**Financial Reporting Council**

**Bulletin on Review of Annual Reports**

**for the six months ended 31 December 2014**

**I Overview**

As part of its function, the FRC reviewed annual reports to ensure compliance with the National Code of Corporate Governance and with the International Financial Reporting Standards issued by International Accounting Standards Board. Such exercise allows FRC to meet its objective of promoting quality reporting by Public Interest Entities (PIEs).

FRC also ensures that the annual reports present a comprehensive and objective assessment of the activities of the company, which allow the stakeholders to understand how the entity is managed.

For the six months ended 31 December 2014, FRC had reviewed the annual reports of 99 PIEs consisting of 56 full reviews and 43 follow-up reviews. Annual reports of PIEs from various sectors of the economy were reviewed.

The annual reports reviewed had year ends June 2013 (24), September 2013 (5), December 2013 (58), February 2014 (1), March 2014 (4) and June 2014 (7).

**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** | **Property Development** | **Sugar** | **Total** |
| Listed on SEM | 1 | 2 | 3 | - | - | 1 | - | - | - | 7 |
| Financial institutions regulated by BOM (excluding cash dealers) | 3 | - | - | - | - | - | - | - | - | 3 |
| Financial institutions regulated by FSC | 3 | - | - | - | 2 | - | - | - | - | 5 |
| Category 4 PIEs as per the FRA | - | 11 | 10 | 1 | 6 | 3 | 6 | 3 | 1 | 41 |
| **Total** | **7** | **13** | **13** | **1** | **8** | **4** | **6** | **3** | **1** | **56** |

*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. [Working Capital (Net Current Liabilities)](#_Hlk395611358)

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

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

6. [Market Capitalisation](#_Hlk395611558)

7. [FSC regulated CIS](#_Hlk395611699" \s "1,34819,34837,0,,FSC regulated CIS)

8. [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. **Frequency of reporting**

This standard states that when an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements the reason for using a longer or shorter period(IAS 1 paragraph 36(a)).

**3 PIEs in Category 4had not disclosed the reasons for using a longer or shorter period.**

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)).

**3 PIEs in Category 4had not provided a description of the nature and purpose of each reserve within equity.**

1. **Information to be presented in the profit or loss section or the statement of profit or loss or in the notes**

* Other comprehensive income

IAS 1 paragraph 82A states that the other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other IFRSs:

(a) will not be reclassified subsequently to profit or loss; and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

The annual report review carried out indicates that**5 PIEs** [1 listed PIE in Commerce sector, 1 public entity regulated by FSC and 3 PIEs in Category 4 (including 1 public)] **had not complied with the above requirements of IAS 1.**

* Nature of items

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.*

**5 PIEs in Category 4 had not provided separate disclosures on the nature of administrative expenses although the amounts were material.**

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.*

**6 PIEs** [1 public entity regulated by FSC and 5 PIEs in Category 4] **had not adequately disclosed their accounting policies in respect of the following items:**

* **Leases**
* **Property, plant and equipment**
* **Dividend**
* **Non-current assets held for sale**

FRC also came across entities disclosing accounting policies which are not relevant to the entities. Thus adding clutter.

1. **Judgments, assumptions and estimates applied**

IAS 1 states that an entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, assumptions and estimates applied in the preparation of the financial statements (IAS 1 paragraphs 122 & 125)

**1PIE in Category 4 had not disclosed the judgements, assumptions and estimates applied with respect to useful live and residual value of property, plant and equipment.**

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** [1 public entity regulated by FSC and 2 PIEs in Category 4], **had not disclosed its objectives, policies and processes for managing 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.

*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.

**5 PIEs** [1 listed in Industry sector and 4PIEs in Category 4 (including 1 public)] **had not complied with IAS 16 in respect of the following:**

* Accounting policy on recognition of increase/decrease in the asset’s carrying amount as a result of revaluation.
* The carrying amount that would have been recognised had the assets been carried under the cost model.
* Assets recognised under the revaluation model had not been revalued with sufficient regularity.

