FINANCIAL
REPORTING
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PUBLICATION

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JULY 2019

By All Accounts

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HOW SUSTAINABILITY STANDARDS CAN HELP ACHIEVE SUCCESS

DIGITAL EVOLUTION
HOW TECHNOLOGY COULD CHANGE THE ANNUAL REPORT

BETTER QUALITY
JAKE GREEN'S TOP THREE FRS 102 APPLICATION ISSUES

A WORLD TO SUSTAIN

Former HSBC group chief accounting officer Russell Picot on the role of reporting in addressing climate change

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Member saving	£5,290.00
Revised on the road price	£36,720.00
Total amount of credit	£31,611.76
Interest charges	£4,822.12
Total amount payable	£41,542.11
Duration of agreement (months)	49
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Optional final payment	£17,281.88
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Figures shown are for comparability purposes; only compare fuel consumption and CO_2 figures with other cars tested to the same technical procedures. These figures may not reflect real life driving results, which will depend upon a number of factors including the accessories fitted (post-registration), variations in weather, driving styles and vehicle load. **There is a new test used for fuel consumption and CO_2 figures. The CO_2 figures shown, however, are based on the outgoing test cycle and will be used to calculate vehicle tax on first registration. Preliminary data. Please contact your retailer for latest information.

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July 2019

It's good to talk!

According to a recent poll, talking about the weather is considered to be one of the most typically British traits. Although recently, it's not so much been the topic of polite small-talk but rather the subject of some hard-hitting headlines.

Climate change has been raised in people's consciences by recent TV documentaries, as well as by teenage activist Greta Thunberg and Extinction Rebellion protests. There's no doubt that people are talking about climate change more than ever and such conversations are often the first step towards positive action. As they say, it's good to talk!

Russell Picot, former group chief accounting officer at HSBC, has been at the forefront of initiatives for many years to encourage the accountancy profession to consider climate risk and sustainability more widely. In this edition's interview, we talk with him about the importance of climate change being considered a mainstream risk by business and why the time may have come for mandatory disclosures. Continuing the theme, we have an article on page 22 from the Sustainability Accounting Standards Board on how its new sustainability standards can help companies achieve long-term success.

Headlines in the business pages have continued to be filled with the fallout from high-profile corporate failures and the subsequent launch of various inquiries. Although most of the focus is on reforming audit, Sir John Kingman's review also examined the role and effectiveness of the Financial Reporting Council. Those of his recommendations aimed specifically at improving corporate reporting and enhancing regulatory powers are outlined on page 14.

For IFRS reporters, first-time implementation of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* has been a focus in the recent reporting season. As might be expected, some challenges have come to light during implementation. A panel of experts considers the most common challenges on page 12. Following hot on the heels of IFRSs 9 and 15, IFRS 16 *Leases* is next up for implementation; on page 10 we have an article looking at the potential effects of IFRS 16 that have received less airtime to date.

For our UK GAAP audience, Jake Green considers his top three FRS 102 application issues on page 16. Section 1A's disclosure requirements for small entities come under the spotlight on page 18; and on page 19 John Selwood again answers your UK GAAP questions in Question Corner. We also have articles looking at how technology might affect the annual report and covering our latest publication, a guide for audit committees of smaller quoted companies along with our regular international news and IFRS roundup features.

Whatever the weather might be, I hope you enjoy reading the magazine!

Sally Baker.

Sally Baker FCA
Technical Manager, Financial Reporting Faculty

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FACULTY NEWS

A NEW LOOK FOR FINANCIAL REPORTING ON ICAEW.COM

We have been working hard to improve the way you can access financial reporting resources on ICAEW's website and bring to the surface the most relevant and recent content.

The financial reporting landing page (icaew.com/financialreporting) displays content according to topic areas, for example UK GAAP and IFRS. We have added further categories and included content from across ICAEW. We have also included links to the most popular items, for example eIFRS (for faculty members) and illustrative accounts and checklists.

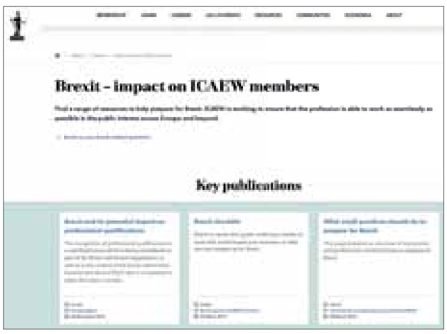
The Financial Reporting Faculty page highlights content according to content type and the key focus is on the premium content available exclusively to faculty members. Here you will find access to the faculty's factsheets, webinar recordings, *By All Accounts* magazine and much more.

A lot of work has also been done to improve our pages on UK GAAP and IFRS accounting standards. These pages now bring together content from the faculty, the Library and the Technical Advisory Service. Each accounting standard has a shortform (eg, icaew.com/frs102 or icaew.com/ifrs16) to take you directly to the content on that topic.

Work is now under way to improve some of the specific areas by updating and generating more content. This is an ongoing project as we strive to constantly improve what we deliver to both ICAEW and faculty members.

We have already seen a marked improvement in the performance of our pages in searches, so we hope you are finding your way more easily to the content you are looking for.

We would very much appreciate your feedback on what we have done so far and what you consider to be a priority for our focus going forward. Please email us at frfac@icaew.com with your suggestions.



BREXIT GUIDE

At the time of writing, Brexit negotiations are ongoing, posing a challenge for UK businesses preparing accounts. Early in 2019 we published a guide, *Brexit and financial reporting: preparing FRS 102 accounts for 2018/19*, which looks at typical areas in the accounts that would be affected in times of uncertainty. A range of other Brexit-related resources are available at icaew.com/brexit

RECENT FACTSHEETS

As 'new UK GAAP' is no longer so new we have replaced *An Introduction to FRS 102* with *FRS 102 Overview* and published a new factsheet *Preparing and filing UK small entity accounts*. We will also be updating our factsheets *The UK Financial Reporting Regime* and *Reduced Disclosure Framework*.

For IFRS we will shortly be publishing IFRS 9 *Financial Instruments – Hedging* to complement IFRS 9 *Financial Instruments – overview*, published late last year. We will be updating our IFRS 15 and IFRS 16 factsheets to reflect some of the practical implementation issues experienced to date.

Our annual factsheets *2019 UK GAAP Accounts* and *2019 IFRS Accounts* will be published early summer.

ACTION ON CLIMATE CHANGE

The faculty is currently producing a series of short videos, in association with Deloitte, on climate change. Aimed at ICAEW members and other finance professionals, the first of two modules sets out, in simple terms, the importance of taking action on climate change and the risks and opportunities that it creates for business. The second module is a set of training videos that explore how businesses need to adapt to manage the risks and take advantage of the opportunities. The videos will be released in summer 2019.

Our annual Financial Reporting Conference will be held on 10 October 2019. Chaired by Veronica Poole, global IFRS leader and UK national head of accounting and corporate reporting, this year's conference will be looking at wider non-financial aspects of corporate reporting as well as more traditional, technical topics. Paul Druckman, chair of the FRC's Future of Corporate Reporting project and former CEO of the International Integrated Reporting Council, will be providing a keynote speech.

It might feel as though everything there is to say about IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* has already been said. But 2018/19's reporting season has demonstrated that the devil is in the detail and some challenging areas of these new standards have come into focus as they are being implemented in earnest. With IFRS 16 *Leases* next up for implementation, what lessons can be translated across from the IFRS 9 and 15 experience?

For UK GAAP reporters, the Triennial review amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* will be the topic of the day.

Other topics will include climate-related reporting, narrative reporting including s172 disclosures and distributable profits. More details as they become available can be found at icaew.com/frconference

Remember that, as a faculty member, you are entitled to receive a discount on normal rates. If you'd like to bring your colleagues along, discounts are also available for group bookings of three or more.

WEBINARS AND BITESIZE BRIEFINGS

Our popular webinar programme will continue throughout the second half of 2019, with both our monthly hour-long interactive webinars and new 20-minute webcasts. Webinars are now exclusively available to faculty members (with limited exceptions) increasing the benefits of membership. Remember that you can also access recordings of past webinars.

The upcoming schedule will include:

Webinars	Bitesize Briefings
IFRS update (20 June)	Performance metrics (4 July)
European Single Electronic Format – understanding the controversy (18 July)	FRS 105 – answering your questions
Strategic Report	Technology and corporate reporting
UK GAAP: final preparations to implement the triennial review amendments	Climate reporting

To find out more and book your place, visit icaew.com/frfevents

AUDIT CONFERENCE

With the theme Audit: reflect, reform, refocus, ICAEW will be hosting its inaugural Audit Conference on 4 October 2019. It will feature a keynote speech from Sir Donald Brydon on the future of audit, and be chaired by Gilly Lord, head of audit strategy and transformation, PwC.

