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Financial Reporting Council

**Bulletin on Review of Annual Reports for the six months ended 31 December 2016**

**Introduction**

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The annual report is a carbon copy of the business image of an entity. The fact is that the annual report has to be prepared in accordance with the relevant laws, regulations and standards which are safeguards for transparency, fairness and good governance.

An annual report which is prepared in compliance with the relevant laws and standards ignites confidence among the stakeholders who use it for decision making for their respective purposes.

The objective of FRC amongst others is to promote the provision of high quality reporting of financial and non-financial information by Public Interest Entities (“PIEs”). To this effect, FRC reviews the annual reports of PIEs.

For the six months ended 31 December 2016, FRC has reviewed 50 PIEs which included 35 PIEs within 2 group of companies and 15 other PIEs.

2 annual reports reviewed were for year ended December 2014, 21 for June 2015, 3 for September 2015, 1 for October 2015 and 23 for December 2015.

The table below indicates the categories of PIEs and their corresponding sectors for the entities whose annual reports were reviewed.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** | **Sectors** | | | | | | | | | | |
| **BIF** | **Commerce** | **Industry** | **Information Technology** | **Investment** | **Leisure & Hotels** | **Others** | **Property Development** | **Sugar** | **Transport** | **Total** |
| Listed on SEM | 4 | 2 | 4 | - | 7 | 2 | 3 | - | 1 | - | 23 |
| Financial institutions regulated by FSC | 3 | - | - | - | - | - | - | - | - | - | 3 |
| Category 4 PIEs as per the FRA | - | 2 | 3 | 2 | 5 | 2 | 3 | 3 | - | 1 | 21 |
| SOEs as per the First Schedule of FRA | - | - | 1 | - | - | - | 1 | - | - | 1 | 3 |
| **Total** | **7** | **4** | **8** | **2** | **12** | **4** | **7** | **3** | **1** | **2** | **50** |

*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.*

1. **Group Reviews**

The objective for reviewing PIEs within the groups is to have a better understanding of the group structure and the businesses undertaken within the groups, which in turn provides deep insight in the disclosures made by the companies in their respective annual reports.

This type of review also helps to identify any irregular transactions among the entities within the groups, which might not be possible if an individual approach is adopted for companies within a group.

Group reviews were mainly based on focused areas of IFRSs significant to the business of the respective PIEs. In this regard, the objectives of the Group review exercise are to:

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

For the six months ended 31 December 2016, FRC carried out the review of 2 groups with 35 PIEs.

The first group (‘Group 1’) of companies selected for review, consisted of 23 companies which meet the definition of Public Interest Entities under the Financial Reporting Act.

The principal activity of the holding company of Group 1 is that of investment holding. Group 1 operates under various business clusters as detailed below:

1. Investment

2. Commercial

3. Property

4. Lifestyle

5. Agribusiness

An analysis of Group 1’s reviews by types of PIEs and their corresponding sectors is set out in the following table:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** |  | **Sectors** | | | | | | | | |
| **BIF** | **Commerce** | **Information Technology** | **Industry** | **Investment** | **Leisure & Hotels** | **Others** | **Property Development** | **Trans-port** | **Total** |
| Listed on SEM | 1 | 1 | - | - | 5 | 1 | - | - | - | 8 |
| Financial institutions regulated by FSC | 1 | - | - | - | - | - | - | - | - | 1 |
| Category 4 PIEs as per the FRA | - | 1 | 1 | 2 | 2 | 2 | 2 | 3 | 1 | 14 |
| **Total** | **2** | **2** | **1** | **2** | **7** | **3** | **2** | **3** | **1** | **23** |

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The second group reviewed (‘Group 2’) had 12 entities, classified as Public Interest Entities under the First Schedule of the Financial Reporting Act.

