ICAEW FINANCIAL REPORTING FACULTY

BY ALL ACCOUNTS

ISSUE 1 | JANUARY 2010 THE JOURNAL OF THE ICAEW FINANCIAL REPORTING FACULTY

IFRS FOR ALL?

Financial reporting by entities of every shape and size is at a crossroads.

BY ALL ACCOUNTS

THE JOURNAL OF THE ICAEW FINANCIAL REPORTING FACULTY

JANUARY 2010 | ISSUE ONE

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FROM THE CHAIRMAN

A warm welcome to the first edition of *By All Accounts*, the journal of the Financial Reporting Faculty.

Publication of the journal marks the latest stage in the development of the Faculty's offering as we respond to initial feedback, which to date I am pleased to say has been very positive.

Since its launch in December 2008, the Faculty has gone from strength to strength, attracting a substantial number of members from the UK and overseas. We were especially pleased to have welcomed the National Audit Office as a corporate member during 2009.

To understand the needs of this diverse membership we need your feedback, and will be encouraging this through a number of focus group meetings in late 2009 and 2010. Do let us know if you would like to participate.

You are part of a growing and highly-respected community of financial reporting professionals, and you are in very good company as the Faculty looks to improve its reach and scope over the coming months. I am proud to act as your chair during this next phase of the Faculty's development.

FROM THE FACULTY HEAD

The past year or so has proved a watershed in financial reporting, perhaps as significant in the round as the switch to IFRS by EU listed companies in 2005.

Financial reporting has been cast by some as the villain of the piece by those seeking to explain the origins of the financial crisis. Erroneous though this may be, it has propelled accounting standards and standard setting to the top of the political and regulatory agendas, not least at the meetings of leaders of the G20 countries. One outcome has been a scramble to amend the requirements for financial instruments standards on both sides of the Atlantic.

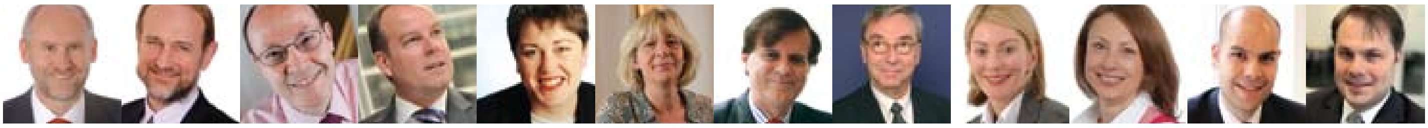
After a deliberate 'period of calm' – in terms of new IASB standards and amendments to standards – following the move to IFRS in 2005, 2009 has seen a welter of changes for IFRS reporters to contend with. In the UK, this has come at a time when major changes to company law also need to be understood and implemented.

The IASB has pushed ahead with proposals for change in 2010/2011 which will radically alter key aspects of financial reporting, including the effective abolition of operating lease accounting and substantial changes to revenue recognition standards.

Major steps have been taken towards the application of IFRS across the UK public sector.

And last but not least, a new and simpler version of IFRS has finally hit the streets, the IFRS for SMEs, and has given rise to proposals to change fundamentally the framework of UK GAAP, with profound implications for private companies and the not-for-profit sector.

The articles in this journal focus on these themes and we hope that many will be of interest to you. I welcome any ideas for the next edition.



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HAVE YOUR SAY

The Faculty is offering you the chance to provide feedback by participating in our focus group sessions. For more information or to get involved please email frfac@icaew.com

REPORTING REFLECTIONS: AN INTERVIEW WITH ROBIN FREESTONE, CFO AT PEARSON

Financial Times publisher and FTSE 100 company Pearson issued positive interims in summer 2009. At the same time, Faculty member Robin Freestone was named Europe's best media CFO by _Institutional Investor_ magazine. Sounds like the perfect time to check in with him and find out how he and his team tackle their financial reporting challenges.

Financial Reporting Faculty: Is it easier to tell Pearson's story when you have good news?
Robin Freestone: When you're performing well – or at least above expectations – it is much easier to explain your financial reports to analysts and investors. There's a well-established rule of thumb that negative variances take five times longer to explain than positive ones. Upbeat numbers are always more readable!

FRF: What difference has the downturn made to analyst and investor reaction to published accounts?
RF: There has been a change of emphasis, and you can see a good example of that in the greater focus on debt now. Equity analysts, who never really bothered very much with the debt side of things and hadn't really thought too much about leverage, are now asking about ratings and bonds and what's going to happen when the next bond renewal comes round.

FRF: So what's the secret of reassuring them?
RF: You have to be open about what's going well – but you also have to be honest and clear about the things that aren't going so smoothly. Anyone presenting universally great news at the moment is probably not going to gain a lot of credibility. With Pearson, the analysts know that advertising is tight at the moment for a paper like the FT, so you have to be up-front about it, explain how the market is operating and where you think visibility of earnings is limited.

FRF: How do you get numbers-driven analysts to take in those broader messages?
RF: If you make your narrative reporting exciting and interesting to read, people will read it. The vast bulk of users of accounts want the numbers, but they also want a context for them, what they mean in terms of strategy and where that's going. They want to know what management thinks and what our competitors are doing. For long-term shareholders, those are the really important questions.

FRF: Are the standards around narrative reporting set about right, then?
RF: Well, you're into that debate on rules versus principles. All businesses are slightly different and you can't simply dictate what every paragraph should say for every company. But at the moment, I think the balance is about right. As a company, we do try to improve the narrative sections of the financial reports all the time, and there are certain things you know have to be covered – risk management, for example. But the annual report is ultimately a means of communication, so it should be as readable as possible – and steer clear of boilerplate.

FRF: What about outside the statutory financial reports?
RF: A lot of analysts and investors get more of the information they want – particularly about the future of the business – from meeting management. We have been putting some of the charts from the management presentations into the annual report too. There is certainly scope for the two formats to work closer. You have to remember that an analyst presentation is all about getting a message across in an hour; reading an annual report cover-to-cover could take you a day. So if we've found ways of communicating financial information more succinctly, it should be in there.

FRF: Are analysts getting better at reading the numbers, particular now IFRS has bedded in?
RF: Yes, but we also have a role in reporting as clearly as possible. For example, most of the conversations we have are around adjusted earnings rather than the statutory numbers. We strip out amortisation of acquired intangibles, for example. And

one-off profits or losses that distort the underlying theme of where the business is going are simply unhelpful. If there are no cash movements, does it really add to your understanding of the business? Of course, every company will have their own version of calculating adjusted earnings, but we're very careful to include reconciliations to the statutory accounts.

FRF: Has the standards environment got better, then?
RF: After the IFRS roll out and a flurry of activity, we're seeing much more stability now. It's nice for a CFO when the standards don't change too much – it means you have less explaining to do in your financial reports to put results in a sensible context – and the last couple of years have been quite settled.

You have to be open about what's going well – but you also have to be honest and clear about the things that aren't going so smoothly.

FRF: Your American Depository Report (ADR) in the US means you avoid quarterly reporting. Is that a good thing?
RF: Not reporting quarterly is very good news! I'm vehemently against it – I've seen in other companies how it promotes the wrong kind of behaviour among people. The focus becomes entirely about the next quarter and you quickly lose sight of the overall year's performance or what you should be aiming at next year.

FRF: Any particular hot issues you can share with the Faculty?
RF: We started applying IFRS 8 on segment reporting last year and it went quite well. That will be quite exciting for some companies, although international groups with complex product lines could have issues. Imagine that you have six business segments and then you decide to reorganise your Asian operations. You could see profits move from one segment to another. The accounting could also end up driving the way you structure the business, which is probably not what was intended.

FRF: Any other areas that are coming to the fore?
RF: Pensions accounting remains tricky. Rates on AA-rated paper are falling rapidly as the recession dies down. That means reported pension liabilities will rise, and under IAS 19 the ratings agencies will see that as debt and adjust ratings downwards accordingly. That's going to make it more expensive for some companies going to the bond markets.

FRF: What's the smartest move your team has made in reporting?
RF: I don't know whether financial reporting necessarily lends itself to moments of genius! But a rather clever move was to use a different format for the annual report – it's somewhere between A4 and A5 sized, so it's smaller than most reports. That seems trivial, but it means if a shareholder or analyst gets a bunch of annual reports in the post, Pearson's report will always be on top of the pile!

More broadly, we prize clarity in our reporting. Majorie [Scardino, CEO] is a huge fan of simple language. And given the way [FT columnist] Lucy Kellaway criticises management-speak, it would look bad if we indulged in it! So if you write jargon in reports – buzzwords that just don't mean anything – you can get shot down very quickly. Good reporting is about clarity, brevity, accuracy and honesty – and we live by those principles.

FRF: As a member of the Faculty, what do you think of its work so far?
RF: I think the Faculty has proved a fantastic addition to the ICAEW and I'm proud to sit on its Financial Reporting Committee. The work we do assessing the implications of new standards is second to none, helped by the breadth of members who sit on the Committee and bring an extraordinary wealth of experience to assessing the technical and practical implications of standards as they come through. I'm not sure how we managed to operate without it but, as ever, there's more to do – I'd like to see the Faculty take a role in reviewing the quality of financial reporting by companies and focusing on where reporting is superfluous or boilerplate as we have a role in taking meaningless stuff out of annual reports as well as adding more in!

THE POLITICS OF ACCOUNTING

Brian Singleton-Green, Faculty Corporate Reporting Manager, examines the impact of the financial crisis on financial reporting.

The struggle for an independent standard setter.

Over the past couple of years, accountants have occasionally been told that they're responsible for the global financial crisis – or at least made it much worse than it had to be. This isn't what most people think (they blame the bankers), but it's a significant minority view and one apparently shared by some of the world's most powerful men and women (and some bankers).

As the crisis isn't over yet and the measures to be put in place to try to stop it happening again are still being argued about, it's a bit early to give a final judgement on how it has affected financial reporting. But we can already see some potentially momentous developments emerging. There are three key issues:

- accounting for financial instruments;
- the objective of financial reporting; and
- global convergence.