**1.3 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.

*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.*

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

* **3 PIEs** [1 public entity regulated by FSC and 2 PIEs in Category 4] **did not apply IAS 19 as they did not have any employees.**
* **24 PIEs** [3 listed (1 Commerce and 2 Industry) **and 21 PIEs in Category 4** (including 2 public)] **had partly complied with IAS 19.**
* **1 PIEs in Category 4 had not complied at all with the requirements of IAS 19 although it had 192 employees.**

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

* **28 PIEs** [4 listed (1 BIF, 1 Commerce, 1 Industry and 1 Leisure & Hotels), 3 regulated by BOM, 3 PIEs regulated by FSC and 18 PIEs in Category 4] **had fully complied with the requirements of IAS 19.**

With regard to the 24 PIEs which had partly complied with IAS 19, the following common non-compliances were notedfor defined benefit plans (IAS 19 paragraphs 120A, 139, 142, 145 & 147):

* Accounting policy for recognising actuarial gains and losses.
* Narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets.
* The actual return on plan assets.
* The amounts for the current annual period and previous four annual periods of:
* the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan; and
* the experience adjustments arising on:
  + the plan liabilities expressed either as (1) an amount or (2) a percentage of the plan liabilities at the end of the reporting period and
  + the plan assets expressed either as (1) an amount or (2) a percentage of the plan assets at the end of the reporting period.

*Experience adjustments are the effects of differences between the previous actuarial assumptions and what has actually occurred.*

* The employer’s best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the annual period beginning after the reporting period.
* Characteristics of the defined benefit plans and their associated risks.
* 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.
* A sensitivity analysis for each significant actuarial assumption.
* 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.

**1.4 IAS 24, Related Party Disclosures**

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.

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.*

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 that16 PIEs** [3 listed PIEs (2 Industry and 1 Leisure & Hotels), 1 regulated by BOM and 12 PIEs in Category 4 (including 1 public)] **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 7 PIEs in Category 4** (including 1 public)]**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).

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

IFRS 7 applies to all entities that deal with and have financial instruments. Financial instruments can be financial assets, cash, shares, derivatives and financial liabilities.

*Disclosures relating to financial instruments are provided in annual accounts to 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 ad audit committee 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 12 PIEs** [1 listed entity in Commerce sector, 1 regulated by BOM, 1 publicPIE regulated by FSC and 9 PIEs in Category 4 (including 2 public)]**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 and 24).
* Management of financial risks (IFRS 7 paragraphs 33 and 39).
* Information on credit risk such as (IFRS 7 paragraphs 36 and 37):
  + Amount that best represents the entity’s 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.
  + Description, carrying amount, fair value and terms and conditions of collaterals.
* 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).

**1.6 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.

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

**The following observations were made in respect of the 7 listed entities:**

* **6 entities** [1 BIF, 1 Commerce, 3 Industry, and 1 Leisure & Hotels] **had fully complied with the requirements of IFRS 8.**
* **1 PIE in Commerce sector had not disclosed the requirements of IFRS 8 as this IFRS was not applicable given that the company did not have more than one operating segment due to the nature of its business.**

**2.** **Corporate Governance Findings**

The National Code of Corporate Governance stabilises the principles for good corporate governance leading towards transparency, accountability and a long-term perspective, that is, sustainability.

**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. Also, the PIEs may use the ‘comply or explain’ principle laid down in the code of corporate governance. According to 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 | 7 | 7 | - | - |
| Regulated by BOM | 3 | 3 | - | - |
| Regulated by FSC | 5 | 4 | - | 1 |
| Category 4 PIEs as per the FRA | 41 | 30 | 9 | 2 |
| **Total** | **56** | **44** | **9** | **3** |

It is commendable to note that 44 PIEs out of 56 had reported on corporate governance. However, there are critical areas as detailed below.

**2.2 Corporate governance findings**

**(a) Reporting on corporate governance**

* For the 44 PIEs that had submitted a corporate governance report, FRC noted that the common non-compliances raisedfrom 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 44 PIEs 25 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 | 6 | 1 | - | **7** |
| Regulated by FSC | 3 | 1 | - | **4** |
| Regulated by BOM | 2 | - | 1 | **3** |
| Category 4 PIEs as per the FRA | 14 | 8 | 8 | **30** |
| **Total** | **25** | **10** | **9** | **44** |

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 directors of the company believed that the Board composition was adequate due to the size and complexity of the business; and
* A representative attends all Board/Committee meetings and contributes in the decision-making process and affairs of the entity.
* 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 | 5 | 2 | - | **7** |
| Regulated by FSC | 2 | 1 | 1 | **4** |
| Regulated by BOM | 2 | 1 | - | **3** |
| Category 4 PIEs as per the FRA | 18 | 6 | 6 | **30** |
| **Total** | **27** | **10** | **7** | **44** |