Technology and its role in driving forward audit quality and effectiveness will be discussed as well as break-out sessions looking at audit inspections, going concern and auditing estimates. Ticket prices include membership of the Audit & Assurance Faculty throughout the remainder of 2019.

For more information, visit icaew.com/auditconference

INFORMATION FOR BETTER MARKETS 2019: THE REAL EFFECTS OF FINANCIAL REPORTING

This year's Information For Better Markets conference will bring together academics and non-academics to explore the real effects of financial reporting. Specifically, we look at the influence financial reporting has had on innovation, financing and remuneration. We also consider what is known, so far, about the real effects of new accounting standards on revenue, leases, insurance and bad debts. The conference takes place at Chartered Accountants' Hall on 16 and 17 December.

To register your interest in the event, please email alison.dundjerovic@icaew.com

Beyond the numbers

Russell Picot, former group chief accounting officer of HSBC, talks to Nigel Sleigh-Johnson and Sally Baker about the importance of an organisation's resilience to climate risk

On the same day that *Our Planet*, Netflix's nature documentary narrated by Sir David Attenborough, premiered in London and HRH The Prince of Wales spoke of the importance of implementing solutions to combat the dangers of climate change, we had the opportunity to sit down with Russell Picot, a keen advocate of sustainability and climate-related reporting. Having been part of the group that helped establish Accounting for Sustainability and more recently as a special adviser to the Task Force for Climate-related Financial Disclosures (TCFD), Russell is at the forefront of efforts to promote understanding of the importance of this emerging area of reporting.

"Climate change is an existential crisis, a threat to our way of life and to humanity," says Russell. "It has the potential to break down the social fabric of society. The only path forward is a complete decarbonisation of the economy, and that will affect every single business. Climate change is a mainstream business risk and businesses need to expect fundamental change to the world they operate in. That in turn impacts corporate reporting, with non-financial information becoming increasingly important. Numbers are important, but they're not the whole story."

LEADING BY EXAMPLE

Numbers were more of a focus for Russell in the past though. With a degree in mathematics, he originally envisaged becoming an actuary. But a summer internship revealed it would mean being in the same office all the time, doing little other than number-crunching. Chartered accountancy was suggested as an alternative.

Russell went on to spend 14 years with KPMG before joining HSBC in 1993, where he stayed until his departure in 2016. But the connection remains, as he currently chairs the board of trustees of the bank's UK pension fund. He clearly holds the bank in high esteem: "I was very privileged to work there for nearly 23 years; HSBC is an exceptional organisation capable of displaying great leadership and truly thinking for the long term. Sir Douglas Flint [group chairman of HSBC Holdings from 2010 to 2017] was an extraordinary leader to work for."

In 1995, Russell was appointed group chief accountant, reporting directly to Sir Douglas, the then group finance director. "The role later transitioned into group chief accounting officer and then in 2003, I became the first group general manager appointed from the finance team – a proud moment for me personally, but also for the function too. It was an expression of the importance of the work we did."

What were the qualities needed to be successful in such a role, we asked. "It's important to be seen to do the right thing as a leader. It helps instill confidence," says Russell. "Leaders need to set a personal example and not shy away from making tough decisions, because this responsibility goes with the territory. Make sure you know where your lines are. When you're in a position of authority, you're going to be tested. If you don't stop those lines being crossed the first time, it's going to be much harder the second time. Having the ability to listen and being accessible are also important attributes."

Alongside his role at HSBC, Russell has always been involved in other projects and initiatives. He chaired a committee which played an active role in the development of IFRS 7 *Financial Instruments: Disclosures*, worked with the Basel Committee on Banking Supervision and in the wake of the financial crisis, and co-chaired the Financial Stability Board's (FSB) Enhanced Disclosure Task Force.

"I've found it enriched my role to have an active external focus and have always been interested in broader aspects of reporting. I worked at HSBC during a time of significant transformation and growth; there was always a lot of change. I believe that you should always move forward, and continually re-equip your skills to remain relevant. After all, what you do today may not be valued tomorrow."

THE COURAGE OF CONVICTION

Russell is a man for whom having strong principles is extremely important. "I've always been a quite idealistic person. I have long held the conviction that business is about more than simply profit, that there's a strong social purpose to it too. Some might argue that that's at odds with working for one of the world's largest banks, but society needs banks where people's money is safe and which are prepared to be moral and principled in how they conduct their business affairs."

The opportunity to combine his personal convictions with the environmental and social aspects of reporting came in 2004 when the Prince of Wales invited HSBC's chairman, along with some other corporates, to help set up Accounting for Sustainability (A4S).

A4S aims to drive a shift towards resilient business models and a sustainable economy. The project was established, in the words of Prince Charles, "to help ensure that we are not battling to meet 21st century challenges with, at best, 20th century decision-making and reporting systems".

"The Prince is an extraordinary man, who works tirelessly and demonstrates very considerable leadership. He has championed environmental and climate issues for many decades and has shown immense personal courage in publicly expressing his views on matters that he believes to be important to society."

PHOTOGRAPHY: DAVID VINTINER

"Leaders need to set a personal example and not shy away from making tough decisions, because this responsibility goes with the territory"

Prince Charles has also been the catalyst behind two other more recent initiatives that Russell is involved with – integrated reporting and climate-related disclosures. It was at an A4S forum in late 2009 that what is now known as the International Integrated Reporting Council (IIRC) was established. Its aim is for integrated thinking and reporting to be a mainstream practice in business. Through integrated thinking and reporting, the IIRC seeks to align corporate behaviour with the wider goals of financial stability and sustainable development.

"Integrated reporting breaks down silos," says Russell. "It brings together all the different disciplines and the result is integrated thinking. As the anecdote goes: 'I went to a meeting on integrated reporting and met people in the organisation I had never met before'."

BECOMING MAINSTREAM

Awareness around climate change and the risks it poses is increasing and stirring many people's consciences. There are some though who are reluctant to build it into their business thinking. What would Russell say to them?

"Climate risk is now a matter of economics. To date, 197 countries have committed to the United Nation's (UN) 2015 Paris agreement to transition the world to a low carbon economy. Climate action is also one of the UN's 17 sustainable development goals, with a target date of 2030. Reducing your carbon footprint is probably going to save your business money. If a meaningful carbon tax is imposed, input costs will increase, so it's sensible to consider sourcing on, or near-shore. Supply chains are also likely to be disrupted by physical events caused by climate change, so there's a need to mitigate that risk. And there are strong expectations from society now. Most young people would find it an anathema to work for an organisation that doesn't consider climate risk to be important. It simply makes good business sense to consider climate as a mainstream business risk."

The TCFD's recommendations aim to connect and communicate the financial impact of climate change on an organisation. Inspired by A4S and the Prince of Wales, the Task Force was established by Mark Carney, governor of the Bank of England and chair of the FSB. A key disclosure recommended by TCFD focuses on the resilience of an organisation's strategy, taking into account different climate-related scenarios.

"Business leaders should be having a conversation around the board table about the resilience of their business model and strategy with respect to climate risk and sustainability," says Russell. "This scenario analysis is one of the most challenging aspects of the TCFD recommendations to implement, but critically, investors are looking at it. My advice is to not get lost in a welter of data but to think of it as stress-testing and assessing the viability of your strategy and business model. In some cases, it will show that businesses need to change what they do. It's difficult to think of any businesses that won't be impacted by the transition to a decarbonisation of the entire economy and our way of life."

There is growing momentum behind putting the TCFD recommendations in place, but what's preventing them being applied more widely?

"A worrying number of businesses and directors are simply not aware of TCFD, but even when they are, there are many competing priorities which can take precedence. For asset owners such as pension funds, it can be seen as being less risky to defer addressing climate change risk than to seek to manage it.

"The TCFD recommendations need to be mandatory: this area of disclosure is growing in importance and is simply too important to be left to a purely voluntary regime. At a recent gathering, a group of NEDs was asked, 'What is the quickest way to get boards of companies to take climate risk seriously?' Their answer was public disclosure. It may be a blunt weapon, but it's effective."

FINANCE FOR THE FUTURE

Later this year, Russell will again be chairing the judging panel for the Finance for the Future awards. Founded by ICAEW and A4S in 2012, and now in partnership with Deloitte, the awards celebrate examples of good practice within finance functions that could be transformational in building sustainable organisations.

