**Financial Reporting Council**

**Bulletin on Review of Annual Reports**

**for the six months ended 31 December 2015**

**I Overview**

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).

This would assist in improving good governance of a PIE in ensuring that 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 2015, FRC had reviewed the annual reports of 42 PIEs consisting of 28 full reviews and 14 follow-up reviews. Annual reports of PIEs from various sectors of the economy were reviewed.

The annual reports reviewed had year ends June 2014 (8), September 2014 (4), December 2014 (27), February 2015 (1) and March 2015 (2).

**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 | 1 | 1 | - | 1 | 2 | - | 1 | 9 |
| 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 | 2 | 1 | 1 | 4 | 4 | 1 | 1 | 17 |
| **Total** | **3** | **5** | **3** | **2** | **1** | **5** | **6** | **1** | **2** | **28** |

*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.*

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

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

1. [IFRS Findings](#IFRS1)

2. [Corporate Governance Findings](#_Hlk395611879)

3. [Liquidity](#_Hlk395611358) risk

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

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

6. [Market Capitalisation](#_Hlk395611558)

7. [Categories of Auditors](#_Hlk395611800)

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

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

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

**PART A - Full reviews**

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

Compliance with IFRS is a means of ensuring transparency and completeness of financial information. FRC has identified issues in respect of 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. **Nature of items of financial statements**

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

**7 PIEs** [4 listed (1 Commerce, 1 Industry, 1 Others and 1 Sugar) and 3 PIEs in Category 4] **had not provided detailed information on the following, although the amounts were material:**

* **Operating and administrative expenses**
* **Rental income**

1. **Accounting policies**

IAS 1 requires companies to provide a summary of their significant accounting policies that are *relevant to an understanding of the financial statements* (IAS 1 paragraph 117)*. Appropriate accounting policies supported by reasonable and prudent judgments must be used consistently by the PIEs.*

**5 PIEs** [2 listed (1 BIF and 1 Information Technology) and 3 PIEs in Category 4 (including 1 public)] **had not made adequate and relevant disclosures in respect of their accounting policies for the following items:**

* **Leases**
* **Retirement benefit obligations**
* **Investment property**
* **Derivatives**
* **Inventories**
* **Investment in subsidiaries**
* **Non-current assets held for sale**

**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.

**FRC observed that 3 PIEs** [1 listed in Sugar and 2 PIEs in Category 4 (including 1 public)] **had chosen to state items of property, plant and equipment at revalued amounts.** **However, these assets recognised under the revaluation model had not been revalued with sufficient regularity** (IAS 1 paragraph 117)**.**

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

**1.3 IAS 17, Leases**

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

**The annual report reviews carried out indicate that 8 PIEs** [3 listed (1 Commerce, 1 Information Technology and 1 Leisure and Hotels) and 5 PIEs in category 4 (including 1 public)] **had not complied with the following disclosure requirements of IAS 17 Leases**:

* The total of future [minimum lease payments](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS17c_2005-08-18_en-3.html#SL145300) under [non-cancellable](http://eifrs.iasb.org/eifrs/stdcontent/2008_Bound_Volume/IAS17c_2005-08-18_en-3.html#SL145282) operating leases for each of the following periods:
* not later than one year;
* later than one year and not later than five years
* later than five years (IAS 17 paragraphs 35 and 56).
* A general description of the lessor’s material leasing arrangements and the lessee’s significant leasing arrangements (IAS 17 paragraphs 31 and 35).

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

**1.4 IAS 19, Employee Benefits**

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

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

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

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

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

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

* **12 PIEs** [6 listed (1 Commerce, 1 Industry, 1 Information Technology, 1 Leisure and Hotels, 1 Others and 1 Sugar) and 6 PIEs in Category 4 (including 1 public)] **had fully complied with the requirements of IAS 19.**
* **14 PIEs** [3 listed (1 BIF, 1 Commerce and 1 Others), and 11 PIEs in Category 4 (including 2 public)] **had partly complied with IAS 19.**
* **2 PIEs** (1 regulated by FSC and 1 in Category 4) **did not apply IAS 19 due to lack of employees and high labour turnover.**