And these are all tangled up with each other.

Both in the US and in Europe there has been political pressure on standard-setters to relax requirements to fair value certain financial instruments. This has had a degree of success, but the pressure continues and the standard-setters' response to it is still evolving. Recent IASB proposals try to reach a principled position on when fair value should and should not be used to measure financial instruments. Some think that, on balance, they probably add up to an increase in requirements for fair value. In the US, the FASB is working on proposals that would require all financial instruments to be fair valued. At the time of writing it seems possible that we will end up in 2010 with the opposite of what those exerting pressure on the standard-setters wanted:

- more fair value accounting; and
- a bigger gap between the US and the IFRS world.

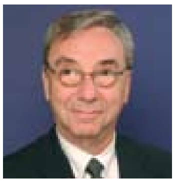
One reason for the political pressures is that politicians and standard-setters have different objectives for financial reporting. For politicians, the key objective is financial stability. For standard-setters, the key objective is information for investors. And they would in any case dispute (as would the ICAEW) whether trying to engineer financial reporting so as to ensure financial stability is likely to be effective. Again, it remains to be seen where this one will end up. But while there is a strong possibility that politicians will force a financial stability objective on standard-setters, the more likely outcome at present seems to be an even narrower focus on investors' interests.

The G20 leaders at their summit in London in April 2009 called for 'a single set of high-quality global accounting standards'. The pressures that some of these same leaders are exerting on standard-setters are leading to the opposite outcome. In some EU countries, it is regarded as perfectly reasonable to tell the IASB what it should do. As we've just mentioned, it's not clear that this will ultimately achieve the particular changes to standards that the politicians want. It is also likely to have a perverse effect on the other side of the Atlantic.

In its November 2008 'roadmap' for deciding whether the US should adopt IFRS, the SEC stated that 'it is important that accounting standards be established under a robust, independent process'. The US is unlikely to conclude that a standard-setting process in which pressure by EU ministers plays a significant role is robust and independent. Indeed, the rest of the world, which is currently using, planning to use, or converging with IFRS, is unlikely to put up indefinitely with such local influence on global standards.

So there is a real risk that some of those who call for 'a single set of global accounting standards' will actually achieve the opposite. Financial reporting is now in danger of becoming a political football. If it does, there is no way of telling where it will end up. Steps are being taken, through for example constitutional changes at the IASB and the establishment of an international monitoring board, to ensure that we emerge from the crisis with a single, robustly independent, global standard-setter. But it may yet all end in tears.

TECHNICAL CONTENT



THE IFRS FOR SMEs: THE UK IS LEADING THE CHARGE

Paul Pacter, Director of Standards for SMEs, International Accounting Standards Board, puts publication of the new IASB standard in context.

Small and medium-sized entities (SMEs) dominate the business world. In virtually every jurisdiction, from the largest economies down to the smallest, over 99% of companies have fewer than 50 employees. There are 21 million SMEs in European Union countries, and 20 million in the United States alone.

In the UK, the Department for Business Innovation and Skills (BIS) reports that in 2007 there were 4.7 million businesses. Of those, only 33,000 have more than 50 employees. BIS says: 'SMEs together accounted for 99.9% of all enterprises, 59.2% of private sector employment and 51.5% of private sector turnover.'

In most jurisdictions, the law requires all or many of these companies to prepare financial statements and, often, to have them audited. Normally, the financial statements are filed with the government and available to the public, or are posted on a website, or are available on request.

> The ICAEW issued a press release entitled 'New accounting standard could open doors for inward investment'. That title expresses beautifully the IASB's goal.

Who uses them? Present and potential lenders (banks and others), vendors, customers, credit rating agencies, family shareholders, venture capital companies, and other capital providers.

STANDARDS FOR SMEs

Which accounting standards do SMEs follow in preparing their financial statements? The global trend, in the past decade, has been for jurisdictions to adopt IFRS directly or to converge their local GAAP to IFRS. Securities regulators actively encouraged this trend because IFRS are designed to meet the needs of companies whose securities trade in public capital markets. This has increased the scope and complexity of issues covered in IFRS, the amount of implementation guidance, and the volume of disclosures. The 2009 bound volume of IFRS has grown to 2,855 pages.

In many countries, this complexity has been pushed down to SMEs. SMEs have become increasingly vocal about the burden of complex standards on themselves as financial statement preparers and about the relevance of the resulting information to those who use small company financial statements.

A reality in some jurisdictions is that the quality of implementation of full IFRS (or converged local equivalents) is less than stellar. Some jurisdictions have developed their own SME standards, but often these have serious limitations from a user perspective, are not readily understood by lenders and other capital providers, particularly across borders, have limited support (eg, textbooks and software), and sometimes are weakly enforced.

If capital providers do not understand or have confidence in the financial information they receive, an SME's access to and cost of capital suffers.

The IFRS for SMEs, issued by the IASB in July 2009, responds to these concerns. It is a self-contained standard of about 230 pages tailored for the needs and capabilities of smaller businesses. Many of the principles in full IFRS for recognising and measuring assets, liabilities, income, and expenses have been simplified; topics not relevant to SMEs have been omitted; and the number of required disclosures has been significantly reduced. To further lessen the reporting burden for SMEs, revisions to the IFRS will be limited to once every three years.

The IFRS for SMEs is separate from full IFRS and is therefore available for any jurisdiction to adopt whether or not it has adopted the full IFRS. It is also for each jurisdiction to determine which entities should use the standard. It was effective immediately on issue.

To support the implementation of the IFRS for SMEs, the IASC Foundation is developing comprehensive training material. The Foundation is also working with international development agencies to provide instructors for regional workshops to 'train the trainers' in the use of the training material, particularly within developing and emerging economies. The training material will be published in a number of languages. The English language material will be downloadable

free of charge from the IASB's website. The complete IFRS for SMEs (together with the basis for conclusions, illustrative financial statements, and a presentation and disclosure checklist) can be downloaded free of charge from http://go.iasb.org/IFRSforSMEs.

REACTIONS TO THE NEW STANDARD

When the IFRS for SMEs was issued in early July 2009, the ICAEW issued a press release entitled 'New international accounting standard could open doors for inward investment'. That title expresses beautifully the IASB's goal – to tailor the financial statements of SMEs to the needs of those who use them and, in so doing, improve SMEs' access to capital while reducing the burden on the companies preparing the statements. In short, there is a 'payback' to using the standard.

There was similar supportive reaction from all over the globe, including public statements from The World Bank, Confederation of Asian and Pacific Accountants (CAPA), American Institute of Certified Public Accountants (AICPA), and South African Institute of Chartered Accountants (SAICA). South Africa, incidentally, became the first country to adopt the IFRS for SMEs as their national GAAP – which they did in August 2009.

Also in August 2009, the UK standard setter the ASB issued a consultation paper *Policy Proposal: the Future of UK GAAP,* which sets out its proposals for the future reporting requirements for UK and Irish entities for comment. The ASB is proposing a three-tier approach to developing UK GAAP converged with IFRS as follows:

- Tier 1 – publicly accountable entities would apply IFRS as adopted by the EU.
- Tier 2 – all other UK entities, except those that elect to apply the Financial Reporting Standard for Smaller Entities (FRSSE), would apply the IFRS for SMEs.
- Tier 3 – small entities could choose to continue to apply the FRSSE if they do not exceed two or more of the following criteria: turnover £6,500,000; balance sheet total £3,260,000; and average number of employees 50.

Entities in Tier 2 and Tier 3 would have the option of using EU-adopted IFRS if they wished, and those

> The ICAEW Financial Reporting Faculty deserves kudos for taking the initiative in early planning for education and training for UK accounting practitioners on the new standard.

in Tier 3 would have the option of using the IFRS for SMEs. Comments are due 1 February 2010. If the proposal is adopted, the changeover date is planned for financial years beginning on or after 1 January 2012.

In all likelihood, the IFRS for SMEs will be a reality in UK and Ireland earlier than in most other jurisdictions. The ICAEW Financial Reporting Faculty deserves kudos for taking the initiative in early planning for education and training for UK accounting practitioners on the new standard.

THE IFRS FOR SMEs: THE ASB INSIDE STORY

Andy Simmonds, member of the UK ASB, Partner at Deloitte and Faculty Chairman, explains ASB thinking on the implications for UK GAAP of the new international standard.

Looking back, it seems as if the ASB has suggested almost every option for the bold new future of UK GAAP.

In 2004, a 'phased approach' was suggested. By 2006, a 'big bang approach' was the favourite based on two tiers: full IFRS and the Financial Reporting Standard for Smaller Entities (FRSSE). This would have been achieved by pushing 30,000 medium-sized companies into the FRSSE, 14,000 subsidiaries of listed groups into full IFRS (with some possible disclosure reductions), and the audience to suggest which way the remaining 7,000 large unlisted companies went (I can imagine ASB Chairman Ian Mackintosh in the role of Brucie – 'Higher!' 'Lower!'). The IFRS for SME project was under way, but it was not yet attributed a role in the UK and Ireland.

Following the issue of an exposure draft by the IASB, the ASB took the opportunity in 2007 to consult again: could the IFRS for SMEs play a role for a middle tier below full IFRS, and above the FRSSE? The answer was a strong 'yes'. The ASB duly set about debating the detail.

THE KEY ISSUES: CUT-OFF, SUBSIDIARIES AND TAX

The first issue was the cut-off between full IFRS and the IFRS for SMEs. Should it be based on size, or on public accountability? A majority of the board favoured public accountability in full knowledge that it could result in some very sizeable private groups, for example groups like Virgin and Clarks shoes, being able to use the IFRS for SMEs. In the other direction, it would mean relatively small investment trusts, building societies and friendly societies, as well as banking and insurance subsidiaries, being required to use full IFRS.