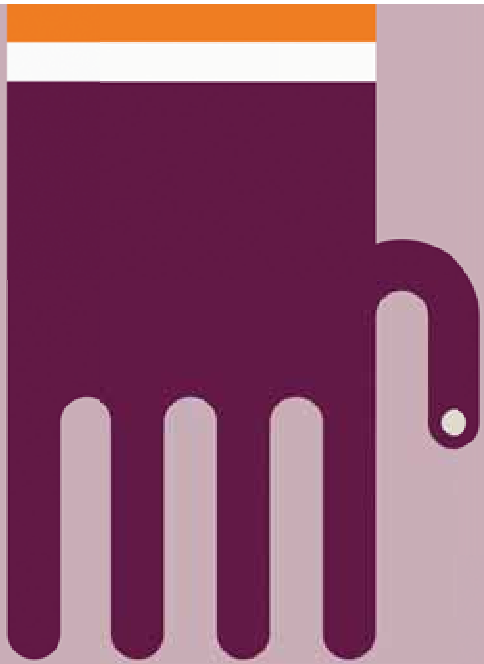
"Being involved with the awards is quite humbling," says Russell. "Many interesting and inspirational stories are told and people are visibly moved by what they hear during the evening."

As well as awards for communicating integrated thinking, and building sustainable financial products, this year will also see an additional award to recognise climate leadership.

As we return to ICAEW, we reflect on Russell's parting comment: "It's time for everyone to consider how to start to take the lead in tackling climate change and ask themselves, 'what can I do to be part of the solution?'" ●

Nigel Sleigh-Johnson is head of the faculty
Sally Baker is a technical manager in the faculty



IFRS 16 – TACKLING THE PRACTICALITIES

Avni Mashru discusses the impact of bringing leases on balance sheet under IFRS 16

The start of 2019 was a significant milestone in the accounting world – former chairman of the International Accounting Standards Board, Sir David Tweedie, is finally able to fly on an aircraft that is almost certain to be on an airline's balance sheet. For accounting periods beginning on or after 1 January 2019, the long awaited IFRS 16 *Leases* comes into effect. The standard has become associated with its ground breaking headline of requiring almost all leased assets to be recognised on balance sheet along with their associated lease liabilities.

While a simple concept in theory, the practicalities of applying the standard are not so straightforward. Aside from the significant amount of data collection required and transitioning to the standard (two significant areas in themselves), there are a number of other practical application issues that receive less airtime but certainly merit attention.

GROUP SITUATIONS

Leasing activity within groups is one area where complexities start to arise. It is not uncommon for groups to have a central property company (often referred to as a PropCo) as a subsidiary. This PropCo will hold all the property that the operating companies in the group (referred to as OpCos) lease from the PropCo to use within their business. Prior to IFRS 16, this resulted in a number of intragroup operating leases where the operating lease income in the PropCo's books would neatly cancel out against the operating lease expenses in the various OpCos.

Under IFRS 16, however, the situation becomes less symmetrical. The standard maintains the finance vs operating lease distinction for lessors, meaning the PropCo recognises operating lease income as before but the situation in the OpCo is now very different. In place of the previous operating lease expense, OpCos now recognise a right-of-use asset, lease liability, depreciation and interest expense. These items will all require elimination on consolidation with the entries required being more intricate than was the case prior to IFRS 16.

This lack of symmetry will also arise where the PropCo and OpCo subsidiaries are applying FRS 101 *Reduced Disclosure Framework* since the recognition and measurement requirements of IFRS 16 apply in the same way under FRS 101 as if the subsidiaries were applying full IFRS.

However, where the PropCo and OpCos

are applying FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, intragroup leases will continue to neatly cancel out as FRS 102 classifies leases as finance or operating in the same way as IFRS 16's predecessor.

Impact of acquisitions

A further consideration under the heading of group situations is the impact of acquisitions following transition to IFRS 16. Previously, a group would assess whether any leases held by an acquired entity as a lessee were favourable or unfavourable when compared to market terms at the acquisition date and recognise an intangible asset or liability as appropriate. IFRS 16 has resulted in amendments to IFRS 3 *Business Combinations* which clarify that a group should measure lease liabilities as if the lease were a new lease at the acquisition date (ie, for the group, the lease commencement date is the acquisition date rather than the original actual lease commencement date). The corresponding right-of-use asset is then adjusted to reflect any favourable or unfavourable terms in the lease when compared to the market, instead of a separate asset or liability being recognised.

Although acquisitions by their nature result in consolidation adjustments, IFRS 16 adds a further layer of complexity. As noted above, the group measures lease liabilities from the acquisition date. This results in the group and the underlying acquired entity having different lease commencement dates for the same leased asset – for the former it's the acquisition date but for the latter, the actual lease commencement date. This results in different right-of-use assets and lease liabilities which in turn result in different depreciation and interest expenses. This creates more intricate elimination entries on consolidation than was previously the case. This additional complexity will also be the case where subsidiary entities apply FRS 101.

Despite this article not focusing on transition issues, it is worth pointing out that groups will need to take care when identifying leases held as a result of acquisitions prior to transition. In the group accounts, these leases must also be accounted for from the acquisition date rather than the original lease commencement date. Where the previously acquired subsidiary applies FRS 101 and is equally transitioning to IFRS 16, a separate exercise will be required to determine the right-of-use

GRUNDINI/IKON

Groups will need to take care when identifying leases held as a result of acquisitions prior to transition to IFRS 16

asset and lease liability balances in the context of the original lease commencement date.

IMPAIRMENT CONSIDERATIONS

Moving away from group considerations, a measurement issue that will be relevant to all right-of-use assets is that these assets will be subject to the requirements of IAS 36 *Impairment of Assets*. Prior to IFRS 16, operating leases were subject to the onerous contract guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to determine whether a provision for the lease contract was required. Now that lease liabilities are recognised on balance sheet under IFRS 16, the assessment is now whether the related right-of-use asset is impaired.

Under IAS 36, an impairment test compares the carrying value of the cash-generating unit to its recoverable amount, which in turn is the higher of value in use and fair value less costs of disposal. An impairment loss is recognised when the recoverable amount is lower than the carrying amount. While it is very unlikely that adopting IFRS 16 will trigger an impairment loss, when companies determine recoverable amount on the basis of value in use, the models used to make this calculation will need to be updated to take account of the changes introduced by the standard, such as future operating lease payments no longer being included and potential changes in applicable discount rates.

ALTERNATIVE PERFORMANCE MEASURES

A final consideration is around the impact of IFRS 16 on alternative performance (or non-GAAP) measures in the annual report, an area gaining increased focus. As already noted, IFRS 16 will result in leased assets and their associated liabilities coming on balance sheet with associated depreciation and interest expenses being recognised in profit or loss.

A significant number of companies report a variant of one or more measures such as earnings before interest, tax, depreciation and amortisation (EBITDA), free cash flow or net debt in their annual reports. Each of these calculations will be affected by IFRS 16: EBITDA will increase as the operating lease rental expense will no longer be included, free cash flow will likely increase since some of the lease payments will be classed as financing rather than operating cash flows, and net debt will likely increase as lease liabilities are included in the measure. As well as affecting the calculations, companies should explain the changes in these measures due to IFRS 16 to help users understand the impact.

WHERE NEXT?

You may have imagined that the practicalities alluded to in the title of this article might have focused on matters such as determining the discount rate, lease term or lease payments in a contract. There's no doubt that a wealth of practical and time-consuming issues lie in each of these areas too. However, as illustrated here, the impact of IFRS 16 goes beyond the direct accounting changes for leases and companies would be well advised to have that broader impact in mind as they go through their implementation projects.

A recording of the faculty's webinar *IFRS 16 Leases – the impact* is available at icaew.com/frfwebinars ●

Avni Mashru
is a Director at PwC

IFRS 9 & 15 – HOW DID IT GO?

With many implementing IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* in the 2018/19 reporting season for the first time, we asked a panel of experts for their views on how it went and, for those yet to report, the challenges to watch out for

IFRS 9 *FINANCIAL INSTRUMENTS*

Helen Shaw,
Director, Deloitte

The introduction of an impairment model based on expected rather than incurred losses has been one of the headline changes on the adoption of IFRS 9. There are particular challenges that are associated with applying the new model to intercompany loans. Such instruments are sometimes poorly documented and may not be considered until relatively late in the transition process because they do not appear in the consolidated financial statements. In the absence of historical loss data it may seem difficult to calculate a loss allowance, however, the wealth of other information available on group companies should allow a reasonable basis for calculation.

The priority for most transition projects has been the underlying accounting and the impact on the primary financial statements. However, extensive new disclosure requirements are included in IFRS 7 *Financial Instruments: Disclosures* due to the introduction of IFRS 9. It is easy to underestimate the amount of work needed in relation to disclosures especially where there is not a big change in the accounting treatment between IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9. In particular, even where an entity chooses to continue to apply the IAS 39 hedge accounting model they are still required to make the new hedge accounting disclosures in IFRS 7.