The principal activity of the holding company of Group 2 is that of investment holding. Group 2 operates in the following business clusters:

1. Real Estate
2. Commercial & financial services
3. Tourism & Hospitality
4. Energy
5. Information technology
6. Food & Beverages
7. Home & Personal Care

The table below illustrates the sectors under which group 2’s companies operate by type of PIEs:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** | **Sectors** | | | | | | |
| **BIF** | **Commerce** | **Information Technology** | **Industry** | **Investment** | **Others** | **Total** |
| Listed on SEM | - | 1 | - | 3 | - | - | 4 |
| Financial institutions regulated by FSC | 2 | - | - | - | - | - | 2 |
| Category 4 PIEs as per the FRA | - | 1 | 1 | - | 3 | 1 | 6 |
| **Total** | **2** | **2** | **1** | **3** | **3** | **1** | **12** |

1. **Review of other entities**

Also, apart from the group review, FRC selected the annual reports of the following types of PIEs for its review exercise:

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

For the six months ended 31 December 2016, FRC conducted the annual report reviews of 15 other entities. The table below illustrates type of PIEs per sector:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** | **Sectors** | | | | | | | |
| **BIF** | **Industry** | **Investment** | **Leisure & Hotels** | **Others** | **Sugar** | **Transport** | **Total** |
| Listed on SEM | 3 | 1 | 2 | 1 | 3 | 1 | - | **11** |
| Category 4 PIEs as per the FRA | - | 1 | - | - | - | - | - | **1** |
| SOEs as per the First Schedule of FRA | - | 1 | - | - | 1 | - | 1 | **3** |
| **Total** | **3** | **3** | **2** | **1** | **4** | **1** | **1** | **15** |

1. **Compliance with IFRS and the National Code of Corporate Governance**

Section 75 of Financial Reporting Act requires a Public Interest Entity to prepare its financial statements in compliance with IFRS and to adopt corporate governance in accordance with the National Code of Corporate Governance.

In line with the above requirements, FRC has carried out group reviews and reviews of other entities to monitor the annual reports of the PIEs so as to ensure quality reporting.

From these reviews, FRC noted that in most cases the PIEs had not complied fully with the requirements of the following IFRS:

1. IAS 1, Presentation of Financial Statements
2. IAS 19, Employee Benefits
3. IAS 24, Related Parties
4. IFRS 3, Business Combinations
5. IFRS 7, Financial Instruments: Disclosures
6. IFRS 13, Fair Value Measurement

The report on Corporate Governance provided in the annual reports of the PIEs was also reviewed and non-compliances with the National Code of Corporate Governance were identified in the following areas as part of the review of the other entities:

1. Information on board composition (section 2 of the code)
2. Disclosures on board committees (section 3 of the code)
3. Details of internal audit function (section 5 of the code)

Details of the non-compliances raised during the review exercise are provided at paragraphs 1.0 and 2.0 below.

**Contents**

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

1. Main findings from the Group Reviews
   1. [Compliances with regard to International Financial Reporting Standards (IFRSs)](#OLE_LINK1)
   2. [Other issues](#Other)

1.3 [Issues raised with auditors](#Issues)

2.0 Main findings from other entities

2.1 [Compliances with regard to International Financial Reporting Standards (IFRSs)](#Compliances)

* 1. [Compliances with regard to corporate governance](#OLE_LINK4)
  2. [Reporting by Auditors in compliance with Section 39(3) of the FR Act](#Reporting)

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

2.5 [Non-financial information](#Non)

2.6 [Market Capitalisation](#Market)

**[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**

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

**PART A - Full reviews**

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* 1. **Main findings from Group Reviews**

FRC had selected 35 PIEs for group reviews. These included 12 listed entities, 3 financial institutions regulated by FSC and 20 Category 4 PIEs.

The sectors under which they operate are illustrated in the table below

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Types of PIEs** |  | **Sectors** | | | | | | | | |
| **BIF** | **Commerce** | **Information Technology** | **Industry** | **Investment** | **Leisure & Hotels** | **Others** | **Property Development** | **Trans-port** | **Total** |
| Listed on SEM | 1 | 2 | - | 3 | 5 | 1 | - | - | - | 12 |
| Financial institutions regulated by FSC | 3 | - | - | - | - | - | - | - | - | 3 |
| Category 4 PIEs as per the FRA | - | 2 | 2 | 2 | 5 | 2 | 3 | 3 | 1 | 20 |
| **Total** | **4** | **4** | **2** | **5** | **10** | **3** | **3** | **3** | **1** | **35** |

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

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

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

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

1. IAS 1, Presentation of Financial Statements

**FRC informed 19 PIEs** [6 listed (2 Industry, 3 Investment and 1 Leisure & Hotels), 1 regulated by FSC and 12 PIEs in Category 4] **within the groups** **of non-compliances in respect of the following requirements of IAS 1:**

* Accounting policies on revenue from sales of services, other operating income, investment in equity instruments, finance leases, transfer of property, leasehold rights, foreign currency, impairment and assets held for sale;
* Detailed information on rental income, revaluation adjustments, intangible assets and other income; and
* Description of the nature and purpose of capital reserve; and
  + Description of description of the nature of the entity’s operations and its principal activities.