27 out of 44 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:

* The Board was of the opinion that its size and composition were optimal for the effective execution of its responsibilities;
* The Company entered into a management agreement with an entity which is the operator and manager and had exclusive responsibility and full control in the operation and management of the company’s business;
* A representative attended all Board/Committee meetings and contributed in the decision-making process and affairs of the entity;
* The Board was satisfied that given the size and structure of the company, appointment of a second executive director was considered not to be necessary. The company also had a strong executive senior management who attended and participated in board meetings; and
* The officer in charge was an executive director of the Board. Moreover, the shareholders had appointed an Acting Chief Executive Officer, subject to regulatory approvals.

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, FRC noted the following:

* 20 out of the 44 PIEs had audit and corporate governance committees.
* 19 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;
    - For the time being the board did not feel the need to implement local and independent committees because of its close collaboration with the existing group structures;
    - All corporate governance issues were considered by the committees formed by the holding company;
    - The ultimate holding company was responsible for board committees' issues;
    - Due to the size of the board and involvement of shareholders who were also directors of the company, no sub committees had been set up;
    - Board committees were functioning at the subsidiary level; and
    - Having given due consideration to its business, its ownership and governance structures, the Board was of view that it would not bring additional benefits at this stage to set up any Board Committees to assist it in implementing the recommendations of the Code.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **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** | **Not Reported on the requirement that all companies should have, at a minimum, an audit committee and a corporate governance committee** | **Total** |
| Listed on SEM | 5 | 2 | - | **7** |
| Regulated by FSC | 3 | 1 | - | **4** |
| Regulated by BOM | 3 | - | - | **3** |
| Category 4 PIEs as per the FRA | 9 | 16 | 5 | **30** |
| **Total** | **20** | **19** | **5** | **44** |

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 | 2 | 4 | 1 | **7** |
| Regulated by FSC | 1 | 2 | 1 | **4** |
| Regulated by BOM | 1 | 1 | 1 | **3** |
| Category 4 PIEs as per the FRA | 18 | 10 | 2 | **30** |
| **Total** | **22** | **17** | **5** | **44** |

From the above, it is noted that:

* 22 out of 44 PIEs reported on individual remuneration; and
* 17 PIEs 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 | 7 | - | - | **7** |
| Regulated by FSC | 4 | - | - | **4** |
| Regulated by BOM | 3 | - | - | **3** |
| Category 4 PIEs as per the FRA | 27 | - | 3 | **30** |
| **Total** | **41** | **-** | **3** | **44** |

As shown in the table above, FRC noted that 41 out of the 44 PIEs reviewed, had reported on consideration and management in key risks. Only 3 PIEs in Category 4 had not disclosed in their annual reports, details of exposure to key risks and management of these risks.

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 | 7 | - | - | **7** |
| Regulated by FSC | 4 | - | - | **4** |
| Regulated by BOM | 3 | - | - | **3** |
| Category 4 PIEs as per the FRA | 24 | 4 | 2 | **30** |
| **Total** | **38** | **4** | **2** | **44** |

The table above shows that 6 PIEs had not provided information on their internal audit function in their annual reports. Out of these 6 PIEs, 4 had explained the following:

* Internal audit function was being discharged at holding level;
* Due to the size and complexity of the business, there is no internal audit function within the company; and
* Oversight of the financial reporting process is 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:

* Information on internal control and internal audit (section 5 Risk Management, Internal Control and Internal Audit);
* Details and amount paid for non-audit services (section 6 Accounting and Auditing);
* Statement of remuneration philosophy (section 8 Communication and Disclosure);
* Policies and practices as regards social, ethical, safety, health and environmental issues (section 8 Communication and Disclosure);
* A detailed time table specifying important events (section 8 Communication and Disclosure); and
* Directors’ responsibilities for financial statements and accounting records (Section 8 Communication and Disclosure).

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

FRC observed that 9 PIEs had provided explanations for not submitting a corporate governance report. These PIEs was reminded to henceforth adopt the Code of corporate governance and to comply with section 75 of the Financial Reporting Act.

A PIE cannot provide explanations for not submitting a corporate governance report. It is essential for a PIE to adhere to the good principles of governance as laid down by the code.