IFRS 9 allows entities to apply hedge accounting in a wider range of circumstances than IAS 39. However, it can be easy to miss the impact of the new standard on existing hedges. In particular, where an entity hedges foreign exchange risk with a derivative they will now need to consider foreign currency basis spreads. Foreign currency basis spreads are an unavoidable cost of hedging with foreign currency derivatives which, under IFRS 9, may be excluded from a hedge relationship. Irrespective of whether they are excluded, their effect will need to be quantified which will require additional time and expertise to update valuation methodologies.

Moses Serfaty,
Director, BDO

Despite the simplified approach to measuring expected credit losses for trade and lease receivables, companies are required to take into account forward-looking information, including macro-economic information such as unemployment levels and interest rates, when calculating all their impairment provisions.

This means that preparers have had to first identify the macro-economic factors that have affected historical loss rates and then source and incorporate forward-looking information about these economic factors into the estimation of expected loss rates. This is proving to be a challenging area for many preparers, both in terms of gathering the relevant historic analyses and overlaying this data with forward-looking information.

While the headline was always that IFRS 9 would not bring about much change in the accounting for financial liabilities, one notable area of change relates to the accounting for modifications. Under IAS 39, if a financial liability was modified but did not meet the criteria for derecognition, then the difference between the original carrying value and the modified carrying value was typically deferred and amortised over the remaining life of the liability.

IFRS 9 though, specifically requires the difference to be recognised in profit or loss at the date of modification. This requirement must be applied retrospectively on transition to IFRS 9, meaning that any deferred gains or losses relating to previously modified financial liabilities, that are still recognised at the date of initial application of IFRS 9, must be identified in order to determine the appropriate transition adjustments. This change has been missed by some, resulting in additional work being required relatively late in the day.

IFRS 15 *REVENUE FROM CONTRACTS WITH CUSTOMERS*

Danielle Stewart OBE,
Partner, RSM

The challenges of initial transition to IFRS 15 were enormous. Much energy was expended analysing sales contracts and working out how the five criteria in paragraph 9 of the standard related to them. Framing the seller's obligations as 'performance obligations' was often a challenge – were those obligations distinct or a 'bundle' of interlinked promises? Allocation of the contract price across the elements was another task, and the timing of revenue recognition also had to be considered.

Timing has been a particularly error-prone area, despite some excellent guidance within the standard. We have seen situations where the performance obligation is fully satisfied upfront, but the company has produced a confidently argued board paper explaining why it should be recognised over time, as well as companies trying to take revenue early, where an ongoing obligation means they should be deferring it forward. This is an area of developing GAAP and new interpretations are being made all the time. Accountancy firms have their latest guidance on their websites, but when decisions on interpretation were being made prior to transition, most of this guidance didn't yet exist. It is indeed a challenge for a CFO who has presented management accounts all year on one basis, to go back to the board and tell a very different revenue story. While they can explain that GAAP has developed over the past 15 months, there will be consequences with shareholders, financiers and other stakeholders.

This is both the curse and the blessing of GAAP. If we had a static, rules-based approach, this problem would not exist. But developing GAAP as we go delivers intelligent reporting, so we must persist, never underestimating how hard it is to introduce a new way of approaching one of the most important figures in any entity's accounts.

Phil Barden,
Partner, Deloitte

If you still have your first year-end under IFRS 15 to look forward to, here are a few areas that you might watch out for.

The guidance on agent/principal has triggered much discussion. It looks deceptively similar to the IAS 18 guidance but, in fact, it is much more prescriptive. Identifying which entity has the primary contractual responsibility to the customer is often key. Where there is an intermediary between you and the end consumer, it can be very important to establish which of them is your customer for the purposes of applying IFRS 15.

With limited exceptions, IFRS 15 requires consideration payable to a customer to reduce revenue. This requirement also applies if you make payments to other parties that purchase your goods or services from your customer – which is easy to miss.

Don't underestimate the new disclosure requirements, which can be quite detailed and quite prescriptive; some of them may require information that was not previously readily available. I'd particularly highlight the disclosure of revenue associated with performance obligations not yet satisfied. This includes all amounts contracted at the reporting date, but should exclude any elements that are optional for the customer or cancellable without significant penalty. Any variable amounts included need to be estimated, and perhaps constrained.

In addition, there are important disclosures around key judgements, and in respect of the methods, inputs and assumptions used for estimating and constraining variable amounts, allocating amounts between performance obligations and measuring return and refund obligations.

Finally, if you choose not to restate comparatives on adoption, remember to disclose how your profit and loss account and balance sheet would have differed had you remained on previous GAAP. ●

KINGMAN AND THE IMPACT ON CORPORATE REPORTING

As the government consults on the Kingman review recommendations, **Michelle Cardwell** outlines seven recommendations that focus on corporate reporting

Following a series of high-profile corporate failures, several inquiries into the UK audit market were launched last year, including Sir John Kingman's independent review of the Financial Reporting Council (FRC). Kingman's report, published in December 2018, sets out 83 recommendations. Inter alia, Kingman called for replacing the FRC with a new, stronger regulator provisionally named the Audit, Reporting and Governance Authority (ARGA).

KINGMAN'S RECOMMENDATIONS

ARGA would have a duty to promote the interests of consumers of financial information. To achieve this, Kingman reviewed the FRC's core functions and made a number of recommendations, including some aimed at improving corporate reporting and enhancing ARGA's regulatory powers. These recommendations are outlined as follows:

1. Report to parliament on the usefulness of corporate reporting: The FRC will be taking forward this recommendation immediately. ARGA would promote concise and understandable corporate reporting, with the aim that reporting should be accurate, complete and not misleading to shareholders and other stakeholders.

2. Strengthening regulation of investor information outside of the annual report: Kingman asks that the government, together with the Financial Conduct Authority, consider whether such regulation should be enhanced and suggests a trial takes place.

3. Pre-clearance procedure for new or complex issues: This charged-for service would assist companies in determining correct accounting treatments prior to publication of their accounts. The Department for Business, Energy & Industrial Strategy (BEIS) is considering a pilot programme by ARGA.

4. Extend corporate reporting reviews (CRRs) to the entire annual report: Current CRRs only cover the directors' report, strategic report and annual accounts. The FRC intends to take this forward immediately (see next page), initially with the agreement of the companies being reviewed, but with supporting legislation to follow.

5. Publication of findings from CRRs: This would increase transparency on reporting shortcomings to investors, as well as aim to encourage preparers to improve the quality of their annual report. BEIS is consulting on this recommendation to avoid potential unintended consequences, such as confidentiality issues.

6. Power to direct changes to accounts: This would avoid the lengthy period of correcting and communicating material misstatements that arise due to court proceedings. BEIS has welcomed this recommendation and will pass necessary legislation shortly.

7. Skilled person review in certain circumstances: ARGA would have the power to require such a review when serious concerns are raised around the standard of a company's corporate governance, corporate reporting or statutory audit. This independent expert would investigate specific issues and could potentially publish their findings. While BEIS agrees ARGA should have investigative powers, they are considering the potential market consequences of this further.

THE RESPONSE

The government has welcomed and endorsed Sir John's findings and recommendations, calling them "well considered, far reaching and transformational". BEIS plans to work with the FRC as it transitions to ARGA and at the time of going to press, is consulting on how to implement the recommendations.

ICAEW has called for bold intervention to restore confidence in audit and corporate reporting and welcomes the creation of ARGA as a strong and credible regulator. We have been studying Kingman's recommendations in depth and gathering ICAEW member views, for our response to the BEIS consultation, which can be found at icaew.com/inquiryintoaudit ●

Michelle Cardwell is a technical manager in the Audit & Assurance Faculty

FRC REVIEWS OF ANNUAL REPORTS – CHANGES AND THEMES

Sarah Dunn on recent proposals to the FRC's corporate review process

As discussed on page 14, Sir John Kingman's independent review of the Financial Reporting Council (FRC) includes some important proposals relating to the FRC's corporate reporting review process. The FRC has also outlined the areas of focus for its upcoming thematic reviews.

CORPORATE REPORTING REVIEWS

Kingman's recommendations in relation to the corporate reporting review process include proposals to:

- Increase the volume of corporate reporting review work.
- Limit corporate reporting reviews to public-interest entities, except to the extent unavoidable by law.
- Extend the corporate reporting review process to cover the entire annual report, including corporate governance reporting.
- Give the regulator power to direct changes to accounts rather than having to go to court.
- Publish corporate reporting review findings, and the full correspondence following all reviews, within a set timeframe.

