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Quarterly Financial Reporting Brief

The final quarter of 2015 saw developments take place in a number of areas internationally, including financial instruments, revenue and leasing. Significant guidance on year end reporting was published by the accounting supervisors. Disclosure of tax risks and dividend disclosures were some of the matters receiving attention nearer home.

Exposure drafts and similar proposals have been published by the International Accounting Standards Board (IASB) and its Interpretations Committee on a number of areas including investment property, income taxes, foreign currency, materiality and financial instruments, together with the latest in the annual improvements cycle.

At European, UK and Irish levels, the financial reporting supervisory authorities were very active in the final quarter, with:

- Europe - the European Securities and Markets Authority (ESMA) report on matters considered especially relevant for 2015 reporting and a public statement aimed at improving the quality of disclosures;
- UK – the Financial Reporting Council (FRC) corporate reporting review annual report and the letters which the FRC has written to both large listed companies and smaller listed companies putting forward advice on year end reporting; and
- Ireland – the Observations document of the Irish Auditing and Accounting Supervisory Authority (IAASA) together with its report of selected financial reporting decisions.

The FRC has also been active in such areas as going concern and disclosure of tax risks, and it has also proposed improvements and amendments to the New GAAP standards – FRS 101, 102 and 103.

The Central Bank has published UCITS Regulations and regulations amending the Companies Act 2014 have been introduced.

This Brief comments on financial reporting and legal/regulatory developments during the final quarter of 2015.

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INTERNATIONAL ACCOUNTING AND RELATED DEVELOPMENTS

ESMA – Priority Issues and Disclosures

ESMA published a report which highlighted the following topics as being especially relevant for examinations of the 2015 financial statements of listed entities: -

- » Impact of financial markets conditions on financial statements;
- » Statement of cash flows and related disclosures; and
- » Fair value measurement and related disclosures.

ESMA has also published a public statement aimed at improving the quality of disclosures in financial statements and has developed five disclosure principles that issuers should consider:

- » Telling the entity's own story by focusing on entity-specific disclosures and avoiding boilerplate language;
- » Providing relevant, understandable information on financial performance and position in an accessible way;
- » Thinking about materiality and applying the IFRS materiality principle;
- » Providing readability by presenting in a clear and concise way; and
- » Providing consistent information within annual reports.

ESMA has also published a further extract (18th) from its confidential database of European enforcement decisions, with eight standards within scope.

IASB – Annual Improvements

The IASB has published an Exposure Draft 'Annual Improvements to IFRS 2014-2016 Cycle'. It contains proposed amendments to the following Standards – (1) IFRS 1: Adoption of International Financial Reporting Standards, (2) IFRS 12: Disclosure of Interests in Other Entities, (3) IAS 28: Investments in Associates and Joint Ventures. The effective date is to be decided after the exposure period, with comments requested by 17 February 2016.

Investment Property

The IASB has published an ED of proposed amendments to IAS 40 'Investment Property' with comments requested by 18 March 2016. The amendments address transfers of investment property, stating that an entity shall transfer a property to or from investment property when, and only when, there is evidence of a change in use. The list of examples of evidence to substantiate the transfer will be presented as a non-exhaustive list, not exhaustive.

Uncertainty on Income Tax Treatments

The IFRS IC has observed diversity in practice regarding recognition and measurement when there are uncertainties in the amount of income tax payable or recoverable. The IC has developed a proposed Interpretation with comments suggested by 19 January 2016. An entity has to consider whether it is probable that the relevant authority will accept each tax filing. An entity has to reassess its judgements and estimates if facts and circumstances change. There are proposed transition provisions with retrospective application.

Foreign Currency Transactions and Advance Consideration

The IFRS IC has published a draft interpretation to address foreign currency transactions where (1) there is consideration that is denominated or priced in a foreign currency; (2) the entity recognises in advance a prepayment asset or a deferred income liability; and (3) the prepayment asset or deferred income liability is non-monetary. The IC has reached a proposed consensus to deal with the determination of the date of the transaction and therefore the exchange rate to be applied. The Interpretation is to be applied prospectively. Comments are requested by 19 January 2016.

Lease Accounting

The IASB has completed its decision making for the leases project and a working draft of the final standard has been prepared subject to final refinements before issuance. The IASB has voted for an effective date of 1 January 2019 with early application permitted but only if the entity is also applying IFRS 15.

Revenue

The Joint Revenue Transition Resource Group (TRG) discussed at its recent meeting a number of potential issues related to implementing the new revenue model standard, including:

- » Customer options for additional goods and services;
- » Pre-production activities; and
- » Licenses – specific application issues related to restrictions and renewals.

Materiality

The IASB has published an ED of a proposed Practice Statement 'Application of Materiality to Financial Statements', which emanates from the project on materiality which was added to the IASB's Disclosure Initiative. The proposed guidance is intended to provide explanations and examples to help management apply the definition of materiality, and covers three main areas – (1) characteristics of materiality; (2) presentation and disclosure in the financial statements; and (3) omissions and misstatements, with some additional guidance on recognition and measurement.

Financial Instruments

EFRAG has recommended adoption of IFRS 9 as of 2018 for companies other than those carrying out insurance activities.

The IASB has published an ED with proposed amendments to IFRS 4 'Insurance Contracts' that are intended to address concerns about the different effective dates of IFRS 9 and the forthcoming standard on insurance contracts.

