The future of financial reporting 2014: re-questioning some old assumptions

A discussion Paper based on the British Accounting and Finance Association Financial Accounting and Reporting Special Interest Group (FARSIG) Symposium, 10 January 2014.

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About FARSIG

The Financial Accounting and Reporting Special Interest Group (FARSIG) is a group set up under the aegis of the British Accounting and Finance Association (BAFA). The main purpose of FARSIG is to further the objectives of BAFA and for that purpose to:

- encourage research and scholarship in financial accounting and reporting
- establish a network of researchers and teachers in financial accounting and reporting
- enhance the teaching of financial accounting and reporting
- provide support for PhD students in financial accounting and reporting
- develop closer links with the accounting profession in order to inform policy
- publish a newsletter and organise targeted workshops
- develop and maintain relationships with the BAFA and the professional accountancy institutes
- provide a forum for the exchange of ideas among accounting academics.

The symposium, which is one of an annual series that started in 2007, provides a forum for academic, practitioner and policy-orientated debate. Such forums are useful for expressing and developing rounded opinion on the current meta-issues facing financial reporting. Furthermore, they serve to illustrate the policy relevance and impact of current academic thinking and outputs in accordance with calls from the Economic and Social Research Council (ESRC)/Advanced Institute of Management (AIM) for relevant and rigorous research combining practitioner and academic perspectives.

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Mike Jones is chairman of the FARSIG Committee. Andrea Melis is on the FARSIG committee and Silvia Gaia and Simone Aresu are, respectively, lecturer and research fellow at the University of Cagliari, Italy.

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Foreword

ACCA was pleased to host again the FARSIG annual discussion of the future of financial reporting. The meeting continues to provide a valuable discussion between interested parties – principally academics studying financial reporting and those involved with its practical application in way or another. The speakers this year reflected that with three regulators and two academics. The audience at the event seems to reflect that mixture as well.

The 2014 papers and discussion covered three main areas. Firstly, a couple of aspects of the new conceptual framework from the IASB were looked at – the users of financial information and measurement. The literature review on users indicated just how much investigation of this issue has been carried out, but also that some users have attracted more attention than others. Measurement is a more complex issue than the black and white choice between cost and fair value. We will hear more over 2015, perhaps at FARSIG and certainly more generally, on these and other aspects as the debate resumes in earnest with the publication of the exposure draft of the new framework.

The other IFRS related issue was disclosure. IASB seem to have taken on board that the length of financial statements is excessive and the disclosure overload issue. The quality and consistency of provision of existing disclosures has been looked at and to a degree found wanting. The clutter of immaterial information may not be not helpful, but there may be greater risks in terms from the omission of significant items. Again we will hear further from the IASB on this issue in future.

The third area of focus was on the upcoming changes to UK accounting from convergence with IFRS (in the guise of FRS102) and from implementing the new accounting directive from the EU. These will be implementation issues for practice over the next few years and then perhaps they will be the subject of academic studies.

We are seeing an increased impact of academic studies on the development of financial reporting. Standard setters need, quite rightly, evidence to support the development and revision of their standards. IASB published a key post-implementation review of IFRS3 on business combinations, and this is now part of their regular due process. They are hosting a regular research forum. Legislators also need to prepare impact assessments. All of these can and should benefit from the findings of academic research. The need for interaction between practice and academia, such as the FARSIG symposium, is therefore more important than ever.

I extend my thanks to Mike Jones, Andrea Melis, Silvia Gaia and Simone Aresu for providing this summary of the event.

Richard Martin
Head of Corporate Reporting, ACCA

1. Introduction

In 2013, there were, once again, economic problems related to international austerity policies, unemployment and the economic downturn. The social consequences of the crisis stemming from 2007 still trouble policymakers and regulators. Moreover, since the symposium, the Ukraine crisis and the recent tensions in the Middle East, driven in particular by the emergence of ISIS (Islamic State of Iraq and Syria) and by the never-ending conflict between Israel and the Palestinians, do not favour worldwide peace. As a consequence, the economic recovery may be further delayed. There is, however, some positive news: the latest European GDP data shows that the output lost in the 2007–8 recession is being recovered and, in future, low growth is expected. Reforms are being undertaken and the European Central Bank has adopted a 'cheap money' policy that sits uneasily with a tight fiscal policy. Some economies, such as those of Germany and the UK, have to date increased. The UK, in particular, registered the fastest annual rate of growth since 2007, with the manufacturing sector increasing significantly. While UK growth is expected to continue, it is still low and economists have raised concerns that the recovery is over-reliant on consumer spending, unsupported by a significant improvement in wages, export and investments.