Interestingly, while the Department for Business, Energy & Industrial Strategy (BEIS) is now calling for views on the Kingman recommendations, it has stated that the proposal to extend the corporate reporting review process to the entire report will take place with immediate effect.

THEMATIC REVIEWS

In the meantime, the FRC has issued its plan and budget for 2019/20. As expected, this document has been prepared in light of the Kingman recommendations. However, it also provides some interesting insights into areas of focus for upcoming thematic reviews. In particular, the FRC has outlined its plans to:

- Follow up on its thematic reviews on the adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* in June 2019 interim reports.
- Monitor companies' disclosures relating to IFRS 16 *Leases* in 2019 interim reports where it expects to see explanations of the impact of the new standard (which is mandatory from 1 January 2019).
- Conduct a thematic review of impairment of non-financial assets.

The FRC has also stated a change in previous practice by only making limited use of the practice of pre-informing companies of its intention to include their reports in its samples for thematic reviews.

Sarah Dunn is a technical manager in the Financial Reporting Faculty

IFRS ROUNDUP

Sally Baker provides a roundup of the latest IFRS developments

IFRS 17 INSURANCE CONTRACTS

The IASB expects to publish an exposure draft at the end of June 2019 setting out proposed amendments to IFRS 17 *Insurance Contracts*. It is intended that the effective date of the proposed amendments will be aligned with the effective date of IFRS 17 which, subject to consultation, has been deferred to accounting periods beginning on or after 1 January 2022.

IFRS 9 FINANCIAL INSTRUMENTS

An exposure draft is also expected in June 2019 which will propose amendments to IFRS 9 *Financial Instruments* to clarify which fees and costs a company should include in a quantitative 10% test when assessing whether to derecognise a financial liability.

IBOR REFORM

The IASB plans to propose amendments to IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* to address concerns relating to the uncertainties arising from IBOR reform. An exposure draft is expected in the second quarter of 2019.

DEFERRED TAX

Also in the second quarter of 2019, the IASB intends to publish an exposure draft of proposed amendments to IAS 12 *Income Taxes*. The proposals would narrow the exemption from initial recognition of deferred tax assets and liabilities. The exemption would no longer apply to transactions that give rise to both taxable and deductible temporary differences, to the extent that an entity would recognise equal amounts. ●

Sally Baker is a technical manager in the Financial Reporting Faculty

FRS 102 – THREE WAYS TO BETTER QUALITY REPORTING

Jake Green outlines his thoughts on FRS 102's top three application issues

The triennial review of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* has made a number of amendments to the standard that are effective from 1 January 2019. With preparers and their advisers considering the impact of these changes, now seems like a perfect opportunity to also look back at the application of FRS 102 to date and identify areas where the quality of reporting could be improved.

The topics I cover in this article are also often identified by the Financial Reporting Council (FRC) in their thematic and annual reviews as areas for improvement in the reports of listed companies. Although the accounting treatments may be a little different for listed companies (they apply IFRS as opposed to FRS 102), the observations made by the regulator are often equally relevant to companies adopting FRS 102.

CASH FLOW STATEMENT

The cash flow statement is often criticised by the FRC. In their recent publication *Corporate Reporting Thematic Review: Small Listed and AIM Quoted Companies (November 2018)*, their primary concern was the classification of items. FRS 102, like IFRS, requires the allocation of cash flows to three headings: operating, investing and financing, based on the definitions in the box (right).

These seem like clear principles. However, in practice the actual classification required does not always follow. Here are a couple of examples to illustrate my point.

Development costs

The definition of investing activities refers to the acquisition of an asset or other investment. In other words, for a cash flow to be investing it requires an asset to be recognised – something clearly stated in the equivalent international standard, but only implied in FRS 102. This means, given the accounting policy choice in FRS 102, a company choosing to capitalise development costs as an intangible asset will show the associated cash flows as investing, while a company that chooses to expense development costs would show those cash flows as operating.

Acquisition of a non-controlling interest

In a consolidated cash flow statement, the cash spent acquiring an interest in a subsidiary, associate or joint venture is recognised as an investing activity. However, the acquisition of a non-controlling interest in a subsidiary is classified as a financing activity. This is because the acquisition is treated in

FRS 102 as a transaction between different equity holders (Section 22, paragraph 19) and as such changes the size of equity.

PROFIT, OCI OR EQUITY?

All movements in net assets have to be reported either in one of the performance statements (profit or loss or other comprehensive income) or in the statement of changes in equity. A basic principle exists, set out in Section 2, paragraph 23 to determine which of these two the movement should be in.

The principle is that transactions are recognised in the performance statements unless it is a transaction with a shareholder in their capacity as such. To illustrate, a cash dividend paid to a shareholder results in a reduction to cash and is a transaction with a shareholder in their capacity as such. The resulting debit would therefore be recognised in the statement of changes in equity.

The distinction between profit or loss and other comprehensive income however, is not quite so principles-based. In fact I don't believe there even is one! Instead, the starting point is that all gains and losses should be recognised in profit or loss unless a specific provision of the standard requires those gains and losses to be recognised in other comprehensive income (Section 2, paragraph 44).

Therefore, once you have identified that a movement in net assets is a gain or loss, and not a transaction with a shareholder in their capacity as such, you have to look to the relevant section of the standard to determine whether it requires that gain or loss to be taken to other comprehensive income.

ALLOCATION OF CASH FLOWS

Operating activities:
The principal revenue-producing activities of the entity.

Investing activities:
The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities:
The activities that result in changes in the size and composition of the contributed equity and borrowings of an entity.

For example, the revaluation of an item of property, plant and equipment should be taken to other comprehensive income, unless:

- the revaluation results in the asset being recognised at less than depreciated historic cost, in which case the impairment below depreciated historic cost is recognised in profit or loss; or
- it results in the reversal of a loss previously recognised in profit or loss for that same asset, in which case it is recognised in profit or loss to the extent of that previous loss and thereafter in other comprehensive income.

However, revaluations of investment property are all taken to profit or loss and are never recognised in other comprehensive income.

The other thing to bear in mind when classifying gains and losses between the performance statements, is that any related deferred tax will be recognised in the same performance statement as the gain or loss. For example, deferred tax arising on the revaluation of an item of property, plant and equipment would be recognised in other comprehensive income if the revaluation is recognised in other comprehensive income. If you fancy testing yourself, have a go at the questions to the right. Answers are at the bottom of the box.

WHERE SHOULD THE FOLLOWING CHANGES IN NET ASSETS BE RECOGNISED:

1. New issue of equity shares for cash
2. Upwards revaluation of an intangible asset
3. Revaluation of investment property
4. Fair value gains or losses on forward foreign currency contracts where hedge accounting is not applied
5. For a bonus point, which of the changes above require a revaluation reserve?

Answers:
1. Statement of changes in equity
2. Other comprehensive income
3. Profit or loss
4. Profit or loss
5. Two – the upwards revaluation of an intangible asset

JUDGEMENTS AND ESTIMATES

In its publication *Corporate Reporting Thematic Review: Judgements and Estimates (November 2017)*, the FRC identified that entities often confuse judgements with estimates and vice versa. Does this matter? Yes, because the actual disclosures required depend on whether the matter at hand is a judgement or an estimate (Section 8, paragraphs 6 and 7).

For me, the simplest way to think about it is whether or not the judgement being considered involves making an estimate. If an estimate is involved, for example the likely outflow for a provision, then the disclosures on estimates apply. If the judgement is about how to apply an accounting policy however, for example whether the entity is acting as an agent or principal in making a sale, and does not involve making an estimate, the judgement disclosures apply. The FRC also pointed out in its report that management needs to exercise discrimination in determining what judgements and estimates to disclose. Financial statements would become cluttered if every judgement and estimate were disclosed. Instead, an entity should only disclose information about:

- those judgements that have the most significant effect on the amounts recognised in the financial statements; and
- those estimates that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

CONCLUSION

Companies have been through three, nearly four, reporting cycles now of using FRS 102. As you think about applying the triennial review amendments from 1 January, it's a good time to reflect on the quality of your reporting to date and see whether general improvements can also be made. The thematic reviews published by the FRC are a good place to start. Also, I've only discussed my view of three issues in this article. In March, I co-presented a webinar with Danielle Stewart OBE, of RSM, which counted down our thoughts on the current top 10 hot topics in UK GAAP. To find out what other topics made it into the countdown, a recording is available at icaew.com/frfwebinars

If you'd like more on the triennial review amendments to FRS 102, visit the faculty's resources at icaew.com/triennialreview ●

Jake Green is a technical partner at Grant Thornton

TO DISCLOSE, OR NOT TO DISCLOSE: THAT IS THE QUESTION

Tessa Park discusses Section 1A's disclosure requirements for small entities

Three years after the effective date for application of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* by small companies in 2016, the minimal disclosure regime introduced by company law, and reflected in Section 1A *Small Entities* (Appendices C and D), is causing a number of issues in practice. Accounts prepared under Section 1A must still give a true and fair view, so additional disclosures may be needed when the minimum disclosures are insufficient to meet this requirement.