With regard to the 14 PIEs which had partly complied with IAS 19, the following common non-compliances were noted for defined benefit plans:

* Characteristics of the defined benefit plans and their associated risks (IAS 19 paragraph 139).
* Explanation of amounts in the financial statements such as disaggregation of the fair value of the plan assets into classes that distinguish the nature and risks of those assets (IAS 19 paragraph 142).
* Fair value of the entity’s own transferable financial instruments held as plan assets, and the fair value of plan assets that are property occupied by, or other assets used by, the entity (IAS 19 paragraph 143).
* The significant actuarial assumptions used to determine the present value of the defined benefit obligation (IAS 19 paragraph 144).
  + A sensitivity analysis for each significant actuarial assumption and the methods and assumptions used in preparing these sensitivity analyses (IAS 19 paragraph 145).
* A description of any funding arrangements and funding policy that affect future contributions, the expected contributions to the plan for the next annual reporting period and information about the maturity profile of the defined benefit obligation (IAS 19 paragraph 147).

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

**1.5 IAS 24, Related Party Disclosures**

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

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

1. **Key Management Personnel**

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

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

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

**During the course of its annual report review, FRC noted that 4 PIEs** [3 listed (1 Commerce, 1 Industry and 1 Information Technology) and 1 public PIE in Category 4] **had not classified key management compensation in accordance with the above requirement of IAS 24.**

1. **Related Party Transactions**

**From the review exercise, FRC observed that 3 PIEs in Category 4** **had not disclosed details of the terms and conditions of their related party transactions including whether they are secured, the nature of the consideration to be provided in settlement and details of any guarantees given or received** (IAS 24 paragraph 18).

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

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

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

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

**From the review exercise, FRC observed that 5 PIEs** [2 listed entities (1 Information Technology and 1 Others) and 3 PIEs in Category 4] **had partly complied with IFRS 7.**

The following disclosures as per IFRS 7 were found missing:

* Terms and conditions of pledge (IFRS 7 paragraph 14).
* Disclosures related to cash flow hedge (IFRS 7 paragraphs 23 & 24).
* Management of financial risks (IFRS 7 paragraph 33).
* Description of collaterals (IFRS 7 paragraph 36).
* Information on credit risk such as (IFRS 7 paragraphs 36 and 37):
* 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.
* 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).

**1.7 IFRS 8, Operating Segments**

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

The following observations were made in respect of the **9 listed entities:**

* **6 entities** [1 BIF, 1 Commerce, 1 Industry, 1 Leisure and Hotels and 2 Others] **had fully complied with the requirements of IFRS 8.**
* **2 PIEs** [1 Commerce and 1 Information Technology] **had not disclosed the requirements of IFRS 8 as this IFRS was not applicable given that the entities did not have more than one operating segment due to the nature of their businesses.**
* **1 PIE in the Sugar sector had not made disclosures in respect of the factors used to identify the entity’s reportable segments, including the basis of organisation** (IFRS 8 paragraph 22(a)).

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

**2. Corporate Governance Findings**

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

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

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

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

|  |  |  |  |
| --- | --- | --- | --- |
| **PIEs** | **Total** | **Reported on CG** | **Not Reported on CG, but explanations provided** |
| Listed on SEM | 9 | 9 | - |
| Regulated by BOM | 1 | 1 | - |
| Regulated by FSC | 1 | 1 | - |
| Category 4 PIEs as per the FRA | 17 | 16 | 1 |
| **Total** | **28** | **27** | **1** |

It is commendable to note that 27 PIEs out of 28 had reported on corporate governance. However, there are critical areas where non-compliance is still a concern such as:

* Board composition – Only 9 out of the 27 PIEs had the appropriate number of independent directors; and
* Board committees – 11 out of the 27 PIEs had audit and corporate governance committees;
* Board remuneration – 15 out of 27 PIEs reported on individual remuneration.

