent issues

With respect to the Code, **the following were not properly addressed in the current annual reports of 3 PIEs in Category 4**:

* Details of the remuneration of directors on an individual basis (Section 2 of the code).
* Composition of the Board committees (Section 3 of the code).

1. Other non-compliances with respect to corporate governance arising from the follow-up reviews

**FRC informed 1 PIE in Category 4 of the following new issues with respect to corporate governance, arising from its follow up reviews:**

* Policies and practices as regards social and environmental issues (Section 8 of the code).
* Detailed time table specifying important events (section 8 of the code).

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

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FRC had graded the quality of the 18 annual reports reviewed (13 full reviews and 5 follow up reviews) for the six months ended 30 June 2016. The PIEs for which group reviews had been conducted, were not graded.

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.

Out of the 18 PIEs reviewed, FRC noted that:

* 4 PIEs a grade of 2A;
* 16 PIEs had obtained grade 2B; and
* 2 PIEs 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 Reviews** | | | **Follow-up Review** | | **Total** |
| **Grade 2A** | **Grade 2B** | **Grade 3** | **Grade 2A** | **Grade 2B** |  |
| Listed on SEM | 4 | - | - | - | - | **4** |
| Financial institutions regulated by BOM (excluding cash dealers) | - | 1 | - | - | - | **1** |
| Financial institutions regulated by FSC | - | 1 | - | - | - | **1** |
| Category 4 PIEs as per the FRA | - | 3 | 1 | 4 | 1 | **9** |
| SOEs as per the First Schedule of FRA | - | 3 | - | - | - | **3** |
| **Total** | **4** | **8** | **1** | **4** | **1** | **18** |

A follow up review was carried out with respect to the 5 entities who had received grades 2A and had liquidity issues in their previous reviews and FRC observed the following during the follow up exercise:

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

For the PIE that had still obtained grade 2B as in previous year, FRC raised various non compliances with respect to corporate governance and IFRSs:

* The fair value estimation of the buildings (IFRS 13);
* Accounting policy regarding frequency of revaluation of buildings (IAS 16);
* Remuneration of directors (Section 2 of the code);
* Detailed time table specifying important events (Section 8 of the code); and
* Statement of Compliance had been signed by 2 directors instead of 1 director and the chairman of the company (Guidelines on Compliance with Corporate Governance – Government Gazette No. 32 of 13 April 2013, General Notice No. 1016).

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

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FRC noted that there is a continuing improvement in the corporate reporting of PIEs in general.

During the period ended 30 June 2016, FRC issued letters of observations to PIEs copied to the Chairman of these entities. In light of FRC’s comments, many PIEs provided explanations and gave undertakings to improve the quality of their future annual reports where relevant.

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**

**29 September 2016**