The second issue was whether we could see an option to allow subsidiaries of listed groups to use full IFRS recognition and measurement rules but with reduced disclosure. The board considered segment reporting and realised that wholly-owned subsidiaries were already exempt from that. Financial instruments disclosures were considered highly relevant, especially in the credit crunch environment. And then there was earnings per share – which is not too tricky for a wholly-owned subsidiary. Overall the outcome was that the board did not identify a significant number of useful disclosure relaxations and consequently avoided introducing a fourth tier.

The third issue was whether to accept the IFRS for SMEs verbatim, or adapt it. As a founder member of the 'I hate IAS 12' club, I was up for deleting anything that looked remotely like IAS 12. In a bizarre leap of faith, the IASB not only included the full horror of IAS 12, they went further than IAS 12 by including proposals based on their 2009 taxes exposure draft. Needless to say, wiser heads on the ASB advised keeping the full version, and avoiding a UK/Irish carve out. Given that it now looks as if the international board will put deferred tax on their slow-track list, there is a hope that the section on taxes may be toned down at the first review in around two years time – roughly the time that the UK might implement it.

Apart from that modest lapse on the subject of deferred tax, the final IFRS for SMEs does not disappoint. The IASB in general, and Paul Pacter in particular, must be extended warm congratulations for an excellent piece of work!

THE EUROPEAN CONTEXT

Turning to the European response, the ideal would be full legal endorsement by the EU so that companies could follow the IFRS for SMEs as part of full IFRS without also having to comply with company law accounting requirements. Presently that does not seem too likely.

Work is under way to demonstrate that there is nothing in the IFRS for SMEs that conflicts with the 4th Directive. So while the UK and Ireland may not be encouraged forward by the EU, hopefully there will be no obstacles.

One other possibility, discussed elsewhere in this journal, is the idea of introducing a classification of 'micro entity' and take those companies out of all reporting requirements. Were this to happen, around 80% of all small companies would drop out of the FRSSE's scope. In that case, I am sure the ASB would look again at combining our lower two tiers.

In the meantime, we await UK and Irish reaction to the ASB's consultation paper, and a new chapter in the development of UK standard setting.

TECHNICAL CONTENT

THE IFRS FOR SMEs: THE UK REACTION?

Brian Shearer, member of the UK Urgent Issues Task Force, National Director of Financial Reporting at Grant Thornton and member of the Faculty Board, anticipates implementation issues for UK Ltd.

TECHNICAL CONTENT

What we have been watching from afar is now on our doorstep, and about to gain entry. The IFRS for SMEs is set to become UK GAAP for our mid-market: most of the unlisted companies that are bigger than small according to the EU size criteria. This is a diverse community – some huge private companies all the way down to turnovers of £6.5m or even less. What kind of response might we expect?

Most will acknowledge the achievement of writing a full set of GAAP in 230 pages. They will be charmed by the clarity of the prose, and the topics set out in subject order. Some will delight in the concepts statement made in 52 short paragraphs, and the vision of revisions only every two or three years. All will hope that such merits might cascade upwards to the full IFRS production line.

CHALLENGES FOR PREPARERS

What concerns might UK preparers reasonably have? More extensive use of fair values will be feared. But in truth it is only for financial instruments that mandatory extra fair value requirements are added to UK GAAP for most companies. However, this involves grappling with the value implications of contractual terms that they have signed up to. Deferred tax is possibly a worse ogre, introducing temporary differences and some illogical rules.

Preparers will find the IFRS for SMEs liberally sprinkled with relaxations, 16 due to practicability and 11 if you can claim undue cost or effort. Another 12 references allow a potential fair value measurement to change to a cost base if fair value cannot be measured reliably.

However, I think that the biggest problems facing preparers will be practical, related to familiarity. The IFRS for SMEs vocabulary is IFRS-speak, not UK GAAP. That means inventory and tax bases, and statements of financial position rather than balance sheets. And that belief in an often faded understanding of what UK GAAP requires will be completely removed. When IFRS was introduced in the UK in 2005, not knowing the geography of the new standards was a big barrier to effective implementation.

Allied with that is the need to apply extra resource to the financial reporting area (with XBRL waiting in the wings as well), the kind of resource that many medium-sized private companies do not have. Many companies are reliant on their accounts production software, which will need to change, with the consequent period of further disruption. There are implementation issues other than those in IFRS for SMEs itself, such as assessing whether an entity has public accountability: what is a 'broad group of outsiders', for example? Implementation would ideally avoid applying XBRL to existing UK GAAP

> Most UK companies will find their accounts are recognisable and the numbers relatively familiar.

and then to IFRS for SMEs very soon after. Timing of implementation for 'public benefit' (not-for-profit) entities could be delayed if additional work is needed on a public benefit entity standard.

ALL'S WELL THAT ENDS WELL?

But in the end, most UK companies will find their accounts are recognisable and the numbers relatively familiar. The balance sheet can still be called by that name. After the hiccup of first-year struggle, UK Ltd will probably settle down to a simpler GAAP-life under the IFRS for SMEs. We shall be free from the horrible discontinuities in the currently partly-converged UK GAAP, particularly for financial instruments.

Is that how it will be seen in responses to the Accounting Standards Board consultation? The Faculty will be monitoring events very closely in 2010 as the ASB considers its next moves.

COMPANIES ACT 2006

In a two-part article, Kathryn Cearns, Consultant Accountant at Herbert Smith LLP, Faculty Board member and Chair of the ICAEW Financial Reporting Committee outlines the key accounting changes and the new provisions on directors' duties.

KEY FINANCIAL REPORTING CHANGES

The Companies Act 2006 (the Act), the largest piece of legislation ever to go through the UK Parliament, has reached the final stages of implementation with the last commencement date being 1 October 2009. The Act has changed almost all aspects of company law. What about the rules on financial reporting?

The good news is that changes have been few because most of the detailed rules are either embedded in EU legislation (the Accounting Directives), which UK law is obliged to follow or, where companies are following IFRS, the accounting standards themselves.

Part 15 of the Act covers accounts and most of it applies for the first time to accounts for periods beginning on or after 6 April 2008. What is new is that the law has been rewritten to make it more accessible and easier to follow. In particular, it draws all the main accounts requirements into one place, whereas previously they were scattered around the old Companies Act 1985, and it follows a 'think small first' approach, making it easier for small companies (and their advisers) to work out what they need to do. Its predecessor provided small companies with a list of exemptions from large company requirements as something of an afterthought. All the detailed requirements are contained in secondary legislation, with stand alone versions for small companies on the one hand (SI 2008/409) and medium-sized and large companies on the other (SI 2008/410).

Directors of all companies, whatever their size and whichever standards they are following, must now expressly only sign off accounts if they are satisfied that they show a 'true and fair view'. For directors' accounting disclosures, see pages 22–23.

KEY POINTS

- **The accounting provisions of the new Companies Act are now in place.**
- **The existing requirements have been reordered and restructured.**
- **New filing deadlines apply.**
- **Company size thresholds have been increased.**
- **Medium-sized companies must prepare group accounts.**
- **New disclosure requirements apply to all but small companies.**

FILING REGIME

One very important change effective for accounting periods beginning on or after 6 April 2008 was that deadlines for filing accounts at Companies House have fallen by one month, to nine months for private companies and six months for public companies. This is particularly important as the fines for late filing are now much greater and penalise repeat offenders. As private companies no longer need to hold an AGM, the rules on when companies need to send accounts to shareholders is tied to Companies House filing deadlines; for public companies the rules stay the same.

From 1 October 2009, the rules on authentication and delivery of documents to the Registrar of Companies are governed by the new Registrar's Rules, available on the Companies House website, along with relevant guidance. For documents to be considered 'properly delivered' they must contain only black ink (and care must be taken that all text, including any signature, is in black ink). The company name and registered number must be included on one of the balance sheet, directors' report, directors' remuneration report or audit report. Existing practices may therefore need to be updated.

Accounts not 'properly delivered' may be rejected by the Registrar and filing penalties could be incurred. Furthermore, the concession permitting 14 days to re-file rejected documents will no longer be available for documents due to be filed on or after 1 October 2009.

NEW FOR SMALL COMPANIES

The major issue for small companies relates to who is classed as 'small'. The limits for determining whether a company is small have been raised to the maximum permitted by EU law (two out of turnover £6.5m, gross assets £3.26m, employees 50) and there are some changes to the eligibility criteria. For companies that may meet the size criteria for the first time, it is important to check the transitional provisions. These mean that companies can take advantage of the extended small companies regime in the first period in which Companies Act 2006 applies, even if they had not met the old size limits in their last financial year under the 1985 Act.

The exemptions, new thresholds and the requirements for small companies are examined in more detail in the Faculty factsheet *Companies Act 2006 – Small Companies.*

NEW FOR MEDIUM-SIZED AND LARGE COMPANIES

While the new Companies Act heralded good news for small companies, medium-sized companies have lost out somewhat, with fewer exemptions available than under the 1985 Act. The major loss is the withdrawal of the exemption from preparing group accounts; producing group accounts for the first time could represent a lot of work. The Faculty factsheet *Group Accounting and Medium-Sized Groups* provides practical help to those medium-sized companies which find themselves in the position of now having to prepare consolidated accounts.

Medium-sized companies must also now disclose turnover in their abbreviated accounts, as the exemption from disclosing this figure has been removed.

New rules on the business review were introduced early, on 1 October 2007. These mainly affect quoted companies and are not dealt with here. Full details are provided in the Faculty factsheet, *The Business Review.*

Finally, there are also new rules on disclosure about off balance sheet arrangements and related parties. Much of this is already dealt with by accounting standards, but companies may need to consider whether they have made all necessary disclosures about off balance sheet arrangements as the law is vague as to what this covers. There are some relaxations for medium-sized companies.

IFRS COMPANIES

Companies that follow IFRS on a mandatory or voluntary basis will continue to find that the law acts as a framework for the IFRS preparation. Most of the detailed accounts provisions in the Regulations do not apply; however, some elements of Part 15 and the Regulations will apply in terms of detailed content, including the disclosures of off balance sheet arrangements and information on employee pay, directors' reports, directors' and auditors' remuneration disclosures and so on.