Details are provided below:

**2.2 Corporate governance findings**

**(a) Reporting on corporate governance**

* For the 27 PIEs that had submitted a corporate governance report, FRC noted that the common non-compliances raised from the annual report reviews of these PIEs were as follows:

1. **Information on the Board of Directors**

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

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

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

As depicted in figure below, out of 27 PIEs 9 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 | 7 | 1 | 1 | **9** |
| Regulated by FSC | - | 1 | - | **1** |
| Regulated by BOM | 1 | - | - | **1** |
| Category 4 PIEs as per the FRA | 1 | 14 | 1 | **16** |
| **Total** | **9** | **16** | **2** | **27** |

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 small-size, the present structure of the Company and that the skills, expertise and experience of the current directors.
* The entity would consider the appointment of additional independent directors.
* The appointment of the directors was done by minister’s prerogative.
* The company was part of a group. Therefore, the Board of the entity was under the control of the parent company.
* Matters relating to the company were taken up at board level.
* 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 | 5 | - | **9** |
| Regulated by FSC | 1 | - | - | **1** |
| Regulated by BOM | 1 | - | - | **1** |
| Other PIEs | 1 | 14 | 1 | **16** |
| **Total** | **7** | **19** | **1** | **27** |

7 out of 27 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 undertook to consider the appointment of one Executive director in the future, should the need arise.
  + The Board comprised of Directors with extensive management backgrounds and ranges of experience. The company was part of a group and accordingly senior and executive management of the holding company were involved in the management and oversight of the Company's operations.
  + The Board was satisfied that given the size of the Company, that having the Managing Director on the Board and the Finance Manager attending Board meetings was in accordance with the Code’s spirit regarding executive’s presence on the Board.
  + The board was of the view that the current composition was adequately balanced given the present structure of the company.
  + The Board was of opinion that its size and composition are optimal for the effective executive of its responsibilities.
  + Based on the nature of its activities, the company did not consider it necessary to appoint additional executive directors.
  + The Board was of the view that the attendance and participation of senior executives during the board deliberations met the spirit of the Code.
  + All the activities of the company were conducted at group level and the board was ultimately accountable for the performance and affairs of the company.
  + The Company was in the process of appointing additional executive directors.
  + The Board of directors had the right mix of expertise, experience and gender to fully discharge all its functions. All the shareholders of the Company were represented on the Board.

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, 15 PIEs had not disclosed information on committees, but explanations were provided in this regard.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **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, and no explanations provided** | **Total** |
| Listed on SEM | 8 | 1 | - | **9** |
| Regulated by FSC | - | 1 | - | **1** |
| Regulated by BOM | 1 | - | - | **1** |
| Category 4 PIEs as per the FRA | 2 | 13 | 1 | **16** |
| **Total** | **11** | **15** | **1** | **27** |

The 15 PIEs explained the following:

* Discussions were under review to constitute a Board Committee.
* The board performed the duties of audit review and corporate governance committee. The board had not considered the need of delegating authority to board committees due to the present structure of the company.
* There were no Committees as the entity was a small size company with only one Executive Director. All decisions in respect of Corporate Governance and Audit and Risks, adoption of policies and best practices were taken by the Board of Directors.
* No Board committee had been set up as this had been done at the level of the parent company. The company was a family owned business and the shareholders were adequately represented on the board of directors.
* Based on the business model of the Company and its lack of employees, no Remuneration Committee, Corporate Governance and Nomination Committees had not been established and as the Company evolves, these would be considered.

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** | **Total** |
| Listed on SEM | 3 | 6 | **9** |
| Regulated by FSC | 1 | - | **1** |
| Regulated by BOM | 1 | - | **1** |
| Category 4 PIEs as per the FRA | 10 | 6 | **16** |
| **Total** | **15** | **12** | **27** |

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

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

1. **Risk management**

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

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

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **PIEs** | **Sections 5.1.7 / 8.4** | | | |
| **Reported on the requirement that risk consideration and management in key risk areas** | **Explanations provided** | **Not Reported on the requirement that risk consideration and management in key risk areas** | **Total** |
| Listed on SEM | 8 | - | 1 | **9** |
| Regulated by FSC | 1 | - | - | **1** |
| Regulated by BOM | 1 | - | - | **1** |
| Category 4 PIEs as per the FRA | 14 | 1 | 1 | **16** |
| **Total** | **24** | **1** | **2** | **27** |

As shown in the table above, FRC noted that 24 out of the 27 PIEs reviewed, had reported on consideration and management of key risks. One PIE explained that no disclosures regarding risk management had been made as risk management issues are dealt with, at group level.