Section 1A Appendix E also lists some disclosures which, when relevant, are encouraged. Entities need to exercise judgement in deciding which of these are necessary. Furthermore, for material transactions, events or conditions, small entities are encouraged to provide any of the disclosures as required by FRS 102 when being applied by entities not adopting the small entities regime.

RELATED PARTY DISCLOSURES

The disclosures required by Section 1A are quite limited. Material transactions are required to be disclosed if they are not conducted under normal market conditions and are with:

a) owners holding a participating interest in the small entity;
b) companies in which the small entity itself has a participating interest; and
c) the small entity's directors or members of its governing body.

Determining whether a transaction is under normal market conditions is sometimes straightforward, eg, the sale of an asset, such as a car, to a director where market values are readily available. However, this is much more difficult with transactions such as directors' remuneration or dividends where market rates are not so easily established.

Transactions beyond those listed above also require consideration. Suppose a close family member of a director lends the entity £2m for three years at zero interest. Although the loan is clearly not at a market rate, transactions with close family members of directors are not related parties for the purposes of Section 1A so disclosure is not explicitly required. However, the Basis for Conclusions accompanying FRS 102 encourages small entities to consider whether disclosure about loans from other parties is necessary for the purposes of giving a true and fair view (paragraph B11.40).

GOING CONCERN

Disclosures relating to material uncertainties that cast doubt on the ability of the entity to continue as a going concern are encouraged for small entities in Appendix E but are not mandatory. However, it is unlikely the accounts will show a true and fair view if there are going concern issues and no disclosure is included. If the entity is audited, a lack of disclosure is likely to affect the audit opinion. Judgement will be required about exactly how much needs to be said, depending on the circumstances.

ADDITIONAL STATEMENTS

Section 1A encourages small entities to prepare statements of other comprehensive income and/or changes in equity when there are items of income or expense not recognised in profit or loss, or transactions with owners. Examples include a revaluation of property, a share repurchase or a transfer between components of equity. In these circumstances, presenting these statements is likely to be needed to ensure the accounts give a true and fair view.

CONCLUSION

Directors of small entities applying Section 1A, their accountants and, when relevant, their auditors need to ensure that they consider carefully what additional disclosures are needed, beyond the minimum required, for the accounts to show a true and fair view. They should review their assessment each reporting period, to ensure any changes in circumstances are taken into account. Judgement will be required and it is not enough to rely on accounting software alone. ●

Tessa Park
is technical partner at Kingston Smith

QUESTION CORNER

John Selwood looks at some of the questions raised at the spring Financial Reporting Essentials CPD Updates

A UK subsidiary, adopting FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, supplies cloud-based software to customers. The group accounts are prepared under International Standards (IFRS). Can the subsidiary adopt the group's revenue recognition accounting policy by 'carving out' Section 23 *Revenue* of FRS 102 and adopting IFRS 15 *Revenue from Contracts with Customers* instead?

UK GAAP and IFRS are different accounting frameworks and entities cannot 'mix and match' the requirements of the two (with the exception of financial instruments). IFRS 15 cannot, therefore, be applied by a subsidiary preparing accounts in accordance with FRS 102.

Section 23 of FRS 102 is comparatively brief and does not include the detail of IFRS 15. As a result, it may be that the accounting policy used in the group accounts would also be acceptable under FRS 102. If this is the case, but the group accounting policy is materially different to the one currently being applied, the subsidiary would need to change its accounting policy.

A change in accounting policy is permitted if the new policy is considered to provide reliable and more relevant information. The change in accounting policy would need to be applied retrospectively.

As an alternative, the subsidiary may be eligible to apply FRS 101 *Reduced Disclosure Framework,* which would result in the recognition and measurement requirements of full IFRS being applied but with fewer disclosure requirements.

Company A has acquired 100% of the share capital of company B as a result of company B's shares being put forward as security on a loan that is now in default. Company A intends to sell its interest in company B as soon as possible. Under FRS 102, does company A have to account for company B as a subsidiary in its group accounts?

Subsidiaries are excluded from consolidation when the interest is held exclusively with a view to subsequent resale and the subsidiary has not previously been consolidated. An interest that was acquired as a result of the enforcement of a security meets this definition, as long as company A's actions do not show any intention of company B becoming part of the continuing activities of the group.

A company has investment property that has been accounted for at cost less depreciation, having previously taken the undue cost or effort exemption in FRS 102. The triennial review amendments to FRS 102, effective for accounting periods beginning on or after 1 January 2019, have removed this exemption. How should investment property be treated when the amended version of FRS 102 is first applied?

Going forward, investment property must be accounted for at fair value through profit or loss (FVTPL) unless the property is rented to another group entity.

When FRS 102 (March 2018) (ie, FRS 102 as updated for the triennial review amendments) is first applied, the change in accounting for investment property should be applied retrospectively as a change of accounting policy. The fair value of investment property must be established at the date of transition to the amendments (ie, the beginning of the comparative period).

For instance, for a December year-end, the accounts for the year to 31 December 2019 should contain a prior period adjustment where the investment properties are measured at fair value on 1 January 2018. The comparative profit or loss account and balance sheet will also require restatement.

If you've got a question you'd like John to answer, contact us at frfac@icaew.com

Essentials CPD Updates covering accounting and financial reporting will be held at locations across the country in the autumn. To find out more, visit icaew.com/frfevents ●

John Selwood is a freelance lecturer and writer

BUILDING THE FUTURE

Thomas Toomse-Smith examines how technology could evolve the annual report

It is fair to say that the accounting and auditing profession is currently going through a period of contemplation and reflection. While much of this is focused on expectations, quality and trust, it is also true to say that technological change is another challenge. Since its inception, the profession has been focused on a physical and often paper-based document - the annual report. However, modern technologies such as blockchain, artificial intelligence (AI) and augmented/virtual reality might be about to radically disrupt the annual report, its process and ultimately the industry that has been built around it.

THE SHAPE OF THINGS TO COME

In our Digital Future project, the Financial Reporting Council's Financial Reporting Lab (the Lab) has been looking at how the concepts that underpin corporate reporting in paper format will be translated into the digitally centred reporting of the future. We have looked at technologies, including blockchain and AI, to see where and how they might affect corporate reporting, and how they might help to improve quality and trust. What we have found is a complex environment where different technologies will build upon each other to create a new structure for reporting.

Quality data = structured data

In our previous article (see *A short history of the digital reporting future*, July 2018) we talked about how structured data programs (such as XBRL) will lead to new ways to collect, present and package data. However, this is just the beginning. Greater demands are being made on companies to disclose environmental, social and governance information in a more structured way. The resulting data canal (ie, a structured data pool) becomes the key input into the corporate reporting process of the future. Technologies such as blockchain and AI will power this quality, contextual data.

Blockchain = structured trust

XBRL and other technologies can underpin structured data but how can the users of that information rely on its authenticity? One way may be through the use of blockchain. A blockchain is a type of shared database that creates a permanent record of a transaction. Because it is distributed across a number of participants in a network, and therefore not under the control of a single participant, it is robust. This robustness, combined with the fact that any changes made to the data are visible to all participants, ensures that both the data and the network are resilient in a way that creates structured trust. The business community can use blockchain to rethink how it builds and communicates trust and it is that potential that makes blockchain disruptive.

Using our framework of digital reporting (which expresses the qualities that preparers, users and others value in digital reporting), we considered the case for blockchain in specific aspects of the accounting and reporting process. Our review concluded that:

- **For the production of accounting records -** blockchain has the potential to improve the efficiency and timeliness of creating error/tamper-free records (across markets, industries and companies) and may increase the speed of consolidation within groups, particularly where there are multiple participants. However, there are issues of cost and interoperability which need to be solved.
- **For the distribution of corporate reports -** the use of blockchain to create a single location for credible, usable corporate data across Europe is a real possibility and would be highly valuable. While such a system is already being worked on (by the European Commission through their transparency gateway project), ultimate success is dependent upon any resulting solution being easy to use.
- **For consumption of corporate reporting -** the potential for using blockchain to form an unalterable group of communications (to meet reporting requirements) across different formats and entities is worth investigating as it could lead to different ways to meet regulatory requirements, perhaps leading to more engaging reporting. However, the need for broader adoption may reduce the likelihood of its use.

