



Quarterly Financial Reporting Brief

July 2018

The second quarter saw significant developments in international accounting with the conceptual framework published and developments on insurance and debt/equity to the fore. Sustainability reporting and corporate governance and enforcement were also high on the agenda. A new International Code of Ethics was also published.

The European Commission (EC) has published legislative proposals that aim at identifying which investments are sustainable. In the UK, a report has been produced setting out how 'green finance' can become fundamental to commercial development. A whole host of organisations continue to build momentum towards improved non-financial reporting and underlying thinking.

Corporate governance has been under focus with the Financial Reporting Council (FRC) publishing 'Corporate Governance Principles for Large Private Companies',

which are consistent with legislative measures being taken by the UK Government.

The European Securities and Markets Authority (ESMA) has published its report on the activities of accounting enforcers and their findings within the EU in 2017. ESMA has also published its 22nd enforcement decisions report. The Irish Accounting and Auditing Supervisory Authority (IAASA) has also recently published selected financial reporting decisions.

The International Ethics Standards Board for Accountants (IESBA) has published a new Code of Ethics, which will be effective in June 2019.

With interim reporting in mind, the FRC has published a Corporate Reporting Review Briefing setting out current 'hot topics' including the implementation of the new standards, IFRS 9 and IFRS 15.

The FRC's Financial Reporting Lab has published reports on Blockchain and Performance Metrics and is currently conducting a review of Digital Reporting.

The International Accounting Standards Board has published a revised Conceptual Framework and there have been developments in relation to the endorsement of IFRS 17 and also with regard to debt/equity.

The Central Bank has published its Annual Report 2017 and commented on a number of matters including Brexit.

This Brief comments on financial reporting and legal/ regulatory developments during the second quarter of 2018.

Ireland & UK – New Developments

Corporate Reporting Review Briefing

The FRC has issued a Briefing setting out the current 'hot topics' of its Corporate Reporting Review Team (CRR), much of which will be relevant to companies preparing their 2018 interim reports. The FRC reminds preparers and auditors that it will be monitoring companies' disclosure of the effect of the new standards, IFRS 9 'Financial Instruments' and IFRS 15 'Revenue'. The FRC indicates that materiality should be borne in mind and that disclosures should be clear, concise, company-specific and focused. Other areas of focus include:

- Supplier financing arrangements, notably reverse factoring;
- Asset impairment;
- Issues identified by CRR's monitoring activities.

The Financial Reporting Lab

Performance Metrics

The FRC Lab has published a report setting out a framework and set of questions for companies and their boards to consider when deciding on how they report their performance. Considerations include alignment to strategy, transparency, context, reliability and consistency. The report supplements the current regulatory focus on alternative performance measures following the guidance issued by ESMA.

Reporting on Blockchain

The FRC Lab considers how current developments and applications of Blockchain - might impact corporate reporting processes in the future. It concludes that the growing use of Blockchain means that those involved in corporate reporting processes need to consider its impact.

Digital Reporting

The FRC's Financial Reporting Lab is investigating how artificial intelligence and related technologies are, and will be, used in the production and consumption of corporate reporting data. As part of its Digital Future Project, the Lab has already:

- Released a report setting out a framework for future digital reporting;
- Released a report concluding that iXBRL is an important technology in the path to digitalisation of company reporting;
- Explored the possibilities of Blockchain in the corporate reporting process.

Corporate Governance

The FRC has published 'Corporate Governance Principles for Large Private Companies'. Large private companies will be

encouraged to follow six principles to inform and develop their corporate governance practices and adopt them on an 'apply and explain' basis.

The six principles are:

- Purpose – promote the purpose of a company – alignment with its values, strategy and culture;
- Composition – an effective chairperson, with a balance of skills, background and experience on the Board;
- Responsibilities – a clear understanding of its accountability and terms of reference, with policies and procedures to support effective decision-making;
- Opportunity and Risk – promote long-term success by identifying opportunities to create and preserve value with effective oversight;
- Remuneration – executive remuneration should be aligned to the sustainable long-term success of a company;
- Stakeholders – oversee meaningful engagement with material stakeholders, including the workforce.

Consultation will close in September and the final version will be published in December.