1. **Internal Audit**

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

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **PIEs** | **Section 5.3** | | | |
| **Reported on internal audit** | **Explanations provided** | **Not reported on internal audit and explanation not provided** | **Total** |
| Listed on SEM | 8 | - | 1 | 9 |
| Regulated by FSC | - | 1 | - | 1 |
| Regulated by BOM | 1 | - | - | 1 |
| Category 4 PIEs as per the FRA | 12 | 4 | - | 16 |
| Total | 21 | 5 | 1 | 27 |

The table above shows that 6 PIEs had not made disclosures in the annual report for their internal audit function, as per the requirement of the code. Out of these 6 PIEs, 5 had explained the following:

* Internal audit function was being discharged at group level.
* There was no internal audit function due to the size of the company.
* The company was in the process of implementing a proper Corporate Governance Structure.
* The Board was of the opinion that it was not necessary to set up an internal audit function for the time being. However, the Board ensured that effective controls were in place.

With respect to the 1 PIE that had not provided information on internal audit function, FRC draws its attention to Section 5 Risk Management, Internal Control and Internal Audit, Paragraph 5.3 (Page 37) of the Code of Corporate Governance which states that companies should have an effective internal audit function that has the respect, confidence and co-operation of both the board and management.

* **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 Accounting and Auditing);
* Description of the methods used by the directors for internal control (section 5 Risk Management, Internal Control and Internal Audit);
* Detailed time table specifying important events (section 8 Communication and Disclosure); and
* Material clauses of the company’s constitution (Section 8 Communication and Disclosure).

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

FRC observed that 1 PIE had provided explanations for not submitting a corporate governance report.

The entity stated that the Company was a family business, owned, managed and directed by the shareholders themselves. The system by which the Company was directed, managed and controlled was in the interest of all its stakeholders. The strength of the Company was its reputation and its ability to achieve its objectives. The Company had so far ensured compliance with all the relevant legal and statutory requirements.

This PIE was reminded to henceforth adopt the code of corporate governance and comply with section 75 of the Financial Reporting Act (“FRA”).

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

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

From the 28 Annual Reports reviewed, FRC observed that the **auditors** of:

* **27 PIEs** [9 listed (1 BIF, 2 Commerce, 1 Industry, 1 Information Technology, 1 Leisure & Hotels, 2 Others and 1 Sugar), 1 regulated by BOM, 1 PIE regulated by FSC and 16 in Category 4 of the FRA (including 3 public] **had reported on the consistency of the requirements of the Code; and**
* **1 PIE** in Category 4 of the Financial Reporting Act **had not reported on the consistency of the requirements of the Code.**

In this respect, the auditor took note of the requirements of the Guidelines on Reporting on Compliance with the Code of Corporate Governance – Government Gazette No. 64 of 20 July 2013, General Notice No. 1819.

**3. Liquidity risk**

During the annual report review exercise, FRC noted that **4 PIEs** [1 listed entity involved in Sugar and 3 PIEs in Category 4] **had indicators of potential going concern problem such as loss for the year, revenue deficit, negative cash flows and net current liabilities.**

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

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

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

1. **Legal requirements for PIEs**

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

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

With respect to audit and non-audit fees, the following observations were made following the 28 reviews:

* **14 PIEs** [5 listed (1 Commerce, 1 Information Technology, 1 Leisure and Hotels, 1 Others and 1 Sugar), 1 regulated by FSC and 8 PIEs in Category 4 (including 1 public)] **had paid fees for audit services only.**
* **12 PIEs** [4 listed (1 BIF, 1 Commerce, 1 Industry and 1 Others), 1 PIE regulated by BOM and 7 PIEs in Category 4 (including 2 public)] **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.**
* **2 PIEs** in Category 4 **had not disclosed the audit and/or non-audit fees after having complied with sections 218(2) and 221(4) of the Companies Act 2001.**

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 28 annual reports reviewed, FRC made the following observations:

* 39% of companies discussed their corporate strategies
* 68% of the entities made disclosures regarding their business objectives;
* 36% of firms discussed values and principles;
* 100% of the PIEs provided a description of their businesses and scope; and
* 14% 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.