Members are reminded that the Faculty has produced a number of very useful factsheets for its members related to the new accounts provisions of the Companies Act 2006, providing more detail on many of the topics highlighted above.

DIRECTORS' DUTIES: WHAT YOU NEED TO KNOW

If you are a director of a UK company, you have various duties and responsibilities to the company in law, many of them relevant in a financial reporting context. Until recently, most directors' duties were formulated under the common law; that is, they had developed over time through precedent case law. That has changed under the 2006 Act, which has codified directors' duties into statute for the first time.

The aim of this change was to simplify things for directors, adding clarity and certainty, as their duties would be clearly articulated in one place.

> Ultimately it will be for the courts to interpret the effect of the new statutory statement, but in the meantime directors need to understand – and follow – the newly-codified requirements.

The difficulty of case law is that its conclusions at any one time are probably fairly obscure to a non-lawyer and hard to access without taking legal advice even in the simplest situation. The downside to moving to a statutory approach, however, is that the subtleties of previous case law decisions are potentially lost: statute being rather a blunter instrument, differences would inevitably arise, notwithstanding the aim of preserving exactly the same law. Additionally, the flexibility of the common law to deal with specific situations would be lost.

DIRECTORS' DUTIES NOW IN COMPANIES ACT 2006

There are seven duties laid out in the Act, as set out overleaf. One or two of the more interesting ones from the perspective of the finance director are discussed below.

Each duty is enforceable as a fiduciary duty – the director is liable for damages or for an account of the profits and the transaction is voidable. The exception is the duty of reasonable care and skill, which is not a fiduciary duty and the only remedy is damages to the company for loss suffered as a result.

DUTY TO PROMOTE THE SUCCESS OF THE COMPANY FOR THE BENEFIT OF ITS MEMBERS

A director of a company must act in the way they

TECHNICAL CONTENT

consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and in doing so have regard (among other matters) to the:

- likely consequences of any decision in the long term;
- interests of the company's employees;
- need to foster the company's business relationships with suppliers, customers and others;
- impact of the company's operations on the community and the environment;
- desirability of the company maintaining a reputation for high standards of business conduct; and
- need to act fairly as between members of the company.

The roughly equivalent common law duty is the fiduciary duty to act in good faith in the best interests of the company, but the new duty also encapsulates the concept of 'enlightened shareholder value' ie, taking into consideration the wider community and the longer term. Note that it ties in with the statutory purpose of the business review in annual reports, which is framed in terms of how the directors have succeeded in fulfilling this duty. A duty to creditors is still retained as a common law concept for companies on the verge of insolvency.

DUTY TO EXERCISE REASONABLE CARE, SKILL AND DILIGENCE

This duty will be of particular interest to finance directors, but also to any chartered accountant who acts as a director to a company, even if he or she has no direct responsibility for financial reporting or financial controls.

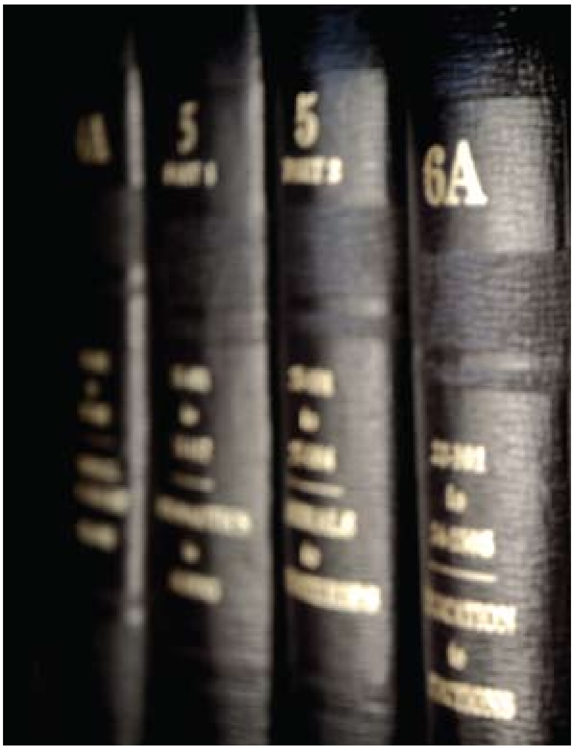
THE SEVEN DUTIES

In force from October 2007

1. **To act within the powers conferred by the company's constitution.**
2. **To promote the success of the company for the benefit of its members.**
3. **To exercise independent judgement.**
4. **To exercise reasonable care, skill and diligence.**

In force from October 2008

5. **To avoid conflicts of interest.**
6. **To not accept benefits from third parties (ie, don't take a bribe).**
7. **To disclose any interest in a proposed transaction or arrangement with the company.**



This duty means using the care, skill and diligence that would be exercised by a reasonably diligent person with:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
- the general knowledge, skill and experience that the director has.

What that means in practice is that there is a subjective and objective test, reflecting the more recent case law as to what a director's duty of care and skill should be. So chartered accountants would always be expected to have applied their higher skills and abilities, including in respect to corporate reporting.

CONCLUSION

How will this all work in practice? The statutory duties cannot be excluded or changed by a company except as specifically permitted in the 2006 Act. The government attempted to finesse the problem of losing some of the subtleties of the common law by explaining that the statute is based on common law rules and equitable principles and has effect in place of them, but regard should be had to the corresponding common law rules and equitable principles when interpreting and applying the statutory duties.

Ultimately it will be for the courts to interpret the effect of the new statutory statement, but in the meantime directors need to understand – and follow – the newly-codified requirements to the best of their ability.

EU FINANCIAL REPORTING: IS SIMPLIFICATION ON THE HORIZON?

Pablo Portugal, ICAEW European Union Affairs Manager, looks at proposals for 'micro-companies'.

TECHNICAL CONTENT

The much-publicised commitment to reduce 'administrative burdens' on businesses arising from EU legislation by 25% – and by 2012 – has made the simplification of the 4th and 7th Company Law Directives a policy priority in Brussels.

Despite the momentum for comprehensive reform, overhauling a financial reporting regime that affects around seven million SMEs in a single market of 27 national jurisdictions poses particular challenges. The SME sector is, after all, markedly diverse and the reporting needs of businesses can vary considerably according to their individual characteristics and specific national environments.

Reform has so far been pursued through two parallel work streams: a proposal giving member states the option to exempt micro-companies from the accounting directives, and also a root-and-branch review of those directives for companies that remain within their scope.

WHAT IS A MICRO-COMPANY?

Companies with:

- **fewer than 10 employees**
- **a balance sheet total (ie, total assets) below €500,000**
- **annual turnover below €1 million.**

Two out of the three criteria would have to be satisfied.

EXEMPTING MICRO-COMPANIES

The legislative proposal to exempt micro-companies from the scope of the directives was published by the European Commission in February 2009. The proposal is yet to be fully considered by the European Parliament and Council given that the Parliament had to break for European elections in 2009.

Micro-companies, as defined by the Commission, are estimated to constitute over 75% of EU companies. If adopted, the proposal would account for a major portion of the targeted 25% reduction of regulatory burdens in this area.

The case for considering the exemption has been articulated by a number of stakeholders, including the UK Government and the ICAEW. The benefits of a common EU financial reporting regime are less compelling for very small businesses, which tend to be active mainly within their local national environment. The proposal could thus provide the flexibility needed for each member state to instigate a comprehensive debate about the financial reporting regime that most appropriately meets the needs of its smallest businesses.

The proposal's unprecedented deregulatory nature has also raised awareness about the broader purpose of reporting requirements at the EU and national levels. Is there really a need for an EU-level obligation for all incorporated businesses to prepare and publish annual accounts, as currently required by the directives? Are there potential systemic risks if the freedom from EU requirements is not replaced with other appropriate measures by all 27 national governments? Such questions are likely to be important as national authorities and the new body of MEPs continue their debate.

REFORMING THE ACCOUNTING DIRECTIVES – THINKING SMALL FIRST?

Following a public consultation in early 2009, the Commission announced that legislative proposals revising the accounting directives would not be published later in 2009 as originally intended. The Commission will instead conduct further consultations, particularly regarding the IFRS for SMEs and the needs of users of SME financial reporting in the EU.

The Faculty welcomed this less ambitious timetable for two main reasons. Firstly, it is important that the outcome of the review is fully compatible with the IFRS for SMEs, given that a number of member states have expressed an interest in its application in their jurisdiction. Secondly, extending the timeframe of the exercise would permit a much needed root-and-branch modernisation of the directives to be undertaken according to the 'think small first' principle, rather than a piecemeal revision. The Faculty has argued that the outcome should be a comprehensively-simplified and forward-looking framework comprising a set of principles-based requirements, leaving detailed accounting practices to be addressed at the national and standard-setter levels.

As a new vision for reporting for SMEs and other private companies is debated, the Faculty and the ICAEW's Brussels office will continue to engage very closely with policy makers to try to ensure that the outcome is an improved and more proportionate reporting regime for UK reporters.

IFRS IN TRANSITION

Nigel Sleigh-Johnson, Faculty Head, reviews changes to IFRS effective for 2009 and highlights relevant Faculty resources.

The 'period of stability' in IFRS after 2005 did not mean that the IASB downed tools – far from it. Work has continued on a huge technical programme, and the upshot is a raft of changes coming into force for 2009, with much for IFRS preparers and auditors to get to grips with. This article highlights some of the main changes that impact 2009 reporters. More detail is available in the Faculty's factsheets and webcasts, which are referred to below. They offer practical help with the new accounting requirements.

PRESENTATION

One of the most visible recent changes to IFRS has been the application of IAS 1 revised, effective for annual periods beginning on or after 1 January 2009.

One result of the changes is to terminology. The balance sheet becomes the 'statement of financial position' and the cash flow statement becomes the 'statement of cash flows' – although companies should note that they can choose not to use any of the new terms introduced by the standard in their financial statements.