The UK Companies (Miscellaneous Reporting) Regulations have been laid before parliament, representing the legislative strand of the Government's package of corporate governance reforms, covering three areas:

- Executive pay;
- Additional statements in the annual report regarding directors' stewardship;
- Corporate governance arrangements in large private and unlisted public companies.

The Quoted Companies Alliance has published a revised version of its Corporate Governance Code, tailored to meet the needs of small and mid-sized quoted companies.

Environmental Reporting

The UK Government appointed 'Green Finance Taskforce' has prepared a report that sets out recommendations on how the government and the private sector can work together to make 'green finance' an integral part of the UK's financial services. The report notes that existing UK legislation includes several areas that need to be addressed for the UK to implement the Task Force for Climate Related Disclosures (TCFD) recommendations. The report makes the following proposals:

- Companies and investors should use the TCFD framework to develop their financial, corporate governance and

stewardship disclosures on a comply or explain basis;

- Relevant financial regulators should integrate the TCFD recommendations throughout the existing UK corporate governance and stewardship reporting framework;
- Government and relevant financial regulators must clarify in their guidelines that disclosing material environmental risks, including physical and transition climate-related risks, is already mandatory under existing law and practice.

The Institute of Chartered Accountants in England and Wales (ICAEW) has published a practical guide on how organisations can best implement the TCFD recommendations.

IFRS 17 – FRC Considerations

An FRC Panel discussion has highlighted some key benefits and barriers to implementation of IFRS 17 Insurance Contracts, commenting that it will address some of the problems of current accounting, especially the inconsistency in financial reporting by issuers. Matters highlighted include:

- It is predictable that implementation of IFRS 17 will be costly, but it is difficult to accurately estimate cost which should not be a barrier to adoption. EFRAG endorsement process includes a cost/benefit analysis;
- The question of whether IFRS 17 and Solvency II should be more closely aligned is a challenging one with IFRS 17 more principles based while Solvency II has a prudential purpose and is more prescriptive by nature;
- IFRS 17 will make financial statements more understandable and accessible to generalist investors, but judgements and options available may mean that comparability may continue to be challenging in some instances;
- There are no immediate plans to amend FRS 103, and the FRC will review the implementation experience of listed insurers before considering the case for change.

International Accounting and Related Developments

Conceptual Framework

The IASB has published its revised 'Conceptual Framework for Financial Reporting'. Included are revised definitions of an asset and a liability as well as new guidance on measurement and derecognition, presentation and disclosure. The new Conceptual Framework does not constitute a substantial revision of the document as was originally intended when the project was first taken up in 2004. Instead the IASB focused on topics that were not yet covered or that showed obvious shortcomings that needed to be dealt with.

IFRS 17 – Adoption

The European Parliament Committee on Economic and Financial Affairs (ECON) voted on a draft resolution for adoption of IFRS 17. The draft resolution notes that IFRS 17 will bring "a harmonisation of the accounting rules for insurance contracts across different constituencies" and "is intended to provide a more realistic description and better comparability of financial statements within the insurance sector". However, the draft also notes that the benefits of more consistency and transparency comes at the price of a fundamental accounting change entailing significant efforts and costs as the standard is deemed to be complex.

The draft resolution calls on EFRAG (in developing its endorsement advice) and the European Commission (in deciding on the final endorsement):

- to examine the potential effects on financial stability, on competitiveness, on the insurance markets and the cost-benefit analysis;
- to consider broader tests, including field tests, to assess the effects and interactions;
- to consider the concerns put forward by EBA and ESMA and the issues identified by EFRAG itself;
- to assess in particular whether IFRS 17 meets the endorsement criteria of understandability and public good;
- to consider the aspects of long-term investment and possible pro-cyclicality;
- to assess the potential interaction and mismatches between IFRS 9 and IFRS 17;
- to examine the achievability of the current implementation timeline of IFRS 17; and
- to closely monitor its implementation in the EU if IFRS 17 is endorsed at the EU level.