While it is clear that blockchain is not the only possible answer (or even always the best), it does have the potential to solve some of the challenges of corporate reporting. Blockchain, therefore, merits consideration and experimentation by preparers and regulators.

AI = structured processes

If structured data and structured trust are achieved, the next question is how to analyse the structured, trusted data efficiently and effectively. AI presents a way to do this. In the world of business and finance, the term AI acts as a shorthand for a range of different technologies and techniques (from robotic

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process automation to machine learning and natural language processing) that represent the current leading edge of computerisation and automation. It is this more comprehensive range of AI and related technologies that are now finding a home in the world of corporate reporting. The Lab explicitly considered corporate reporting processes where both the level of repetition and standardisation as well as the amount of data makes it difficult for a human to undertake the task efficiently or effectively and therefore creates an opportunity for structured processes. In considering the case for AI in specific aspects of accounting and reporting, our review concluded that:

- **To produce accounting records –** AI is being used to improve productivity by replacing repetitive human processing of underlying transactions and the recording of those in accounting and management information systems, ultimately feeding into annual reports.
- **To distribute accurate annual reports –** AI is being used to efficiently and effectively support auditors and boards in the internal and external validation processes ensuring that annual reports are credible and compliant.
- **To consume annual reports –** AI is being used by investors to enhance the effectiveness of investment analysis by extracting meaning and value, not only from company reporting but also from various sources of alternative data.

Our work on AI leads us to conclude that it is not a question of whether AI will become important for corporate reporting, but when. However, as this AI-powered world of reporting develops, it will be essential for all stakeholders to understand how corporate reporting, empowered by AI, needs to evolve in a way that enhances trust.

Structured data + structured trust + structured process = new possibilities
Our work points to the possibility that by combining the benefits of structured data, trust and process, corporate reporting can evolve from the static annual report process to a dynamic, real-time communication process. However, that will take change and action.

WHAT DO YOU NEED TO DO?

Across the Lab's technology projects, we have heard from many who consider that this new structured future offers significant promise. However, that promise can only be met if everyone involved in corporate reporting looks forward. To do this, we recommend some simple actions:

- Build your understanding, knowledge and experience. Combining technology, governance and finance skills will be the key.
- Cautiously innovate. Try out new technologies in a controlled way.
- Get involved. Change only happens if we all get involved. Take opportunities to feedback to professional bodies, regulators and others.

WHAT'S NEXT

The Lab's next technology report will be focused on virtual reality, augmented reality and video in reporting – structured experience. We will also be feeding the results of all our work into the FRC's project on the Future of Corporate Reporting.

The Lab's reports provide more detailed examples of blockchain and AI in action and can be found at frc.org.uk/lab/reports ●

Thomas Toomse-Smith
is project director at the FRC's Financial Reporting Lab

ACCOUNTING FOR SUSTAINABLE, LONG-TERM VALUE

Jeffrey Hales and **Robert H Herz** explain how new sustainability standards can help companies achieve long-term success

In recent years, corporations and investors alike have demonstrated an increasing interest in ensuring their financial performance can be sustained over the long term. A new set of rigorously developed, investor-focused sustainability reporting standards aims to help. We believe that this latest evolution in the landscape of corporate reporting will create a lasting wave of new opportunities for the accounting profession.

CAPTURING PERFORMANCE

In November 2018, the Sustainability Accounting Standards Board (SASB) opened the London Stock Exchange to mark the launch of a set of standards that provide industry-specific, evidence-based and market-informed metrics. These standards are designed to capture performance on the sustainability issues most likely to have material financial impacts on companies in each industry.

Why industry based? For an oil and gas company, a key sustainability issue is the sensitivity of its hydrocarbon reserves to future scenarios that account for a price on carbon emissions. For a beverage manufacturer, long-term success will depend more on how it manages water consumption, particularly in stressed regions, to avoid supply disruptions or added costs. In short, when viewing sustainability through the lens of financial materiality, each industry has its own unique profile.

These standards are the culmination of six years of effort, during which time thousands of corporate professionals, investors and industry experts provided input on the standards. The extensive feedback from outreach and public comment periods helped shape the codified set of 77 industry standards and has enabled SASB to gain the broadening market support it has today.

GATHERING SUPPORT

As visible evidence of that support, members of SASB's Investor Advisory Group represent the world's leading asset owners and managers with approximately $29trn in assets under management. Their firms include Aberdeen Standard, BlackRock, Vanguard, State Street, Goldman Sachs, Morgan Stanley, PIMCO and UBS, among others. Why would investors support SASB? As Nordea Asset Management has said: "Incorporating SASB standards in our environmental, social, and governance (ESG) analysis enabled us not only to better assess and identify the financial materiality of ESG issues, but also to identify the relevant indicators or data points that could reflect a company's positioning on those issues."

SASB has also begun to see increasing uptake of its standards by companies around the world, including ArcelorMittal, Diageo, The Gap, General Motors, Kellogg's, Nike, Peugeot, Schneider Electric and many others. For companies looking to comply with the EU's non-financial reporting directive, SASB standards have been recognised by the European Commission as a suitable basis for providing such information. And, as JetBlue Airways has said: "The SASB standards allowed us to better target investors by focusing on the ESG metrics material to our industry, rather than on broad metrics that are less applicable to aviation."

OPPORTUNITIES FOR THE PROFESSION

Back in 2004, ICAEW's forward-thinking publication *Sustainability: The Role of Accountants* pointed out that increasing attention to – and technical rigour around – sustainable business would offer broad opportunities to both the accountancy profession and society at large. That time has come. With the launch of SASB's rigorous industry-specific standards and with corporations acknowledging the need for investor-grade data, markets increasingly need accountants' expertise in measurement, controls, assurance and reporting. Is the profession ready to seize these opportunities? ●

Jeffrey Hales is chair of the SASB
Robert H Herz is a member of the SASB Foundation Board of Directors

ANDREW BAKER/IKON

SMALLER LISTED AND AIM QUOTED COMPANIES: A PRACTICAL GUIDE

Alison Dundjerovic explains the background to the faculty's guide for audit committees of smaller quoted companies

Financial reporting and compliance with relevant reporting frameworks are designed to give investors the ability to assess the financial integrity of a company; they are essential tools for holding management to account. More than this, high-quality financial reporting can contribute to a strong and efficient economy by improving transparency and liquidity and thereby reducing the cost of capital.

THE ISSUE

For smaller listed companies and Alternative Investment Market (AIM) quoted companies however, financial reporting is not always seen as a top-tier issue. The diversity of companies in this sector, in terms of size, structure and strategy, can influence how financial reporting is perceived within the company and the extent to which it is prioritised. While some of these companies may be planning a period of growth and therefore require high-quality financial reporting for investment purposes, others (perhaps smaller companies) may have listed as a one-time financing exercise with no need for further investment. The effect of this diversity has contributed to varying standards of financial reporting quality in this segment of the market.

With the aim of addressing the quality of financial reporting by these companies, the Financial Reporting Council (FRC) published a discussion paper in 2015, *Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies*. Focusing on listed companies with a market capitalisation between £20m and £100m, and UK companies quoted on AIM with a market capitalisation greater than £5m, the FRC found that "while the system of financial reporting is not fundamentally flawed, there is a higher incidence of poorer quality annual reports by smaller quoted companies than by their larger counterparts".

Early engagement by the audit committee chair will set the right tone from the top and demonstrate the company's commitment to high-quality financial reporting

Smaller Listed and AIM Quoted Companies: A Practical Guide for Audit Committees on Improving Financial Reporting

THE RESPONSE

In response to these findings, the Financial Reporting Faculty, in association with the FRC, has recently published *Smaller Listed and AIM Quoted Companies: A Practical Guide for Audit Committees on Improving Financial Reporting*.

The guide is aimed at audit committees which, with responsibility for oversight of the annual reporting process, are well positioned to drive up the quality of the annual report and accounts.

Drawing on discussions at a series of meetings and conversations with relevant stakeholder groups, the guidance offers:

- practical, cost-effective suggestions about how smaller listed companies and AIM quoted companies can improve the quality of financial reporting;
- questions for audit committees to ask of themselves and those associated with the financial reporting process including the board, chief financial officer, finance team and external auditors. These questions are designed to encourage the company to reflect on current financial reporting practices and consider areas for improvement.

The impact of asking the right questions at the right time, combined with recommendations for small practical changes, should enable audit committees to nurture a culture of improvement within the company. In turn, this should bring about a step change in the quality of financial reporting.