1. IAS 19, Employee Benefits

**With regard to IAS 19, FRC queried 12 PIEs** [2 listed (1 Investment and 1 Leisure & Hotels) 1 regulated by FSC and 9 PIEs in Category 4] **reviewed within the groups** **in respect of the following:**

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

1. IAS 24, Related Parties

**FRC informed 14 PIEs in the groups** [5 listed (1 BIF, 1 Industry, 2 Investment and 1 Leisure & Hotels) and 9 PIEs in Category 4] **of issues relating to IAS 24 requirements:**

* Classification of key management compensation;
  + Terms and conditions of related parties’ outstanding balances including whether they are secured, and the nature of consideration to be provided in settlement; and
* Information on related parties, management fees and loans.

1. IFRS 3, Business Combinations

**FRC observed that 4 PIEs** [2 listed in Investment and 2 PIEs in Category 4] **within the groups, had not disclosed the following information that enables users of financial statements to evaluate the nature and financial effect of a business combination as per IFRS 3:**

* + Primary reasons for the business combination;
* Revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period; and
* Qualitative description of the factors that make up the goodwill recognised.

1. IFRS 7, Financial Instruments: Disclosures

**FRC informed 10 PIEs** [1 listed in Investment, 2 regulated by FSC and 7 PIEs in Category 4] **within the groups, of their non-compliances with the following requirements of IFRS 7**:

* + Objectives, policies and processes for managing financial risks and the methods used to measure the risk;
  + Maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities;
  + Sensitivity analysis with respects to price risk;
  + Analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired; and
  + Fair value of the collateral held, sold or repledged and the terms and conditions associated with its use of the collateral.

1. IFRS 8, Operating Segments

IFRS 8 *Operating Segments* is applicable to listed entities. With respect to the 12 listed entities reviewed within the groups, the following observations were made**:**

1. **8 entities** [1 BIF, 2 Commerce, 3 Industry and 2 Investment] **had fully complied with the requirements of IFRS 8.**
2. **1 PIE** involved in Investment **had not disclosed the requirements of IFRS 8 as this IFRS was not applicable given that the entity did not have more than one operating segment due to the nature of its business.**
3. **3 PIEs** [2 Investment and 1 Leisure & Hotels] **had not disclosed:**
   * + Basis of accounting for its inter-segment transactions;
     + Information relating to interest revenue, interest expense and income tax expense or income for each reportable segment; and
     + Geographical information.
4. [IFRS 13, Fair Value Measurement](file:///\\frcdatasrv01\Guidancenotes\Bulletin\2014\Bulletin%20(July%20to%20Dec%202014)\Methodology%20Manual\IFRS%2013%20-%20Fair%20Value%20Measurement.doc)

**From the annual reports of 5 PIEs** [1 listed involved in Investment and 4 PIEs in Category 4] **of the groups, FRC identified issues, which related to the following requirements of IFRS 13:**

* The level of the fair value hierarchy within which the fair value measurements of assets and liabilities are categorised in their entirety;
  + For recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances; and
* Description of the valuation technique(s) and the inputs used in fair value measurement.
  1. **Other issues**

Furthermore, FRC observed the following issues arising during the course of the group reviews:

1. 1 PIE in Category 4 had not reported on Corporate Governance and had not enclosed a Statement of Compliance in its Annual Report (Section 75 of the Financial Reporting Act 2004 and Government Gazette No. 32 of 13 April 2013, General Notice No. 1016 refer).
2. 1 PIE in Category 4 had a wholly owned subsidiary (a Category 4 PIE) which had liquidity indicators such as negative cash flows and net current liability. The latter issued shares to its holding company to maintain its shareholders’ funds. FRC was of the view that the subsidiary’s adverse liquidity position might indicate that the investment held by the holding company had been impaired.
   1. **Issues raised with auditors**

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

**During the course of its review, FRC informed the auditors of 7 PIEs** **within the group** [3 listed (1 Industry, 1 Investment and 1 Leisure & Hotels) and 4 Category 4 PIEs] **of the following issues noted from their audit reports:**

1. Provision of other services

The auditors of 2 PIEs [1 listed in Investment and 1 Category 4 PIE] within the groups had provided other services such as insurance claim preparation cost and review of consolidated pack.