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

* The PIE was a wholly owned subsidiary of another entity and had only one director. Given the current organisational structure, it considered that disclosures made in other sections of the annual report were sufficient for the various stakeholders in understanding of the operations and the financial performance of the entity;
* The directors were aware that the requirements of the Code of Corporate Governance had not been fully implemented during the year and remained committed in implementing the full requirements of the Code of Corporate Governance in the next financial statements;
* Corporate governance was done at holding level and the principles of good governance were being followed throughout the group;
* The board of directors was accountable and responsible for the performance and affairs of the company and assumed all tasks of compliance and governance; and
* The company was a family owned business consisting of investment in subsidiaries which are listed on the Stock Exchange of Mauritius and equipped with fully fledged systems of Corporate Governance.

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

3 PIEs had not submitted a corporate governance report and had not provided explanations in this respect.

The PIEs were reminded of the requirement of section 75(2) of the Financial Reporting Act and that of the need to comply with each requirement of the code of corporate governance on a ‘comply or explain principle.’

Out of the 3 PIEs, 2 PIEs took note of the non-compliance raised with regards to the requirements of the code of corporate governance. The reply of the remaining PIE is still outstanding.

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

Section 39(3) of the Financial Reporting Act 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 56 Annual Reports reviewed, FRC observed that the **auditors** of:

**50 PIEs [**7 listed (1 BIF, 2 Commerce, 3 Industry and 1 Leisure & Hotels), 3 regulated by BOM, 4 PIEs regulated by FSC (including 1 public) and 36 PIEs in Category 4 (including 2 public**] had reported on the consistency of the requirements of the Code; and**

**6 PIEs [**1 PIE regulated by FSC and 5 PIEsin Category 4] **had not reported on the consistency of the requirements of the Code.**

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

**3.** **Working Capital (Net Current Liabilities)**

Section 61(b) of the Companies Act 2001 provides that the board may authorise a distribution at such time and of such amounts it thinks fit, if it is that the company shall, upon the distribution being made, satisfy the solvency test.

One of these indicators for assessing the solvency of an entity is working capital. This is used to assess the liquidity position of the entity and its ability to pay its debts in the near future.

**During the course of the annual report review exercise, FRC observed that 8 PIEs** [1 entity listed in Leisure & Hotels sector and 7 PIEs in Category 4] **had negative cash flows and net current liabilities.**

**Out of the 8 entities which had net current liabilities, 5 PIEs** [1 listed in Leisure & Hotels sectorand 4PIEs in Category 4] **had distributed dividend out of retained earnings.**

It should be emphasised that when an entity pays dividend in a net current liability situation, this might put pressure on the entity’s available cash flow resources and its ability to pay its debts as they become due in the normal course of business. **It may also lead to the inability to meet the solvency test as defined in Companies Act 2001.**

**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* also 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 reviews of the 56 PIEs:

* **27 PIEs** [1 entity listed in Industry sector, 3 regulated by BOM, 4 regulated by FSC (including 1 public) and 19 PIEs in Category 4 (including 1 public)] **had paid fees for audit services only.**
* **10 PIEs** [3 listed (1 BIF, 1 Commerce and 1 Industry), 1 PIE regulated by FSC and 6 PIEs in Category 4 (including 1 public)] **had disclosed fees paid for audit services as well as ‘other services’ provided by the same firms of external auditors. The ‘other services’ were mainly tax services.**
* **7PIEs in Category 4 had not disclosed the audit and/or non-audit fees after having complied with section 218(2) of the Companies Act 2001.**
* **12 PIEs** [3 listed (1 Commerce, 1 Industry and 1 Leisure & Hotels) and 9 PIEs in Category 4] **had not disclosed the nature of non audit services provided by the auditor.**

FRC had requested these entities to report separately on fees paid for 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 56 annual reports reviewed, FRC made the following observations:

* 14% of companies discussed their corporate strategies and business objectives;
* 25% of firms discussed values and principles;
* 64% of the PIEs provided a description of their businesses and scope; and
* 9% 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 31 December 2014, FRC reviewed the annual reports of 7 listed companies and noted that their market capitalisation approximately totalled Rs 4.5 billion.

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

**7. FSC regulated CIS**

Collective Investment Schemes are FSC regulated investment companies that collect funds from various investors to collectively invest in a portfolio of diversified investments.The funds aim to provide growth in the value of investment over time. The investment value of these investment funds provides an idea of the total amount of funds generated by the Collective Investment Schemes.