The guide is available to download now at icaew.com/SQCguide ●

Alison Dundjerovic is a technical manager in the Financial Reporting Faculty

INTERNATIONAL ROUNDUP

Financial reporting news from around the world

CHINA: ACTIVELY RESPONDING TO CLIMATE CHANGE

Global climate change has a profound impact on human survival and development, and is a major challenge facing all jurisdictions. Across the world, countries are taking a series of measures to cope with the effects of global warming.

This includes China which has recently proposed new developments to accelerate green concepts. In December 2017, the Chinese government launched the initial framework for a national carbon market, marking China's response to tackling pollution and climate change moving into a new phase.

China's authorities, its carbon emissions exchange, investors, lenders and creditors all need carbon-related information to help them make decisions. Among the different types of information required, accounting information is an important component and plays a key role.

An accounting standard on carbon emissions trading schemes (ETS) is therefore critical for the improvement and development of the national carbon market in China.

Since piloting the carbon emissions trading mechanism, China's standards-setter has been working on the accounting issues related to ETS. In 2019, this work will actively continue based on the demands of China's stakeholders. International accounting practices on ETS will be analysed and China's carbon accounting requirements developed.

The aims will be to provide institutional guarantees to help with the development of the trading market and carbon financial markets, to better stimulate the potential of energy conservation and emission reduction, and ultimately to promote the transformation to a green and low carbon economy.

The views expressed in this article are those of the author.

Dr Huaxin Xu works in the Chinese Ministry of Finance and is also head of the Secretariat of the Asian-Oceanian Standard-Setters Group

EUROPE: CLEARING THE DECKS FOR A NEW LEGISLATIVE TERM

EU institutions have been busy cleaning up before the end of term and thinking about what remains on the to-do list for the next legislature. European Commission officials are getting their wishlists ready to present to the next leadership team, due to be nominated after the European Parliament elections. Member states are also making their priorities for the next five years known.

This flurry of activity has not hindered a period of self-reflection though. In May, EU27 leaders met in Romania and reaffirmed their commitment to a common future. The Sibiu Declaration sets out 10 commitments to defend the Union's achievements while also working to safeguard the future for future generations.

The Commission has also been hard at work, issuing recommendations for the next five years that focus on the five labels of protection, competition, fairness, sustainability and influence. The Commission's department responsible for EU policy on financial services has also identified five priority areas covering financial stability, banking and capital markets union (CMU), sustainable finance, technology and international challenges - the last explicitly referencing the challenges and opportunities that Brexit presents for Europe's capital markets.

Under the CMU banner, Brussels has now agreed most of the key building blocks to mobilise funding for Europe's business and infrastructure needs and is considering what comes next. Among the projects getting a green light is the reform of the European supervisory authorities, including ESMA, accompanied by strengthened anti-money laundering tools at EU level. This is not enough for France, Germany and the Netherlands though, which have recently called for the CMU to be treated as an "urgent strategic issue" for Europe.

The profession continues to await an announcement from the Commission following last year's fitness check on corporate reporting. Measures that may be pursued in the corporate reporting arena are likely to include further actions relating to non-financial information and digital developments, especially blockchain as a potential single source of corporate data across Europe.

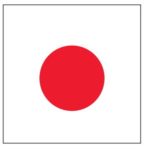
There are hints that the Commission may consider whether a more rules-based approach to IFRS is needed. Additionally, the effectiveness of the current IFRS supervisory framework for cross-border investments may be evaluated, alongside the question of whether ESMA needs to play a more enhanced and central role in interpreting accounting standards. For unlisted companies, consideration may be given to the need for further harmonisation of the principles underlying accounting standards.

Despite all of this activity, sustainable finance remains the main game in town. New (supplementary) guidelines for companies reporting on climate-related information are due for publication in late June, following an early spring consultation.

Meanwhile, MEPs - after much discussion and some division - adopted their position on the so-called "taxonomy regulation", a key piece in the European framework to facilitate sustainable investments. Negotiations with member states should start after the elections. Deliberations on other initiatives, including low carbon benchmarks and sustainable investment disclosures are further advanced.

ESMA is also keeping up the pressure, calling for continued focus on strengthening harmonisation and enforcement of non-financial information disclosures, especially on environmental and climate-related matters (as well as covering issues relating to IFRSs 9, 15, 16 and 17). Climate-related reporting, the first project of EFRAG's European Lab, was also addressed during a high-level conference in March - shortly before the appointment of Chiara Del Prete as chairwoman of EFRAG's Technical Expert Group and Saskia Slomp as EFRAG's new CEO.

Susanna Di Feliciantonio is ICAEW's head of European affairs, based in Brussels



JAPAN: DISCLOSURE INITIATIVE

Efforts to enhance disclosures in annual reports are currently underway in Europe, the US, and other countries. In 2017, the IFRS Foundation published a report, *Better Communication in Financial Reporting*, comprising of case studies illustrating how certain companies improved the way they effectively communicate information in their financial statements. The IASB has also decided to revise the IFRS Practice Statement 1 *Management Commentary* issued in 2010.

Japan is no exception. In December 2018, the Financial Services Agency published draft guidance *Principles for the Disclosure of Narrative Information* (the Draft) to help companies go beyond typical boilerplate style disclosures and enhance their narrative information. It particularly focuses on disclosures relating to business policies and strategies, management's discussion and analysis of financial conditions and risk factors.

The Draft suggests that the disclosure of narrative information should meet all of the following:

- to reflect discussions made at management meetings and board of directors' meetings which enable investors to understand the company from the perspective of management;
- to prioritise disclosure information based on materiality;
- to include management discussions regarding investments in growth, shareholders' return, and capital cost;
- to provide meaningful segment information; and
- to use charts, graphs, and photographs as appropriate for easy understanding.

Japan is also taking measures to improve governance and audit-related information. Furthermore, an exposure draft has also been issued proposing revisions to audit reports by introducing Key Audit Matters. As a result of these combined efforts we believe that investors will be provided with more useful information which in turn has the potential to positively impact corporate values. ●

Takeshi Takada is a researcher (IFRS Desk) at the Japanese Institute of Certified Public Accountants

WEEKLY PLANNER

Take a look at what a week looks like for Head of Financial Reporting, Audit and Assurance, **Nigel Sleigh-Johnson**

As ICAEW's Head of Financial Reporting, Audit and Assurance, Nigel Sleigh-Johnson not only has a busy diary but a varied and interesting one.

Here's an insight into meetings held in one more memorable week from earlier in 2019, illustrating how the faculties' broad range of activities support members, influence policy and promote the public interest.

Monday

☑ **ROUNDTABLE EVENT**
In partnership with the World Business Centre for Sustainable Development, gathering insights for a forthcoming publication *Buyers' Guide to Assurance*

☑ **TEAM MEETINGS**
Weekly faculty staff meetings to discuss current and future activities

☑ **PLANNING MEETING**
Preparations for a visit from the chair of the IAASB and other leadership team members

Tuesday

☑ **ICAEW'S NARRATIVE REPORTING WORKING GROUP**
Quarterly call to discuss latest developments in narrative reporting and put into place action plans to provide relevant support to members

☑ **BREXIT WEBINAR**
Lunchtime webinar: *Preparing for Brexit* – tuning into BEIS's series of webinars

☑ **ICAEW'S FINANCIAL REPORTING COMMITTEE**
Monthly meeting of the committee that responds to financial reporting consultations and considers how developments inform faculty activity

Wednesday

☑ **GLOBAL ACCOUNTING ALLIANCE**
Quarterly call with GAA bodies, discussing developments in integrated reporting

☑ **BITESIZE BRIEFING**
Recording the Financial Reporting Faculty's first, 20-minute webinar *Introducing the FR Lab* with Phil Fitz-Gerald, director of the FRC's Financial Reporting Lab

☑ **FINANCIAL REPORTING FACULTY BOARD MEETING**
Quarterly Board meeting reviewing priorities and operations

Thursday

☑ **CATCH-UP CALL**
Monthly call with the chair of the Audit & Assurance Faculty Board

☑ **FUTURE OF AUDIT**
Discussing Future of Audit thought leadership pieces with staff

☑ **FRC MEETING**
Meeting with FRC's technical director to discuss ICAEW's thoughts on IAASB's Future Strategy & Work Plan consultation

☑ **ICAEW'S TECHNICAL AND PRACTICAL AUDIT COMMITTEE**
Monthly meeting of the committee that provides guidance to ICAEW members on audit matters

Friday

☑ **CONFERENCE CALL**
Monthly call with chair and deputy chair of the Financial Reporting Faculty Board

☑ **TECHNICAL RELEASES**
Internal meeting considering updates to Technical Releases and other special reports

☑ **KINGMAN WORKING GROUP**
Meeting to kick-off planning for ICAEW's response to the audit aspects of the Kingman review, with attendees from practice firms of all sizes representing members' views