1. Going concern risk

3 PIEs [2 listed (1 Industry, and 1 Leisure & Hotels) and 1 Category 4 PIE] in the groups had indicators of going concern risks that may cast doubt on the entity’s ability to continue as a going concern.

1. Capitalisation of receivables

A listed company engaged in Leisure & Hotels had capitalised receivables into investment in subsidiaries.

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

With respect to the 15 other PIEs reviewed, FRC identified issues relating to the following areas of corporate reporting during the six months ended 31 December 2016:

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

1. IAS 1, Presentation of Financial Statements

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

* Relevant accounting policies for financial liabilities at fair value through profit or loss, customer portfolio, other income, leases, functional/presentation currency and joint venture; and
* Information on inventories, other payables and supplies and services

1. IAS 19, Employee Benefits

**With regard to IAS 19, FRC queried 6 other PIEs** [3 listed (1 Investment, 1 Sugar and 1 Others) and 3 State Owned Enterprises as per the First Schedule of FRA] **reviewed within the groups** **in respect of the following:**

* Significant risks to which the entity was exposed through its defined benefit plan;
* 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;
* Description of any funding arrangements and funding policy that affect future contributions and the expected contributions to the plan for the next annual reporting period; and
* Fair value of the plan assets into classes that distinguish the nature and risks of those assets.

1. IFRS 7, Financial Instruments: Disclosures

From the review exercise, **FRC observed that 2 PIEs** [1 listed entity involved in Sugar and 1 State Owned Enterprise as per the First Schedule of FRA] **had partly complied with IFRS 7.**

The following disclosures as per IFRS 7 were found missing:

* Management of financial risks;
* Information in respect of forward foreign exchange contracts that is, type of hedging relationship and the related recognition and measurement criteria;
* Sensitivity analysis;
* Maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

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

**From the annual reports of 2 PIEs** [1 listed in BIF and 1 PIE in Category 4] **of the groups, FRC identified issues which related to the following requirements of IFRS 13:**

* + For recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances; and
  + Description of the valuation technique(s) and the inputs used in fair value measurement.
  1. **Compliances with corporate governance**

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

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

FRC noted that all the 15 other entities had submitted a corporate governance report and that 4 out of these 15 PIEs had partly complied with the Code.

Also, FRC observed that the non-compliances and explanations provided for not complying with the National Code of Corporate Governance related mainly to the following:

* Composition of the Board (section 2 of the code);
* Information on board committees (section 3 of the code);
* Details of internal audit function (section 5 of the code).

1. Information on the Board of Directors

As per the code of corporate governance of Mauritius, a company should have appropriate balance of executive, non-executive and independent directors. This enables the company to make sound decision with competent board members having 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 as illustrated below.

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

As depicted in figure below, out of 15 PIEs, 10 entities had at least 2 independent directors on their boards in line with section 2.2.2 of the code of corporate governance. The remaining entities 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 | 11 | - | - | **11** |
| Category 4 PIEs as per the FRA | - | - | 1 | **1** |
| SOEs as per the First Schedule of FRA | - | 3 | **-** | **3** |
| **Total** | **11** | **3** | **1** | **15** |

The SOEs provided explanations for not complying with this section of the code of corporate governance. They stated that the appointment of the directors was specified in the SOEs’ dedicated laws.

* 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 | 8 | 2 | 1 | **11** |
| Other PIEs | - | - | 1 | **1** |
| SOEs as per the First Schedule of FRA | - | 3 | **-** | **3** |
| **Total** | **8** | **5** | **2** | **15** |

7 out of the 15 PIEs met the minimum requirement of having 2 executive directors on board as per the code of corporate governance. The rest either explained the reasons for not having executive directors on its board or did not comply at all with this requirement.