> Fundamental changes will be seen in upcoming consolidated financial statements as a result of the overhaul of IFRS 3 *Business Combinations.*

More fundamental is the combining of the income statement and elements of the old 'statement of changes in equity' into a new 'statement of comprehensive income', in which all gains and losses, whether realised or unrealised, are reported. This leaves the new 'statement of changes in equity' as a vehicle to report transactions with shareholders, such as dividends and share issues, with all other changes in equity reported in aggregate. Also significant is the fact that a third balance sheet will be required whenever there is a prior year adjustment.

The changes to IAS 1 are examined in detail in the recent Faculty factsheet, *IAS 1 Revised.*

BUSINESS COMBINATIONS

More fundamental changes will be seen in upcoming consolidated financial statements as a result of the overhaul of IFRS 3 *Business Combinations* and the related amendments to IAS 27 *Consolidated and Separate Financial Statements,* effective for periods beginning on or after 1 July 2009.

The revisions to IFRS 3 see the introduction of an option to measure the non-controlling (minority) interest at fair value at acquisition date. As a result goodwill can be measured at its full value, to include both parent and non-controlling interest goodwill. This option is available on a transaction by transaction basis – an odd outcome, which reflects a lack of consensus on the topic at the IASB.

Further changes to accounting for business combinations include:

- the treatment of acquisition costs as period costs rather than part of consideration;
- the measurement of contingent consideration at fair value at the acquisition date even where payment is not considered probable;
- the application of acquisition accounting only at the point where control is achieved; and
- accounting for acquisitions and disposals without a change in control through shareholders' equity.

For acquisitive companies, understanding these changes is critical. A Faculty webcast on business combinations examines in a highly practical way the effect of applying the revised standard. The revision to IFRS 3 is summarised in the Faculty's *2009 IFRS Accounts* factsheet, and practical tips on applying the revised standard will be available in a forthcoming factsheet *IFRS 3 Business Combinations.*

OPERATING SEGMENTS: A NEW APPROACH

IFRS 8 *Operating Segments* became effective for periods starting on or after 1 January 2009, replacing IAS 14. The new, US-inspired standard was not popular with campaigners for more transparency about corporate activity on a country-by-country basis, and was only endorsed for use in the EU after much high level wrangling. There is, so far, no corresponding change to UK GAAP.

The objective of the standard is to require public companies to disclose information about their business activities on the basis of internal reports about components of an entity that are regularly reviewed by the 'chief operating decision maker' (CODM) – in the UK, often the board of directors collectively – in order to allocate resources and assess performance.

The amount of each operating segment that must be reported is the measure that is reported to the CODM. This means more flexibility over what is disclosed for reportable operating segments, and the possibility that non-GAAP measures of assets, liabilities and profit or loss may be disclosed.

There are also a number of important entity-wide disclosures to come to grips with, notwithstanding the title of the standard.

A number of UK companies have adopted IFRS 8 early. For others, advice on the application of IFRS 8 is available in the Faculty's *IFRS 8 Operating Segments* factsheet.

CHANGE, CHANGE – AND MORE CHANGE

Over 30 other changes to IFRS literature became effective in 2009. Some of these are relatively minor – including many arising from the final output of the 2006–2008 'Annual Improvements' cycle – while others are more fundamental. A few of these are referred to in the box.

The Faculty has brought together all of the new requirements with mandatory application dates in 2009 into one bumper factsheet, *2009 IFRS Accounts.* The factsheet also addresses the thorny issues of EU endorsement, which in some cases means the effective date attached to a standard by the IASB is superceded by a later EU one. Other topics are dealt with in standalone factsheets, including IFRS 8, IFRS 3, and the important changes to IFRS 1 and IAS 27 – which remove one of the most significant barriers to UK parent companies adopting IFRS in their separate financial statements.

OTHER CHANGES

Other changes to IFRS effective 2009 include:

- **IFRS 1 and IAS 27 – changes to the accounting for the cost of an investment;**
- **IAS 23 – capitalisation of borrowing costs has been made mandatory;**
- **IAS 38 – promotional expenditure will now generally be expensed on delivery;**
- **IFRS 7 – new disclosure requirements have been added; and**
- **IAS 32 – some 'puttable' instruments must now be classified as equity.**


FINANCIAL REPORTING FACULTY

IAS 1 REVISED

Key changes

PRACTICAL FACTSHEETS ON IFRS, UK GAAP AND COMPANY LAW

The Faculty has published 12 factsheets to date, on topics ranging from small company reporting issues to new requirements in IFRS. The factsheets include practical tips, illustrative examples and sources of further guidance with links to the Faculty's standards tracker and eIFRS.

You can download the factsheets at www.icaew.com/frfukgaapfactsheets and www.icaew.com/frfifrsfactsheets. Comments and suggestions on existing factsheets or new titles should be sent to frfac@icaew.com

UK GAAP: THE CALM BEFORE THE STORM?

Marianne Mau, Faculty Manager, takes a look at developments in the UK GAAP reporting environment and highlights Faculty resources in this area.

Recent years have seen UK GAAP fall into something of a state of limbo while its future is decided. The Accounting Standards Board (ASB) has deferred most of its own projects, with amendments to standards made only as a result of following the IASB's lead on already-converged standards, or the Companies Act 2006 (discussed elsewhere in this journal). Most major changes to IFRS have, of late, not been reflected in UK GAAP – such as IFRS 3 on business combinations, IFRS 8 on operating segments, the prohibition on expensing borrowing cost under IAS 23…and so on.

So, a quick look at the more important developments while we await the proposed radical reform of UK GAAP.

FRS 8 IS OVERHAULED

The new Companies Act has had a knock on effect on FRS 8 *Related Party Transactions,* which has been amended with effect from 6 April 2008 to reflect changes introduced by The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations.

The definition of a related party has been brought into line with that contained within the equivalent international standard, IAS 24, and the exemptions from disclosing related party transactions between group companies have been reduced such that only transactions between a parent company and **wholly**-owned subsidiaries need not be reported.

There are a number of points to watch when first applying the revised standard. Companies need to review carefully existing lists of related parties, and the scope of the disclosures provided under the previous regime. Additional disclosures are needed in those situations where a parent company owns between 90% and 99% of a subsidiary.

The amendment to FRS 8 is one of the topics covered in the Faculty factsheet *2009 UK GAAP Accounts.* The factsheet also explains recent amendments to the converged UK standards on financial instruments and share-based payment following amendments to IFRS.

SMALL COMPANY ISSUES

A number of deficiencies in small company accounts have been identified by the FRC's Professional Oversight Board (POB), for example, the issue of 'boilerplate' or generic disclosures. Too many companies rely heavily on standard reporting packages which suggest non-specific accounting policy disclosures such as 'inventory is stated at the lower of cost and NRV', without going into the detail of how the relevant amounts are determined.

The Faculty's factsheet *Small Company Reporting Issues* discusses this issue and identifies a number of other 'problem disclosures'. These include those for income recognition, where many companies state that 'turnover represents sales made net of VAT and trade discounts' without explaining the basis on which income is recognised, and investment properties, where companies commonly neglect to disclose the true and fair override in operation where investment properties are revalued but not depreciated. The factsheet also considers the FRSSE, small companies and IFRS, and the still-topical issue of impairment reviews.

HERITAGE ASSETS

The ASB did produce one new standard in 2009, FRS 30 *Heritage Assets,* enhancing the disclosure required, first applicable to accounting periods beginning on or after 1 April 2010. The main impact is to give more disclosure without changing the items that are brought on-balance sheet or their measurement.

LOOKING AHEAD

As discussed elsewhere in this journal, in August 2009 the ASB published proposals for the future shape of the UK financial reporting regime. One outcome of the eventual changes may be more UK companies thinking about switching to IFRS. The Faculty has provided a commentary on the transition process by means of a webcast, *Practical lessons from IFRS implementation in the EU.*

MORE THAN THE NUMBERS

Nigel Sleigh-Johnson, Faculty Head, and Rosie Ware, Senior Manager at Deloitte, consider some of the challenges involved in writing the front half of the annual report.

Finance directors are, you might say, in the communications business. According to research, the front half of the annual report of listed companies is read far more widely than the audited financial statements. This is where the directors can explain the financial results and position and, with suitable care, give clues on how the business may do in the future. So what are the key questions to bear in mind in writing or reviewing these narrative sections?

Are key messages communicated effectively?

Communicating the key messages in an increasingly lengthy annual report presents a challenge to many companies, yet is more important than ever in the current economic environment. To assist readers, the majority of companies now include summary information at the beginning of their reports.

Provide a succinct overview of the company's mission, what it does, where it operates, operational highlights and key achievements for the year, both financial and non-financial, as well as a selection of key performance indicators (KPIs).

Does the annual report provide real insight into the business strategy and objectives?

The company's business strategy and objectives should be the foundation of the annual report, against which performance is measured and future prospects discussed.

Provide clear explanations of specific and measurable objectives and link together the strategy, performance measurement, risk management and future prospects.

Is it clear why the performance measures have been chosen?

The business review must include an analysis, using KPIs, explaining how management monitor strategic progress. The KPIs should be specifically identified, clearly defined and provide a balanced analysis of both financial and non-financial performance.

Provide comparatives and set qualitative and quantitative targets to measure performance in the future. Where it is not obvious, also provide reconciliations to the financial statements of numbers used in the calculations.

Is sufficient prominence given to principal risks and uncertainties?

The Companies Act requires a description of the principal risks and uncertainties facing a company. The risks identified within the business review or risk statement should be consistent with those disclosed elsewhere in the report.

Explain the specific risks and uncertainties applicable to the business, rather than referring to risks in generic terms.

Does the business review set the context for the rest of the report?

The business review should provide a meaningful discussion of what the company does, its major markets, competitors and the regulatory environment. It should be a balanced and transparent narrative of the company's performance for the year. The front and back halves of the annual report should tell a consistent story.

Discuss the company's strengths and resources, the impact of laws and regulations, as well its competitors, and link this information to its strategy, objectives and KPIs.

Narrative reporting by UK listed companies is subject to a complex body of requirements that have been subject to significant change.