Out of the 56 PIEs reviewed for the six months ended 31 December 2014, 5 of them were FSC regulated. From these 5 PIEs, 2 were collective investment schemes. FRC observed that the investment value for these 2 Collective Investment Scheme reviewed amounted to Rs 2,657,486,999.

**8.** **Categories of Auditors**

As per section 33 of the Financial Reporting Act, any person who holds any appointment or offers any services for remuneration, as an auditor, has to hold a licence under the Financial Reporting Act. 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 5** | **More than two partners audit firm** | **Two Partners Audit Firm** | **One Partner Audit Firm** | **Sole Practitioner** | **Total** |
| Listed on SEM | **7** | - | - | - | - | **7** |
| Financial institutions regulated by BOM (excluding cash dealers) | **3** | - | - | - | - | **3** |
| Financial institutions regulated by FSC | **5** | - | - | - | - | **5** |
| Category 4 PIEs as per the FRA | **30** | **3** | **4** | **3** | **1** | **41** |
| **Total** | **45** | **3** | **4** | **3** | **1** | **56** |

From the above table, FRC noted the following from the 56 PIEs reviewed:

* 45 representing 80% of the PIEs (7 listed, 3 BOM, 5 FSC and 30 PIEs in Category 4) are audited by Big 5 companies (namely PWC, Deloitte, BDO, Ernst and Young and KPMG);
* 3 PIEs are audited by more than two partners audit firm;
* 4 PIEs had a two-partners firm as auditor;
* 3 PIEs had as auditors a one partner firm; and
* 1 PIE had a sole practitioner as its auditor.

It can be seen that other types of auditors besides the big firms are able to enter the market of PIEs, albeit timidly.

**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, 43 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** | **Information technology** | **Investment** | **Leisure & Hotels** | **Sugar** | **Transport** | **Others** | **Total** |
| Listed on SEM | 1 | 1 | 2 | 1 | 4 | - | 1 | - | 1 | **11** |
| Financial institutions regulated by BOM | 1 | - | - | - | - | - | - | - | - | **1** |
| Financial institutions regulated by FSC | 12 | - | - | - | - | - | - | - | - | **12** |
| Category 4 PIEs as per the FRA | - | 3 | 4 | - | 2 | 7 | 1 | 1 | 1 | **19** |
| **Total** | **14** | **4** | **6** | **1** | **6** | **7** | **2** | **1** | **2** | **43** |

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

**IFRS compliance**

During the follow-up reviews carried out for the six months ended 31 December 2014, 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:**

**13 PIEs**[4 listed (1 Industry, 1 Information Technology, 1 Investment and 1 Others), 4 regulated by FSC (including 1 public) and 5 PIEs in Category 4] **had again not complied with the following IFRSs:**

* **IAS 1, Presentation of Financial Statements (paragraphs 79(a)(v), 112, 117, 134 and 135)**
  + Rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital
  + 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.
  + Information on objectives, policies and processes for managing capital.
* **IAS 16, Property, Plant and Equipment (paragraph 34)**
  + Frequency of revaluations of property, plant and equipment.
* **IAS 17, Leases (paragraph 35(d))**
  + A general description of the lessee’s significant leasing arrangements.
* **IAS 24,** [**Related Party Disclosures**](file:///\\frcdatasrv01\Guidancenotes\Bulletin\2014\Bulletin%20(July%20to%20Dec%202014)\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 differentcategories.
  + 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 41,** [**Agriculture**](file:///\\frcdatasrv01\Guidancenotes\Bulletin\2014\Bulletin%20(July%20to%20Dec%202014)\Methodology%20Manual\IAS%2041%20-%20Agriculture.doc) **(paragraph 49(c))**
  + Financial risk management strategies related to [agricultural activity](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS41c_2005-08-18_en-3.html#SL143218).
* **IFRS 7, Financial Instruments: Disclosures (paragraphs 33(b), 39(c) and 40)**
  + Management of financial risks.
  + A sensitivity analysis for each type of market risk to which the entity is exposed.