The explanations provided by the PIEs are described below:

* The Board was of the view that its present composition was adequately balanced and that current Directors had the range of skills, expertise and experience to carry out their duties properly.
* The appointment of the directors was specified in the PIEs’ dedicated laws.
* The Managing director who is also the Executive Director has the day to day responsibility for the company's operations, implementing the strategies and policies declared by 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, 6 out of 15 PIEs had not disclosed information on committees, but explanations provided in this regard. The PIEs explained the following for not having board committees:

* Due to the nature of business, issues addressed by an Audit Committee and a Corporate Governance Committee were taken up at the subsidiary level.
* An audit committee had already been set up at the level of board. Since the nature of the work at the authority is sensitive, the parent ministry informed that it was not possible to deploy to carry out such tasks. The committee did not meet due to absence of any specific accounting or auditing concerns identified.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PIEs** |  | **Section 3** | | | |
| **Reported on the requirement that all companies should have, at a minimum, an audit committee and a corporate governance committee** | | **Explanations provided** | **Not Reported on the requirement that all companies should have should have, at a minimum, an audit committee and a corporate**  **governance committee and no explanations provided** | **Total** |
| Listed on SEM | 10 | | 1 | **-** | **11** |
| Category 4 PIEs as per the FRA | - | | - | 1 | **1** |
| SOEs as per the First Schedule of FRA | 2 | | 1 | - | **3** |
| **Total** | **12** | | **2** | **1** | **15** |

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** | **Total** |
| Listed on SEM | 10 | 1 | 11 |
| Category 4 PIEs as per the FRA | 1 | - | 1 |
| SOEs as per the First Schedule of FRA | 2 | 1 | 3 |
| Total | 13 | 2 | 15 |

The table above shows that out of the 15 PIEs, 2 PIEs had not made disclosures in the annual report for their internal audit function, but had provided the following explanations:

* The board relies on the subsidiary’s internal audit function. Reasonable assurance over effective internal controls processes and systems are obtained by checks performed by the group internal audit team.
* Since it was not warranted at this stage to hire the services of an internal controller on a full time basis, arrangements was made to carry out an internal audit exercise, as and when required in collaboration with the parent ministry.
  1. **Reporting by Auditors in compliance with Section 39(3) of the FR Act**

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

**It was good to note that the auditors of the 15 PIEs reviewed had reported on the consistency of the requirements of the Code.**

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

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

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

With respect to audit and non-audit fees, the following observations were made for the 15 reviews:

* **7 PIEs** [6 listed (1 BIF, 1 Industry, 1 Investment, 2 Others and 1 Sugar) and 1 PIEs in Category 4] **had paid fees for audit services only.**
* **6 PIEs** [5 listed (2 BIF, 1 Investment, 1 Leisure & Hotels and 1 Others) and 1 Stated Owned Enterprise] **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 of taxation services, human resource and corporate plans, review of statutory return and quarterly figures.**
* **2 Stated Owned Enterprises as per the First Schedule of FRA had not disclosed the audit fees payable to its external auditor as it is not compulsory for them to comply with the requirements of the Companies Act 2001.** 
  1. **Non-financial information**

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

From the 15 annual reports reviewed, FRC made the following observations:

* 40% of companies discussed their corporate strategies
* 47% of the entities made disclosures regarding their business objectives;
* 40% of firms discussed values and principles;
* 100% of the PIEs provided a description of their businesses and scope; and
* 20% mentioned the external forces affecting the entities such as customer, suppliers and competitors.

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

* 1. **Market Capitalisation**

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

For the six months ended 31 December 2016, FRC reviewed the annual reports of 11 listed companies and noted that their market capitalisation approximately totalled Rs 42,967,493,394.

The 3 PIEs with the highest market capitalisation were involved in investment, banking and insurance. The PIEs with the lowest market capitalisation were engaged in sugar and industry.

**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.

For the period under review, 7 follow up reviews were undertaken. These consisted of PIEs which had obtained Grade 2B or had liquidity issues during the previous reviews.

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

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Types of reviews** | **Sectors** | | | | | |
| **Commerce** | **Industry** | **Information Technology** | **Investment** | **Leisure & Hotels** | **Total** |
| Listed on SEM | 1 | - | 1 | - | - | **2** |
| Category 4 PIEs as per the FRA | - | 2 | 1 | 1 | 1 | **5** |
| **Total** | **1** | **2** | **2** | **1** | **1** | **7** |

During the follow-up reviews carried out for the six months ended 31 December 2016, FRC considered whether the issues previously raised in previous full annual report reviews had been properly addressed in the PIEs’ latest annual reports and whether there are still recurrent issues from previous reviews. This would ensure that PIEs had taken corrective actions subsequent to FRC’s previous letters of observations.