**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 2015, FRC reviewed the annual reports of 9 listed companies and noted that their market capitalisation approximately totalled Rs 9,312,866,106.

3 PIEs that were the most capitalised were involved in transportation, Insurance and healthcare services. The entities that were least capitalised were engaged in commerce.

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

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

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Types of reviews** | **Type of audit firm** | | | | | |
| **Big Audit Firms** | **More than two partners Audit firm** | **Two Partners Audit Firm** | **One Partner Audit Firm** | **Sole Practitioner** | **Total** |
| Listed on SEM | 8 | - | - | 1 | - | **9** |
| Financial institutions regulated by BOM (excluding cash dealers) | 1 | - | - | - | - | **1** |
| Financial institutions regulated by FSC | 1 | - | - | - | - | **1** |
| Category 4 PIEs as per the FRA | 13 | 1 | 3 | - | - | **17** |
| **Total** | **23** | **1** | **3** | **1** | **-** | **28** |

From the above table, FRC noted the following for the 28 PIEs reviewed:

* 23 representing 82% of the PIEs (8 listed, 1 BOM, 1 FSC and 13 PIEs in Category 4) were audited by Big Audit Firms (namely PWC, Deloitte, BDO, Ernst and Young, KPMG and Grant Thornton);
* 1 PIE was audited by more than two partners audit firm;
* 3 PIEs had a two-partners firm as auditor; and
* 1 PIE had as auditor a one partner firm.

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

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

During the period under review, 14 follow up reviews were undertaken. These consisted of PIEs in Category 4 which had obtained Grade 2B during the previous reviews. They were from the following sectors:

* Commerce (3)
* Industry (2)
* Information Technology (1)
* Investments (2)
* Leisure & Hotels (2)
* Others (3)
* Property development (1)

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

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.

**1.1 IFRS compliance**

During the follow up reviews, FRC informed the PIEs of the following issues with regards to IFRS.

**1.1.1 Recurrent issues**

**There were certain non-compliances which were reiterated as they were not properly addressed in the current annual reports:**

**3 PIEs** in Category 4 **had again not complied with the following IFRSs:**

* **IAS 18, Revenue (paragraph 30(c))**
* Recognition policy of dividend income
* **IAS 19, Employee Benefits (paragraphs 139(b), 142 and 143)**
  + Description of the risks to which the defined benefit plan exposes the entity.
  + Disaggregation of the fair value of the plan assets into classes that distinguish the nature and risks of those assets.
  + The fair value of the entity’s own transferable financial instruments held as plan assets, and the fair value of plan assets that are property occupied by, or other assets used by, the entity.
* **IFRS 7, Financial Instruments: Disclosures (paragraphs 33(b) and 40)**
  + Management of financial risks.
  + A sensitivity analysis for each type of market risk to which the entity is exposed.
* [**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) **(paragraph 93(b))**
  + The level of the fair value hierarchy within which the fair value measurements of assets and liabilities are categorised in their entirety.

**1.1.2 Other non-compliances with respect to IFRSs 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 3 PIEs** in Category 4 **had not adequately disclosed the following in accordance with IFRSs:**