From periods beginning on or after 20 January 2007, UK listed companies have had to comply with the requirements in the Disclosure and Transparency Rules (DTR) issued by the Financial Services Authority (FSA). Among other things, they are required to produce a narrative report in their half-yearly accounts and to provide some narrative information in the interim management statements, required for the first and third quarter.

The second significant change of late was brought about by the Companies Act 2006, which strengthened the requirements for non-financial and forward-looking information in the business reviews of quoted companies. The review must include information on social and community issues – an area previously attracting little comment in some annual reports – and essential contractual arrangements.

It's also important to note that the directors' report is now within the remit of the Financial Reporting Review Panel, which checks for compliance with the law and FSA rules.

Can good, balanced narrative and non-financial reporting bring a company's story to life for the average investor? This is no easy task, but many companies have yet to rise to the challenge. Key to this is taking the time to stand back and assess whether the annual report forms to the greatest extent possible a coherent whole rather than an amalgamation of disparate sections. While narrative reporting is governed by numerous rules and is under increasing scrutiny from regulators, compliance with the relevant requirements need not be a barrier to logical structure and readability. However this will only be achieved if annual reports are the end result of a well thought-out and well-managed process – from the start right to the end.

PUBLIC SECTOR FINANCIAL REPORTING: AN UPDATE

Andrew Baigent, Director General for Financial Audit at the National Audit Office and Vice-Chair of the ICAEW Financial Reporting Committee, provides an overview of recent developments.

Financial reporting in the public sector has undergone significant changes in recent years, replacing a mainly cash-based system of financial reporting and budgeting to one which uses accruals data. Most significantly, departments are now able to consider the balance sheet implications of policy decisions. This should allow government organisations to fully consider the costs of their business decisions, and to be able to obtain reliable cost data on the outputs they deliver. Reliable financial reporting information is available, but there is much to do in some organisations to make the most of this data in supporting business decisions.

The most significant current change is the transition to IFRS. Central government organisations are mid-way through the transition process. Stage one involved the compilation of opening balance sheets – a task which around half of government departments competed successfully. Stage two involves the preparation of 'shadow' accounts – a full set of IFRS compliant accounts, which restate the 2008–09 statutory accounts on an IFRS basis. These will be subject to an external audit by us at the National Audit Office (NAO).

The last year or so has also been an interesting one for financial reporting in central government, with new and complex issues around accounting for government guarantees, and the assessment of the potential for calling on contingent liabilities gaining new prominence with the economic downturn and the tighter fiscal position. Indeed the need for accurate and timely financial reporting to aid decision making has never been greater at a time when government needs to plan for a reduction in the resources available to support expenditure plans.

As the external auditor of central government we at the NAO clearly see the challenges which government organisations face in making the transition to IFRS. We also see the challenge which Treasury and finance directors face in ensuring the finance profession in government has the skills to provide effective business support and are properly embedded in their organisations. We live, if nothing else, in interesting times!

TECHNICAL CONTENT

IFRS IN CENTRAL GOVERNMENT

Ian Wilmot, Senior Manager in Deloitte's Government Accounting Advisory Team, discusses some of the issues arising from the Chancellor's announcement in the 2007 budget that the accounts of approximately 2,000 public sector bodies would be produced in accordance with IFRS from the year ended 31 March 2009.

The Government's motivation for the move to IFRS was stated clearly when the policy was announced in the 2007 Budget: '…The Government needs to use high value performance data in combination with appropriate financial data…in order to bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice….'

To put the issue into a wider context, the move to IFRS can be seen as an important part of the Government's finance professionalisation agenda. It is an agenda which includes professionally-qualified finance directors sitting on the board of all Whitehall departments; enhanced financial management of programmes and projects; and faster closing of accounts.

TRANSITION TO IFRS IS COMPLEX

There are a number of potentially complex technical accounting issues associated with the move to IFRS, including for example leasing arrangements and employee benefits. One of the most contentious areas is accounting for PPP/PFI/outsourcing arrangements. The effects can be significant, with previously off balance sheet underlying assets likely to be on balance sheet under IFRS. The detailed entries associated with this treatment rely on the availability of supporting documentation, which can be difficult to gather, given that these arrangements are by their nature provided by a third party.

The fact that many of the capital transactions that the public sector enters into are complex and performed with different objectives from those of a commercial organisation adds to the complexity of adopting IFRS in the public sector. In a few cases the underlying international standards have been adapted by HM Treasury, with the agreement of the Financial Reporting Advisory Board, because the standard does not make good sense in a public sector context. For example, public sector assets are constructed for a social good, not to earn a return on the investment.

A DISCLOSURE CHALLENGE

The disclosure required in the annual report and accounts of a public sector body is at least as detailed as that in the financial statements of a comparable corporate entity. In my experience, many public bodies are making reasonable progress in responding to the challenge of transitioning primary accounting statements to IFRS reporting. However it is only now, in autumn 2009, given the shadow reporting requirements, that many have started to consider the notes and disclosures required under IFRS.

While public sector guidance is available to assist in the interpretation of the required entries in the primary statements, there is limited interpretation possible for the notes to the accounts. Under IFRS these are often much more detailed than under UK GAAP. In particular, IFRS requires more disclosure of risks and the potential effects of changes in the economy on financial instruments, pensions, and asset carrying-values than UK GAAP. A question here is whether the level of disclosure for a public sector body should be the same as, or greater than, that for a listed company.

One of the most contentious areas is accounting for PPP/PFI/outsourcing arrangements. The effects can be significant, with previously off balance sheet underlying assets likely to be on balance sheet under IFRS.

THE REQUIREMENT FOR STRONG PROJECT MANAGEMENT

The challenges that public sector bodies face in relation to IFRS transition mean that strong project management is an essential ingredient for success. It is important that the management of the IFRS transition process is led by a dedicated team of individuals as opposed to be treated as an 'added requirement' alongside the day job. There is evidence that those without dedicated resource and a clear focus struggled to meet the early milestones in the IFRS transition process.

RHETORIC AND REALITY

Brian Singleton-Green, Corporate Reporting Manager, previews a new report from the Faculty.

The Financial Reporting Faculty is about to publish *Developments in New Reporting Models,* a new report in its *Information for Better Markets* thought leadership series.

Developments is a follow-up to an earlier report, *New Reporting Models for Business* (2003). This looked at a number of recent calls for a new model for business reporting. These typically drew attention to perceived inadequacies of financial reporting, and proposed a new model that would encompass extensive non-financial disclosures to compensate for financial reporting's alleged weaknesses. Most of these calls for reform emerged in the 1990s, when there was a heavy emphasis on the importance of intangibles. (Remember the internet boom and the 'new economy'?) And financial reporting's apparent inability to cope with intangibles was a strong element in the reformers' case.

The 2003 report raised a lot of questions, but carefully avoided arriving at conclusions. Our new report raises some fresh questions, but tries to answer the more important of those posed in 2003 – partly with the benefit of research that we've commissioned in the past six years.

DRAMATIC EFFECTS

In some ways, of course, the debate has moved on. In particular, the global financial crisis is now often cited as evidence that the reporting model is broken. And there is also much concern about the volume and complexity of reporting.

In *Developments,* we argue that there is a need for constant change in business reporting. Business itself is always changing, changes in IT have dramatic effects on the costs of producing and using information, and users' information needs don't stand still. So business reporting needs to evolve constantly to keep up with changes in its environment.

But the key word in that conclusion is 'evolve'. In the report we look at the arguments for saying that the financial reporting model is broken and don't find any of them convincing. Certainly financial reporting has its limitations, but these are widely acknowledged, including by financial reporting standard-setters. Certainly it needs to be supplemented by non-financial reporting. And in this respect reporting has changed significantly over the past 20 years.

Non-financial reporting now often outweighs financial reporting. A 2008 study by Deloitte, *Write from the Start: Surveying Narrative Reporting in Annual Reports,* found that for UK listed companies on average 54% of the annual report and accounts was taken up by narrative reporting. And there is also a huge volume of non-financial disclosures outside the annual report – mainly on company websites. So you could say that the reformers have won the argument on this point.

But all these disclosures do not follow any single, detailed, externally-prescribed model. In *Developments,* we argue that no such model is possible – what companies need to disclose varies too much, from one company to another, and over time. Having some high-level principles is another matter. The EU's business review requirements and the IASB's *Management Commentary* proposals are examples of such a high-level approach. But they do not provide detailed models.

ATTRACTING ATTENTION

We conclude that calls for a new model or claims that the old model is 'broken' often need to be seen as rhetorical devices. They are ways of attracting attention – something we all have to do if we want to be heard. Whether they are ways of attracting attention to needed reforms is a question that has to be answered on its merits, case by case.

Business reporting, we argue, is unlikely in normal circumstances to need a revolutionary redesign. Market forces, regulation, ethical and emulatory motives, and pressure from participants in the public debate, all push reporting to adapt to changing circumstances. Permanent evolution rather than revolution is likely to be the sensible approach to reform.

But precisely because business reporting evolves in response to its environment, it is also possible for that environment to push it in the wrong direction or to stunt its evolution. Excessive or misguided regulation, for example, or a defective legal framework that encourages a focus on liability problems rather than communication, may lead reporting astray. So the forces that shape reporting – as well as reporting itself – need to be kept under constant and critical review.

Find out more at www.icaew.com/bettermarkets

TECHNICAL CONTENT

DIRECTORS' ACCOUNTING DISCLOSURES: THE NEW UK REGIME

Stephanie Henshaw, Technical Partner at Francis Clark and Faculty Board member, examines the new regime and highlights some of the several pitfalls and areas of uncertainty.

Disclosure in company accounts of matters relating to directors is not a new concept. Disclosure can be more sensitive in some companies than in others, particularly for small owner-managed businesses.

The Companies Act 2006 (the Act) has removed some requirements and reworded others. Companies will therefore need to identify where disclosures require updating.

DISCLOSURES THAT HAVE BEEN WITHDRAWN

The Act repealed the longstanding requirements of the 1985 Act, as set out below.