From the follow up review exercise, FRC observed the following issues:

1. Recurrent non-compliances

T**he following were not properly addressed in the current annual reports of 3 PIEs in Category 4**:

1. IFRS issues

* Information on cash flow hedge (IFRS 7).
* Estimable information relevant to assessing the possible impact of the application of the new IFRS will have on the entity's financial statements in the period of initial application (IAS 8).
* Fair value of the plan assets into classes that distinguish the nature and risks of those assets (IAS 19).

1. Corporate governance issues

* Composition of the board (section 2 of the code)
* Policies and practices as regards social and environmental issues (section 8 of the code).
* Detailed time table specifying important events (section 8 of the code).
* Exposure and Management of key risks (section 8 of the code).
* The statement of compliance has been signed by two directors instead of the chairperson and one director (guidelines on compliance with corporate governance – published in the Government Gazette No. 32 of 13 April 2013, General Notice No. 1016).

1. Other non-compliances arising from the follow-up reviews

**FRC informed 5 PIEs** [1 listed in Commerce and 4 PIEs in Category 4] **of the following new issues arising from its follow up reviews:**

1. IFRS issues

* Detailed information on other receivables (IAS 1).
* Disclosure on the nature of reclassification, amount of each item or class of items that is reclassified and the reasons for reclassification (IAS 1).
* Information on newly issued Standards and Amendments applicable to the entity (IAS 8).
* Description of risks to which the entity’s defined benefit plan are exposed (IAS 19);
* Terms and conditions attached to related party balances (IAS 24).
* Information that enables users of its financial statements to evaluate the nature and financial effect of a business combination (IFRS 3).
* Management of financial risks (IFRS 7).
* Summarised financial information in respect of the group’s major joint ventures and associates (IFRS 12).
* Preparation of Financial Statements under Indian GAAP instead of IFRS (IFRS 10).

1. Corporate governance issues

* Composition of board (section 2 of the code).
* Remuneration of directors (section 2 of the code).
* Internal Audit Function (section 5 of the code).

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

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

FRC had graded the quality of the 17annual reports reviewed (10 full reviews and 7 follow up reviews) for the six months ended 31 December 2016. The PIEs which had not yet replied to FRC’s queries and for which group reviews had been conducted, were not graded.

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

* Good (Grade 1)
* Acceptable with limited improvements required (Grade 2A)
* Acceptable overall with improvements required (Grade 2B)
* Significant improvements required (Grade 3)

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

Out of the 17 PIEs reviewed, FRC noted that:

* 5 PIEs received a grade 1;
* 7 PIEs a grade of 2A; and
* 5 PIEs had obtained grade 2B.

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 1** | **Grade 2A** | **Grade 2B** | **Grade 1** | **Grade 2A** | **Grade 2B** |  |
| Listed on SEM | 4 | 3 | 1 | 1 | 1 | - | **10** |
| Category 4 PIEs as per the FRA | - | - | 1 | - | 4 | 1 | **6** |
| SOEs as per the First Schedule of FRA | - | - | 1 | - | - | - | **1** |
| **Total** | **4** | **3** | **3** | **1** | **5** | **1** | **17** |

A follow up review was carried out with respect to the 7 entities who had received grades 2B or had liquidity issues during the previous reviews in their previous reviews.

FRC observed the following during the follow up exercise:

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

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

* Estimable information relevant to assessing the possible impact of the application of the new IFRS will have on the entity's financial statements in the period of initial application (IAS 8).
* Disclosure on the nature of reclassification, amount of each item or class of items that is reclassified and the reasons for reclassification (IAS 1).
* Terms and conditions attached to related party balances (IAS 24).
* Management of financial risks (IFRS 7).
* Preparation of Financial Statements under Indian GAAP instead of IFRS (IFRS 10).
* Composition of board (Section 2 of the code).
* Establishment of internal audit function (Section 5 of the code).
* Statement of Compliance had been signed by 2 directors instead of 1 director and the chairman of the company (Guidelines on Compliance with Corporate Governance – Government Gazette No. 32 of 13 April 2013, General Notice No. 1016).

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

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

During the course of the annual report reviews, FRC issued letters of observations to PIEs. In light of FRC’s comments, many PIEs provided explanations and gave undertakings to improve the quality of their future annual reports where relevant. It is good to note that this had led to an improvement in the corporate reporting of PIEs in general.

Going forward, FRC would pay particular attention to the new laws and regulations, and new/revised standards effective in 2016/2017 (including IFRSs) that had been applied in the annual reports of PIEs.

**Financial Reporting Council**

**02 February 2017**