* **IAS 1, Presentation of Financial Statements (paragraphs 97 and 117)**
  + 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.
* **IAS 2, Inventories (paragraphs 36(a), 36(b) and 36(d))**
  + Accounting policies adopted in measuring inventories, including the cost formula used.
  + Total carrying amount of inventories and the carrying amount in classifications appropriate to the entity.
  + Amount of inventories recognised as an expense during the period.
* **IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors (paragraph 31)**
  + Nature of the impending change or changes in accounting policy for newly issued Standards and Amendments.
* **IAS 17, Leases (paragraphs 31 (a) and 31 (e))**
* For each class of asset, the net carrying amount at the end of the reporting period.
* A general description of the lessee’s material leasing arrangements.
* **IAS 19, Employee Benefits (paragraphs139 (b) and 147(b))**
  + A description of the risks to which the plan exposes the entity.
  + The expected contributions to the plan for the next annual reporting period.
* **IAS 24,** [**Related Party Disclosures**](file:///\\frcdatasrv01\Guidancenotes\Bulletin\2014\Bulletin%20(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 different categories.
  + Details of the terms and conditions of their related party transactions including whether they are secured, the nature of the consideration to be provided in settlement and details of any guarantees given or received.
* **IFRS 2, Share Based Payment (paragraphs 44, 50 and 51)**
  + Information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period.
  + Information that enables users of the financial statements to understand the effect of share-based payment transactions on the entity’s profit or loss for the period and on its financial position.
* **IFRS 7, Financial Instruments: Disclosures (paragraphs 33, 36(c) and 37)**
  + Exposure to financial risks and management of these risks.
  + Information about the credit quality of financial assets that are neither past due nor impaired.
  + 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.

**1.2 Compliance with the code of corporate governance**

From the follow up reviews, FRC noted the following issues raised 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 4 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).

* The number of times the board committee met during the year and the directors’ attendance details (Section 8 of the code).
* Profile of senior management team (Section 8 of the code).
  + 1. **Other non-compliances with respect to corporate governance arising from the follow-up reviews**

**FRC informed 3 PIEs in Category 4 of the following new issues with respect to corporate governance, arising from its follow up reviews:**

* Composition of board and board committees (Sections 2 and 3 of the code).
* Information on internal audit (Section 5 of the code).
* The number of times the board committee met during the year (Section 8 of the code).
* Policies and practices as regards social and environmental issues (Section 8 of the code).
* Identification and management of risks(Section 8 of the code).
* Detailed time table specifying important events (section 8 of the code).
* Profile of each member of the senior management team (section 8 of the code).

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

FRC had graded the quality of the 42 annual reports reviewed (28 full reviews and 14 follow up reviews) for the six months ended 31 December 2015.

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

• Good (Grade 1)

• Acceptable with limited improvements required (Grade 2A)

• Acceptable overall with improvements required (Grade 2B)

• Significant improvements required (Grade 3)

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

Out of the 42 PIEs reviewed, FRC noted that:

* 1 PIE had received a grade of 1;
* 23 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 1** | **Grade 2A** | **Grade 2B** | **Grade 3** |  |
| Listed on SEM | 6 | 3 | - | - | - | - | - | **9** |
| Financial institutions regulated by BOM (excluding cash dealers) | 1 | - | - | - | - | - | - | **1** |
| Financial institutions regulated by FSC | - | 1 | - | - | - | - | - | **1** |
| Category 4 PIEs as per the FRA | 7 | 9 | 1 | 1 | 9 | 3 | 1 | **31** |
| **Total** | **14** | **13** | **1** | **1** | **9** | **3** | **1** | **42** |

A follow up review was carried out with respect to the 14 entities who had received grades 3 and 2B in their previous reviews and FRC observed the following during the follow up exercise:

* 9 PIEs had been granted grade 2A;
* 1 PIE obtained grade 1;
* 3 PIEs still obtained the same grade (2B) as compared to last year; and
* 1 PIE received grade 3.

From the 3 PIEs that had still obtained grade 2B as in previous year, FRC raised various non compliances with respect to corporate governance:

* Composition of board committees (Section 3 of the code).
* The number of times the board committee met during the year (Section 8 of the code).
* Detailed time table specifying important events (Section 8 of the code).
* Profile of each member of the senior management team (Section 8 of the code).

With respect to the PIE whose grading had moved from grade 2B to 3, FRC observed that various non-compliances arose due to a change in the format and content of the annual report arising from a change in auditor.

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

From the reviews carried out, it has been observed that the number of non-compliances relating to disclosures has been reduced. FRC had raised non-compliances with respect to disclosures in cases where new IFRS or amended IFRS have been adopted.

Also, the level of compliance with the Code of Corporate Governance and IFRS has improved which indicates that the PIEs are aware of the importance of quality reporting.

**Financial Reporting Council**

**19 January 2016**