One effect of the repeal of the directors' interests disclosure has been on the practical application of FRS 8 *Related Party Disclosures.* Directors are related parties of the company as key management personnel. The taking of a material equity-interest by a director requires disclosure as a related party transaction. Therefore, dividends paid to directors in their capacity as shareholders should also be disclosed as related party transactions if they are material. Dividends paid to directors were not disclosed separately before 6 April 2007 because the information was already in the accounts, albeit indirectly, through the directors' interests and the total dividends paid and payable.

ADVANCES AND CREDITS GRANTED TO DIRECTORS

Section 232 of the 1985 Act required disclosure of any loan, quasi loan or credit transaction with a director and also related guarantees and security. The detailed requirements were contained in Schedule 6 to the Act and included the following:

- name of director;
- amount of both principal and interest due by the director at both the start and end of the year;
- highest amount outstanding during the year;
- interest falling due but not paid; and
- amounts written off.

If a loan was made to a connected party of a director, the accounts had to disclose the name of the connected party and name of the director with whom the party was connected.

Section 413 of the 2006 Act requires disclosure of advances and credits granted to directors. The term 'advances and credits' is not defined and is not repeated elsewhere in the Act. For example, Part 10 of the Act which deals with shareholder approval of transactions with directors still refers to 'loans', 'quasi loans' and 'credit transactions'. The wording was changed to bring it closer to the EU company law directives. It is assumed that it refers to the same types of arrangement as Part 10.

The scope of the disclosure has also changed. For advances and credits, companies must disclose the amount advanced but also:

- an indication of the interest rate;
- the main conditions; and
- any amounts repaid.

There is no requirement to disclose the amount of interest owed, any interest due but not paid, and amounts written off. The main conditions could include, for example, whether the advance is repayable on demand, there is a schedule of repayments or the company has taken any security. Companies will therefore need to adjust the information they gather to produce their accounts and also adjust comparatives.

Interestingly, there is no explicit requirement to disclose the name of the director to whom the advances etc were made, although the information will be of limited value without names.

The accounts must disclose the aggregate amounts advanced and repaid, although it is not clear whether this means the total advanced to directors as a whole or for an individual director.

WITHDRAWN DISCLOSURES

From 6 April 2007

- **Disclosure of directors' interests in shares of the company. Replacement provisions apply to companies on a regulated market only, and are not dealt with here.**

From 6 April 2008

- **Disclosure of material interests of directors in transactions of the company.**
- **Disclosure of loans and quasi loans to and credit transactions with connected person of directors.**
- **Disclosure of loans to or transactions between the company and other officers.**

A key difference in wording is that while Schedule 6 required disclosure for 'any transaction or arrangement', section 413 requires disclosure of 'any advance or credit subsisting at any time during the financial year'. This, together with the requirement for aggregate amounts, raises the question of whether companies should disclose each individual advance made during the year. This could prove particularly onerous for small companies, where it is more common for directors to pay personal expenses through the company, repaying later or offsetting advances against bonuses or dividends. Historically, such companies have tended to disclose only the aggregate amount and not individual transactions.

For guarantees the accounts must disclose:

- the main terms;
- the maximum liability incurred by the company; and
- any amounts paid and any liability incurred for fulfilling the guarantee.

The aggregate maximum liability and aggregate amounts paid and incurred must also be disclosed.

The general consensus at present seems to be that small companies should give the same disclosures in any abbreviated accounts they file because there is no explicit exemption. The extent of the disclosures is therefore all the more sensitive.

This is an important and complex area of disclosure, and there continues to be uncertainty about the new requirements. The Faculty will be monitoring developments closely.

INFLUENCING THE DEBATE IN 2009

Nigel Sleigh-Johnson charts the efforts of the Faculty to ensure that new requirements are fit for purpose.

The Faculty is one of the most active and respected commentators around the world on financial reporting issues. In the first nine months of 2009 alone, the Faculty's Financial Reporting Committee submitted and published 44 comment letters to bodies as diverse as the US SEC, the European Commission, and of course the key standard setting bodies, including the IASB and ASB.

We also work closely with Fédération des Experts Comptables Européens (FEE), the representative body for the European accountancy profession, in the formulation of joint submissions with our colleagues in Europe, and work hard to influence the debate in other ways, formal and informal. For example, so far this year we have participated in roundtables on urgent issues held by the ASB, the European Commission, the IASB and the United Nations. We have met with board members and staff from the IASB, and held joint events with the ASB and the IASB.

The topics we address are many and varied ranging from, on the one hand, the ramifications of the financial crisis and complex proposals on financial instruments to, on the other, the potential exemption of most small companies from GAAP reporting.

Our overarching objectives in all of this are the quality of financial reporting and fighting excessive regulation. In an SME context that means ensuring that requirements are relevant and proportionate to the needs of that sector. For example, while we generally welcomed proposals from the IASB and FASB to reform lease accounting, we noted in our submission:

'Abandoning the distinction between operating and finance leases will have a potentially disproportionate effect on SMEs which, materiality constraints notwithstanding, will in principle be required to recognise relatively minor assets. We urge the boards to develop a simplified model for SMEs that recognises their limited resources and the realistic needs of users.'

All of the consultations under review at any one time are listed on the faculty's website, and we welcome member comments on any aspects of the proposals.

THE FACULTY'S ONLINE RESOURCES: PRACTICAL HELP IN A COMPLEX WORLD

From technical briefings to webcasts and standards-trackers – plus practical advice from industry experts and working accountants.

NEWS, VIEWS, AND UP-TO-DATE TECHNICAL DETAIL

The Faculty's community site is an online resource for Faculty members. It includes updates, webcasts, factsheets, IFRS and UK GAAP standards trackers, and access to the IASB's eIFRS information service.

You can also read and respond to Faculty and Faculty-member blogs. As a Faculty member you can join – and start – debates and post your own questions.

DOWNLOAD THE FACULTY WEBSITE GUIDE

If you're a member and you'd like to get the most from your Faculty resources, or a non-member who'd like to know more, then download our Faculty website guide at www.icaew.com/frfguide

HERE'S JUST SOME OF WHAT MEMBERS GET FROM THE FACULTY'S ONLINE RESOURCES

1 Blog: join – and start – debates and conversations; find working accountants' tips and shared experience

If you're a Faculty member you can create a blog post that starts a discussion and you can join a conversation by posting comments. You can also ask questions – we can't guarantee that you'll get all the answers that you need, but Faculty members are a valuable source of practical experience and technical insight.

2 Free access to eIFRS

eIFRS is the IASB's subscription-only information service. It has up-to-date information on IFRSs, Interpretations (IFRICs/SICs), and any revisions.

3 The Faculty's standards trackers (IFRS and UK GAAP)

Use the IFRS and UK GAAP standards trackers to identify (and download) the right standard for the time period you're working on. The IFRS standards tracker is linked directly to eIFRS.

4 Faculty factsheets

Our factsheets give you an in-depth analysis of changes in financial reporting, and practical tips to help you in your work. Every factsheet is reviewed by a team of technical experts and practising accountants before it is published.

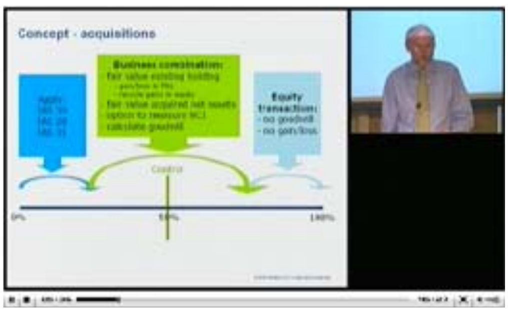
5 Events, webcasts and publications

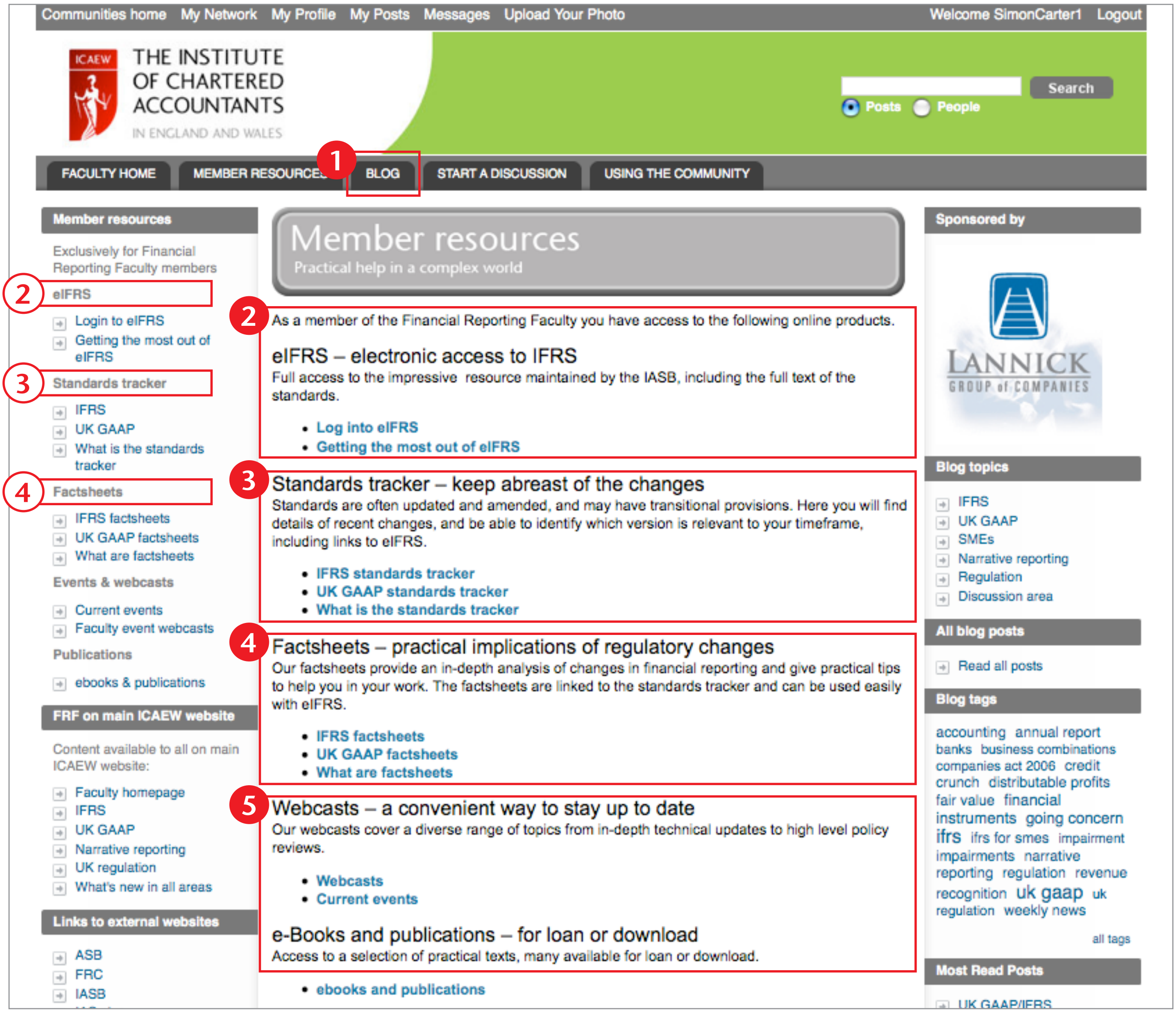
Faculty members get substantial discounts on our events and a selection of CCH financial reporting publications – see below for more on webcasts.

