



Governance in Brief

Your summary of the latest corporate governance developments

Headlines

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In Brief: The Financial Reporting Council (FRC) has published 'An Update for Directors of Listed Companies: Responding to increased country and currency risk in financial reports'. Companies are operating in uncertain and volatile times and country and/or currency risks have seen significant change in the last year. This Update aims to support Directors in considering the impact of these risks on their annual and half-yearly reports and guide them in providing a balanced and understandable assessment of the company's position and prospects to stakeholders, who are likely to be paying particular attention to these risks and the company's response to them. Many financial institutions regulated by the Financial Services Authority are building on the enhanced disclosures in this area included at the June half-year.

The Update highlights the more significant issues Directors and Audit Committees may wish to use as a starting point in considering the possible implications of the current economic uncertainties to their business. These include:

- exposure to country risk both through financial instruments and exposure to customers and suppliers;
- the impact of austerity measures being implemented in many countries on the company's forecasts, impairment reviews, assessment of going concern etc.;
- consequences of currency events not factored into forecasts but that may nevertheless impact reported disclosures and sensitivity testing of impairment and going concern considerations; and
- whether there is a post balance sheet event requiring disclosure to avoid misleading investors.

It pulls together many of the various corporate governance responsibilities and financial reporting requirements that could be affected by the current heightened currency and country risks.

Corporate Governance

The current economic uncertainty must be taken into account by Directors in fulfilling their responsibility under the UK Corporate Governance Code (The Code) to provide a balanced and understandable assessment of a company's position and prospects, information on its business model and whether there are risks to it continuing as a going concern. Where a company has significant trading relationships with businesses or governments facing increased uncertainty, the Update states that Directors should explain how the company's business model and financial position might be affected by a default or other significant event. Although not specified, a significant event could include a country exiting the Eurozone.

Financial reporting

A material exposure to country and/or currency risk may have a number of financial reporting implications. The Update highlights some of these although it is emphasised that it is not intended to be a comprehensive list. Companies should bear in mind the overarching requirement in Company Law that financial statements provide a true and fair view. Additional disclosure may be required where an issue is not specifically required by the law and accounting standards.

Going concern – the Listing Rules and IFRSs require the Directors to make an assessment of the entity's ability to continue as a going concern and to make specific disclosures. Currency and country risk may impact the forecasts and key assumptions used to make this assessment.

Business review – the Companies Act requires a description of the principal risks and uncertainties facing the business. These disclosures may need to be enhanced where a company is facing increased risk in this area e.g. where there is a risk that outstanding balances may not be recovered or future sales are uncertain. An explanation of the actions a company is taking to mitigate the effects of the risks helps the reader understand the exposure. The Financial Reporting Review Panel has stated it would expect to see such disclosure in the annual report.

Potential impairment of non-financial assets – a material exposure to these risks could trigger impairment assessments for assets such as goodwill, property plant and equipment and intangibles, particularly where the carrying value of the assets is justified through an impairment review based on future cash flows.

Potential impairment of financial assets – impairment reviews may be required and Directors should also consider the impact current economic conditions have on the extensive risk disclosures required to be made in respect of financial instruments held by the company. Concentrations of risk could include exposure to a particular currency and/or country.

Risk of change in carrying amount of assets and liabilities – where there is a risk that the carrying amount of assets and liabilities could change as a result of uncertain estimates, the source of uncertainty is required to be disclosed along with assumptions in accordance with IFRSs.

Structure of reporting

To aid transparency to readers of the annual report, it is advisable to bring together, in one section of the annual or interim report, the above disclosures so that the effects and risks of the most recent crisis are more easily understood.

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Source: The Financial Reporting Council

Further info: <http://www.frc.org.uk/press/pub2694.html>

Time to take action

- Re-visit the principal risks and uncertainties disclosed by the company in the annual report to ensure that they remain pertinent.
- Ensure you have a coordinated response strategy for the Eurozone crisis by identifying areas of likely exposure (e.g. due to redenomination risk), assessing their financial impact (potential impact on balance sheet and income statement), taking steps to manage and minimise such exposures and evaluating the impact of potential Eurozone scenarios on the strategy and operations of the business covering key areas such as:
 - Supply-chain.
 - Manufacturing.
 - Pricing.
 - Commercial.
 - Demand.

The ensuing mitigation actions should include strategies to offset risks of redenomination and depreciation of a new national currency, short term tactical considerations as well as a long term response in relation to strategy and business model.

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On the horizon

- Consultations on limited changes to the UK Corporate Governance Code in the areas of diversity, audit committees, internal control and risk management and going concern and the related guidance documents plus limited changes to the Stewardship Code. Final documents are likely to be issued in the summer with an effective date of 1 October 2012. There will then be a two year moratorium on changes.
- Legislative proposals from the EC further to the Green Paper on corporate governance.

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