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 13 PIEs** [3 listed (1 Information Technology, 1 Investment and 1 Others), 1 regulated by BOM, 5 regulated by FSC and 4 PIEs in Category 4] **had not adequately disclosed the following in accordance with IFRSs:**

* **IAS 1, Presentation of Financial Statements (paragraph97)**
  + Additional information on the nature of expenses and other information that is of relevance to an understanding of the financial statements.
* **IAS 10, Events after the Reporting Date (paragraph 17)**
  + The date when the financial statements were authorized for issue and who gave that authorization.
* **IAS 19, Employee Benefits (paragraphs 139(b), 145 and 147)**
  + Description of the risks to which the defined benefit plan exposes 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 24,** [**Related Party Disclosures**](file:///\\frcdatasrv01\Guidancenotes\Bulletin\2014\Bulletin%20(July%20to%20Dec%202014)\Methodology%20Manual\IAS%2024%20-%20Related%20Party%20disclosures.doc) **(paragraph18(b))**
  + 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 3, Business Combinations (paragraph B64)**
  + Nature and financial information as regards business combination
* **IFRS 7, Financial Instruments: Disclosures (paragraphs 24(b), 39(c) and 40)**
  + The ineffectiveness recognised in profit or loss that arises from cash flow hedges.
  + Management of liquidity risk.
  + A sensitivity analysis for each type of market risk to which the entity is exposed.
* **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(July%20to%20Dec%202014)\Methodology%20Manual\IFRS%2013%20-%20Fair%20Value%20Measurement.doc) **(paragraphs 93(b) and 97)**
  + The level of the fair value hierarchy within which the fair value measurements of assets and liabilities are categorised in their entirety
  + For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed:
* the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety.
* for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement.
* for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

1. **Compliance with the code of corporate governance**

**• Non-submission of Corporate Governance Report**

2 PIEs in Category 4 had not submitted a Corporate Governance Report and this issue was reiterated to the companies.

These companies were again informed that they had not reported on Corporate Governance as required by Section 75 of the Financial Reporting Act (FRA).

**• Part-compliance with corporate governance**

With respect to the Code, the following were not properly addressed in the current annual reports of 10 PIEs [1 listed in Industry, 6 regulated by FSC and 3 PIEs in Category 4]:

o Composition of the Board of Directors (Section 2 paragraphs 2.2.2, 2.2.3 and 2.5.5 of the code of corporate governance (code))

o Description of non audit services rendered by the external auditor (Section 6 paragraph 6.3.3 of the code)

* Integrated sustainability reporting (section 7 of the code)
* Information on remuneration of directors (section 8.4 of the code)
* Submission of statement of compliance (section 75(3) of the Financial Reporting Act 2004)

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

FRC had graded the quality of the 99 annual reports reviewed (56 full reviews and 43 follow up reviews) for the six months ended 31 December 2014.

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 13 PIEs had received a grade of 1, 49 PIEs a grade of 2A while 36 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 | - | 6 | 1 | - | 4 | 6 | 1 | - | 18 |
| Financial institutions regulated by BOM (excluding cash dealers) | - | 2 | 1 | - | - | 1 | - | - | 4 |
| Financial institutions regulated by FSC | - | 2 | 3 | - | - | 9 | 3 | - | 17 |
| Category 4 PIEs as per the FRA | 2 | 13 | 26 | - | 7 | 10 | 1 | 1 | 60 |
| **Total** | **2** | **23** | **31** | **-** | **11** | **26** | **5** | **1** | **99** |

With respect to the grading of the 43 PIEs for which follow up reviews were conducted, FRC observed the following:

* 21 were not previously graded as FRC’s grading system was not yet implemented.
* 22 PIEs had received a grade 2B in their previous reviews. Out of these 22 PIEs, the following were noted:
* 4 PIEs is still obtaining the same grade (2B) as compared to last year;
* 13 PIEs had been granted grade 2A; and
* 5 PIEs received grade 1.

FRC reiterated non-compliances previously raised with respect to corporate governance for 4 PIEs which had obtained grade 2B for two consecutive years. Out of the above 4 PIEs, 1 PIE had not submitted a corporate governance report in last year review but had submitted its explanations in this respect for the year under review. Also, FRC raised non-compliances with respect to board composition for the remaining 3 PIEs (paragraphs 2.2.2, 2.2.3 and 2.5.5 of the code refer).

It can be clearly seen the improvement in corporate reporting. 18 PIEs had moved from grade 2B to grades 2A and 1.

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

From the annual report reviews carried out, FRC observed that a major chunk of the PIEs reviewed had scored a grade 2A which indicates that few non-compliances were noted from the review of the annual reports. This shows sign of improvement in quality reporting.

FRC also expectsPIEs to collaborate with the FRC to ensure that issues previously raised are satisfactorily addressed in the companies’ next annual reports.

**Financial Reporting Council**

**19 January 2015**