WEBCASTS OF EVENTS AND BRIEFINGS

RIGHT: **Webcasts of Faculty events**
When we host technical-update and policy events we record them and make them available to Faculty members as webcasts.

FAR RIGHT: **Briefings webcasts**
We've asked experts to record briefing webcasts on technical topics – they're useful distance learning tools.





STANDARDS TRACKERS: FIND THE RIGHT IFRS* OR UK GAAP STANDARD – AND FIND IT FAST

Standards change frequently, and different standards apply to different time periods. The Faculty's IFRS* and UK GAAP standards trackers will help you to:

- identify the right standard for your time period
- find more detail on the standard.

*Our IFRS standards tracker and factsheets link to eIFRS, the IASB's online IFRS information service. Access to eIFRS is free for Faculty members but generally costs non-members £200.

NEW AND AMENDED UK AND IASB STANDARDS EFFECTIVE DATES

IFRS

Periods ENDING on or after 30 June 2009

Amendment to IFRIC 9 and IAS 39 *Embedded Derivatives**

Annual periods BEGINNING on or after 1 January 2009

Amendments to IFRS 1 and IAS 27 *Cost of Investment in a Subsidiary, Jointly Controlled Entity or Associate*
Amendment to IFRS 2 *Vesting Conditions and Cancellations*
Amendment to IFRS 7 *Financial Instruments: Disclosures**
IFRS 8 *Operating Segments*
IAS 1 *Presentation of Financial Statements (revised)*
IAS 23 *Borrowing Costs (revised)*
Amendment to IAS 32 *Puttable Instruments and Obligations Arising on Liquidation*
Annual Improvements 2008
IFRIC 15 *Agreements for the Construction of Real Estate*

Annual periods BEGINNING on or after 1 July 2009

IFRS 1 *First-time Adoption of International Financial Reporting Standards (revised)**
IFRS 3 *Business Combinations (revised)*
IAS 27 *Consolidated and Separate Financial Statements (revised)*
Amendment to IAS 39 *Eligible Hedged Items*
IFRIC 17 *Distributions of Non-cash Assets to Owners**
IFRIC 18 *Transfers of Assets from Customers**

Annual periods BEGINNING on or after 1 January 2010

Amendment to IFRS 1 *Additional Exemptions for First-time Adopters**
Amendment to IFRS 2 *Group Cash-settled Share-based Payment Transactions**
*Annual Improvements 2009**

Annual periods BEGINNING on or after 1 February 2010

Amendment to IAS 32 *Classification of Rights Issues*

*Not EU endorsed at the time of publication

UK GAAP

Annual periods BEGINNING on or after 1 January 2009

Amendment to FRS 20 *Vesting Conditions and Cancellations*
Amendment to FRS 29 *Financial Instruments: Disclosures*
Improvements to Financial Reporting Standards

Periods ENDING on or after 31 December 2009

Amendment to UITF 42 and FRS 26 *Embedded Derivatives*

Annual periods BEGINNING on or after 1 July 2009

Amendment to FRS 26 *Eligible Hedged Items*

Annual periods BEGINNING on or after 1 January 2010

Amendment to FRS 20 *Group Cash-settled Share-based Payment Transactions*
Amendment to FRS 25 *Puttable Instruments and Obligations Arising on Liquidation*

Annual periods BEGINNING on or after 1 April 2010

FRS 30 *Heritage Assets*

EU preparers are required to prepare their financial statements in accordance with IFRS as adopted in the EU, and therefore can only apply accounting standards once they have been endorsed. The latest version of the Endorsement Status Report is available on the website of the European Financial Reporting Advisory Group (EFRAG) at www.efrag.org. The **principles** of unendorsed standards and interpretations may be adopted early if they do not conflict with the requirements of any endorsed standards or interpretations. The applicable dates in the EU for IFRIC 12 *Service Concession Arrangements*, IFRIC 13 *Customer Loyalty Programmes* and IFRIC 14 IAS 19 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* are later than in the original interpretation.

For more information on all new standards, EU endorsement and effective dates visit www.icaew.com/frf

AND FINALLY...

What goes around comes around? We reproduce a tongue in cheek article (we think) from 1987 which still strikes a chord today!

ED 1487: ACCOUNTING FOR OFF BALANCE SHEET FINANCE

1. Preface

1.1 Off balance sheet finance has become an important accounting problem in the last year and the Accounting Standards Committee (ASC) with the assistance of the Auditing Practices Committee (APC), have responded to public concern about it by issuing this exposure draft.

1.2 Off balance sheet finance is not a credit to the profession. Neither is it a credit on the balance sheet. Sometimes it is a credit in note 23. When note 23 is on the left hand side it is difficult to know if it is a credit at all.

1.3 An ASC working party for some time considered different ways of bringing off balance sheet finance on the balance sheet. This seemed the obvious thing to do. The difficulty is that bringing finance on to a balance sheet results in the balance sheet no longer balancing – there are too many credits. The ASC then set up a separate working party to consider ways of bringing on balance sheet both finance and the assets it finances. This approach initially appeared to show more promise. Various options were considered. These included redefining 'subsidiary', defining assets and liabilities broadly, and requiring consolidation of companies with complex share capitals which appeared to belong to no one and everyone at the same time. However, all these approaches had drawbacks – they were all in the 'too difficult' category.

1.4 The ASC has therefore reluctantly concluded that at present an accounting solution is not feasible but that instead full disclosure is needed. Some companies give note disclosure of off balance sheet finance already but do not give sufficiently explicit descriptions of the arrangements. They sometimes head the note 'related companies' and give anodyne descriptions of innocuous sounding investments.

The ASC believes that this is not good enough and the attached exposure draft therefore makes proposals for improving the clarity and visibility of the disclosure.

1.5 The ASC believes that everyone will comply with the attached proposals when they are issued in the form of a final standard. However, just in case someone doesn't, ASC has asked APC to help by preparing suitable qualifications to audit reports. These are shown in the appendix. The ASC is grateful to APC for this assistance.

Part 1: Explanatory note

1. Off balance sheet finance has emerged recently. It is not a good thing. Its presence, that is its absence, distorts gearing ratios and return on capital employed ratios. It is often marketed to companies by merchant banks. Once such schemes are entered into, the borrowings of a company are disguised and users of the company's accounts may be misled. For example, clearing banks, when making lending decisions, may not realise the full extent of prospective customers' obligations and may lend too much money. Financial difficulties may result and there may be a need for advice on capital restructuring, for example, from merchant banks. This is how the banking system works.

Part 2: Definition in terms

2. *Off balance sheet finance* is finance which is not on a balance sheet. *Finance* can mean either equity or debt but in the present context means debt: it is unusual for equity to be off balance sheet (except in the case of some banks).

Part 3: Standard accounting practice

3. All off balance sheet finance should be owned up to, added up and displayed prominently in note 1 to the accounts.
4. Note 1 should be called 'off balance sheet finance'. The heading 'off balance sheet finance' should be in bold type and capital letters.
5. Companies may alternatively call note 1 'Interests in funny companies which the group really owns but which don't need to be consolidated because the group is exploiting the Companies Act definitions of subsidiary and equity share capital'. This, too, should be in bold type and capital letters.
6. Note 1 should state the country of incorporation of the companies which carry the off balance sheet debt, unless it is the Netherlands Antilles.

Part 4: Legal requirements

7. The ASC believes the above is legal.

Part 5: Compliance with International Accounting Standards

8. The requirements of this standard nearly comply with the requirement of IAS 1 that substance over form should govern the selection and application of accounting policies.

Appendix: suggested wording for audit reports

1. Unqualified opinion, emphasis of matter. 'We draw attention to the off balance sheet finance set out in note 1. This is not a good thing, but is correctly set out.
   'In our opinion…'
2. Qualified opinion, wrong title.
   'Note 1, which sets out the group's off balance sheet finance, should be entitled "off balance sheet finance" and not "analysis of distribution costs".
   'In our opinion, because of this error, the accounts do not give us a true and fair view…'
3. Qualified opinion, absence of bold type and capital letters.
   'Note 1, "off balance sheet finance" is correctly set out and titled except the title should be in bold print and capital letters.
   'In our opinion, because of this error, the accounts do not give a true and fair view….'

Note: the above qualifications are likely to be material in determining the legality of a distribution (see s271, Companies Act 1985).

Reproduced from *Accountancy,* April 1987, Vol.99, Issue 1124, p.166.

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