Financial instruments with characteristics of equity

The International Accounting Standards Board (IASB) has published a comprehensive

discussion paper DP/2018/1 'Financial Instruments with Characteristics of Equity'. The discussion paper defines the principles for the classification of financial liabilities and equity instruments without, however, fundamentally changing the existing classification outcomes of IAS 32. The IASB's proposed preferred approach is based on two features, timing and amount, and is accompanied by the provision of additional information through a separate presentation of expenses and income from certain financial liabilities in other comprehensive income and additional disclosures. The comment period ends on 7 January 2019.

Accounting Enforcement

ESMA has published its report on the activities of accounting enforcers and their findings within the EU in 2017. The matters reported are based on the activities of the enforcers when examining compliance of financial information provided by issuers listed on EU regulated markets with the applicable financial reporting framework in 2017. The enforcers examined financial statements of about 1,100 issuers, resulting in 328 actions being taken to address material departures from IFRS. The main deficiencies were identified in the areas of financial statement presentation, impairment of non-financial assets and accounting for financial instruments.

Sustainability Reporting Developments

The evolution of non-financial and sustainability reporting continues to gather momentum with recent developments including:

- The World Business Council for Sustainable Development (WBCSD) has launched the Social and Human Capital Coalition, designed to help companies recognise, measure and value the importance of people and communities;
- The WBCSD, together with the Committee of Sponsoring Organisations of the Treadway Commission (COSO) have published draft guidance, 'Enterprise Risk Management: Applying to Environmental Risk Management - Related Risks';
- The Task Force on Climate-related Financial Disclosures (TCFD) and the Climate Disclosure Standards Board have launched the TCFD Knowledge Hub: a platform with relevant insights, tools and resources to help organisations implement the TCFD recommendations;
- The United Nations Environment Programme Finance Initiative has published 'Connecting Finance and Natural Capital', which is a tool for financial institutions to assess how their

business is impacted by, and depends on the natural world.

Non-Financial and Diversity Information

Accounting Europe, CSR Europe and the Global Reporting Initiative ("GRI") have published an updated report on their research into the implementation by Member States of the EU Directive on non-financial and diversity information reporting. The report provides a high-level overview of similarities and differences in disclosure across Europe, including scope, reporting features, auditors' involvement and fines.

Sustainable Finance

The EC has published legislative proposals that aim at identifying which investments are sustainable. This follows the publication of a report in January setting out its strategic recommendations for a financial system that supports sustainable investments and an action plan on sustainable finance, published in March. The proposals are aimed at establishing a framework that can be used for judging whether the public reporting obligations including financial and non-financial reporting requirements are meeting their objectives, which is the aim of the EU 'Fitness Check'. The key features of the proposed measures aim at:

- A unified EU classification system to determine whether an economic decision is environmentally sustainable;
- Consistency and clarity on how institutional investors should integrate ESG factors in their investment decision making process;
- Benchmarks reflecting companies' carbon footprint and better information thereon.

Code of Ethics

The International Ethics Standards Board for Accountants (IESBA) has released a completely rewritten Code of Ethics for professional accountants. The fundamental principles of ethics have not changed, but major changes have been made to the unifying conceptual framework – the approach used by all accountants to identify, evaluate and address threats to compliance with fundamental principles and, where applicable, independence. New highlights include:

- Revised 'safeguards' provisions better aligned to compliance;
- Stronger independence provisions;
- New and more robust sections for professional accountants in business;
- New guidance to emphasise the importance of understanding facts and circumstances when exercising professional judgement.

The new Code will become effective in June 2019.

Legal and Regulatory Developments

IAASA – Developments

IAASA has recently published selected financial reporting decisions regarding accounting treatments adopted by companies in a wide range of areas, including financial instruments disclosures, presentation of financial statements, revenue, impairment of assets, fair value, operating segments and statements of cash flows.

IAASA has published a review report entitled 'Brexit and its potential impact on 'Audit and Accountancy' which provides an overview of the challenges and opportunities that Brexit may bring to IAASA and entities within its remit.

IAASA has also published its 2017 Annual Report.

Central Bank

The Central Bank has published its 2017 Annual Report which sets out how it delivers on its mission of safeguarding stability and protecting consumers. Its comments include those on:

- The inherent volatility of the Irish macro-financial system requiring ongoing vigilance;
- Defending the integrity of enforcement processes;
- The inevitable challenges that will be presented by Brexit.

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