There have been a number of developments in relation to impairment accounting and expected credit losses, including:

- » The IFRS Transition Resource Group for Impairment has held its third and final meeting to discuss implementation issues on impairment, with ten different matters discussed;
- » The FSB has published a report by the EDTF which considers the changes banks will need to make to their financial disclosures with the implementation of a new expected credit loss approach for impairment under IFRS 9; and
- » The Basel Committee on Banking Supervision has issued final guidance on accounting for expected credit losses. Eleven fundamental principles provide guidance on supervisory expectations for applying an ECL accounting framework.

IRELAND AND UK - DEVELOPMENTS

Corporate Reporting Review

The annual report of the FRC's Corporate Reporting Review activities has found that the overall quality of corporate reporting remains generally good, particularly by large public companies. An increasing number of companies appear to have conducted 'Clear and Concise' reviews of their reports and accounts and achieved improved reporting by removing unnecessary disclosures. The report acknowledges the challenge to boards and audit committees of determining what is material information.

The FRC's assessment is based on a review of 252 sets of reports and accounts in the year to 31 March 2015.

Year-end Advice

The FRC has written to both large listed companies and to smaller listed/AIM quoted companies with advice on ways that improvements could be made to annual reports in areas of particular relevance to investors.

In large listed companies, the areas highlighted are:

- Clear and concise reporting – this includes avoiding 'boilerplate' disclosures and ensuring that the annual report only contains information that is material to investors; and
- Risk reporting – companies to disclose how each particular risk affects them and the steps they are taking in mitigation.

Other areas commented on include effective disclosure, reduced disclosure framework and digital communication.

The FRC considers that, in particular, investors in smaller listed companies expect:

- The strategic report to be clear, concise, balanced and understandable;
- Accounting policies to be clear and specific, particularly in relation to revenue recognition and expenditure capitalisation; and
- A clear explanation of how the company generates cash flow.

Clear and Concise Reporting

The FRC has issued a report, 'Clear & Concise: Developments in Narrative Reporting', which includes practical tools to help companies achieve clear & concise reporting and provides an overview on developments in narrative reporting including the Strategic Report. The study notes that business model and strategy reporting provides useful insight into how a company is managed and that best practice in the area is evolving. It also highlights focus areas for the next reporting period such as the application of materiality and improving reporting of key performance indicators, principal risks and forward-looking information.

Going Concern

The FRC has issued for consultation draft guidance on the assessment of and reporting on the going concern basis of accounting together with solvency and liquidity risks. In September 2014 the FRC updated the UK Corporate Governance Code in response to the Sharman Inquiry and issued related guidance for companies applying the Code. The draft guidance published is best practice for all entities that are not required to apply the Code.

New GAAP – Improvements and Amendments

The FRC has proposed limited scope amendments to FRS 102 relating to financial institutions and retirement benefit plans only. These are with regard to classification within the fair value hierarchy structure. The intention being to simplify the preparation of disclosures for the entities affected, and increasing the consistency with disclosures required by EU-adopted IFRS.

Limited amendments have been proposed to:

FRS 101 – principally disclosure exemptions in relation to IFRS 15 – Revenue

FRS 103 – to reflect changes in the regulatory framework, the introduction of Solvency II.

Dividend Disclosures

The Financial Reporting Lab has issued a report 'Disclosure of dividends – policy and practice' exploring how companies can make dividend disclosures more relevant for investors. Investors consider it would be helpful to group together similar or related disclosures on dividends, or to draw links between the disclosure elements.

Disclosure of Tax Risks

The FRC has announced that it will conduct a thematic review of companies' tax reporting to encourage more transparent recording of the relationship between the tax charges and accounting profit. The FRC plans to take a particular interest in

- The transparency of tax reconciliation disclosure and how well the sustainability of the effective tax rate is conveyed; and
- Uncertainties relating to tax liabilities (and assets) where the value at risk in the short term is not identified.

The FRC's targeted review will consider the totality of the selected companies' reporting including relevant disclosures in their strategic and other narrative reports, as well as the accounting disclosures.

Conceptual Framework

The FRC has called on the IASB to reconsider its proposed Conceptual Framework so that it properly reflects the importance of stewardship, prudence and reliability, which it describes as cornerstones of an accounting framework.

LEGAL AND REGULATORY DEVELOPMENTS

IAASA – Guidance

IAASA published its annual Observations document highlighting key topics to be considered by those preparing, approving and auditing 2015 financial statements, with the following sections of the document considered of particular relevance – (a) deferred tax assets, (b) alternative performance measures, (c) judgements, assumptions and auditors' risks of material misstatements, (d) avoiding the use of boilerplate disclosures.

IAASA has also published:

» Survey of directors' critical accounting judgments and auditors' assessed risks of material misstatement – with an objective of providing preparers, auditors and users of financial statements with factual information which may encourage debate on the nature and extent of assessed risks and judgments in the next round of financial reporting; and

» Report of selected financial reporting decisions – following the introduction of the Transparency Regulations earlier in 2015, IAASA is availing of the wider discretion it now has in terms of publication of its financial reporting decisions.

UCITS Regulations

The Central Bank has brought in the UCITS regulations with effect from 1 November 2015 which brings into one place all of the requirements which the Central Bank imposes on UCITS, UCITS management companies and depositaries of UCITS. They also supplement existing legal requirements.

Corporate Governance Statement

Regulations have been introduced to amend the Companies ACT 2014 to clarify the duties of the statutory auditor regarding the corporate governance statement, where such a statement is prepared.

Contacts

Our firm's website, www.iasplus.com, provides a world-leading continuously updated information source on international financial reporting developments and includes a link to our freely accessible IFRS eLearning programme, and a focused subsite, UK Accounting Plus.

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