It was against a prudent optimistic scenario in much of Europe that the annual FARSIG symposium on the Future of Financial Reporting was held at ACCA, London on 10 January 2014. Before this, in July 2013, the IASB issued a Discussion Paper on a new version of the IFRS Conceptual Framework and is currently reviewing the feedback received on the Discussion Paper in order to develop an Exposure Draft, which it expects to present during the first quarter of 2015. The IASB is also working on a comprehensive review of the IFRS for SMEs, and amendments to this standard may be issued. Other IASB longstanding projects, such as the IASB and FASB joint revenue recognition standard, have been successfully concluded.

Nonetheless, international accounting convergence is far from being accomplished and improvements to disclosure in financial reporting are always required. At the national level, financial accounting regulation continues to change and adapt, reflecting, in part, the changes made by the IASB, and, in part, the European Acts and Directives. In the UK, the old accounting system changed with the issue of a new set of Financial Reporting Standards (FRS 100, 101 and 102) that move towards an IFRS-based framework and keep pace with evolving business transactions. There has been also a re-questioning of fundamental issues in accounting, such as measurement principles, financial regulation (both for large and small companies) and the Conceptual Framework. The title of the 2014 FARSIG symposium was 'The Future of Financial Reporting: Re-questioning Some Old Assumptions'. Five speakers offered their views on the major accounting changes and future challenges from the perspectives of the regulatory bodies and academia. Some of the issues raised and discussed, such as the IFRS conceptual framework, were old favourites. Other issues, such as the accounting implications for tax affairs and the small and micro company regime, had not previously been discussed.

For 2014, the five speakers were:

- Mark Clatworthy, Professor of Accounting, University of Bristol: 'The use of Information by Capital Providers: An Academic Literature Review'
- Rob Harvey, Advisory Accountant, HMRC: 'Accounting Transition and Tax: The Case of FRS 102'
- Andrew Lennard, Director of Research, Codes and Standards Division, Financial Reporting Council: 'Reflections on Measurement: How Conceptual Should a Conceptual Framework Be?'
- Ioannis Tsalavoutas, Lecturer in Accounting, University of Stirling: 'Are Mandatory Disclosures Really Mandatory?'
- Vickie Wood, Assistant Director (Accounting Policy), Department of Business, Innovation and Skills: 'Small is Beautiful: Reducing Small Companies' Regulatory Burden'.

As can be seen from the titles of these presentations, the speakers discussed a variety of topics, from the use of accounting information by different stakeholders to the administrative burdens for small and micro firms. As usual, after each presentation, there was a lively and informed discussion among the many symposium delegates.

ISSUES RAISED BY THE SYMPOSIUM

Before introducing the commentaries, we highlight some of the key issues that were presented and debated at the symposium in Table 1.1. There was a fundamental examination of some of the basics of accounting during the symposium and the subsequent audience discussion. Some of the issues raised and discussed were, in many ways, old favourites that continue to present us all (practitioners, standard setters and academics among others) with complex challenges, such as IFRS convergence, patterns of national accounting, the Conceptual Framework and measurement issues. Nonetheless, the speakers also focused on many specific, new aspects, such as the tax implication of the new UK Financial Reporting Standards (FRS) and new Small and Medium Enterprise (SMEs) requirements. Some common themes emerged during the symposium that were discussed in greater details after the commentaries.

A summary of the key issues raised at symposia over the past seven years is shown in Table 1.1. As can be seen from the table, the main issues covered in 2014 were: the IASB's Conceptual Framework, the New European Accounting Directive, the tax implications of the new UK FRS, the use of accounting information by capital providers and compliance with mandatory disclosure requirements.

Some of the main developments that have occurred during 2013–14 are discussed below.

Accounting convergence has been highly debated for many years. The harmonisation of the accounting standards issued by different regulatory bodies has been considered fundamental to enhance the consistency, comparability and efficiency of the financial statements. The current debate on accounting convergence is relevant at both the international and national level. International accounting convergence mainly refers to the process, started in the 2000s, in which the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) attempted to converge their respective financial reporting standards into one global set. This process appears to have stalled in 2012, and therefore the IASB, now leading a more independent path, is developing its own new Conceptual Framework. This was critically analysed by Andrew Lennard in his presentation.

In July 2013, the IASB issued a Discussion Paper on a new version of the Conceptual Framework, which remained available for comment until January 2014. At this stage, the IASB began reviewing the feedback received on the Discussion Paper in order to develop an Exposure Draft, which it expects to issue during the first quarter of 2015. In addition to the review of the Conceptual Framework, the IASB is also in the midst of a comprehensive review of the IFRS for SMEs, first issued in 2009 and since then adopted by several countries around the world.

The comprehensive review is intended to consider whether there is a need for any amendments to the standard. At the current stage, the SME Implementation Group (SMEIG), an IASB advisory body established to support and monitor the adoption and implementation of the IFRS for SMEs, is considering the feedback received from respondents to the Exposure Draft and developing a report of recommendations for the IASB. The IASB plans to issue the amended version of the IFRS for SMEs in the first half of 2015.

National accounting convergence is also under the spotlight, particularly in the UK. Over the last few years, a new regulatory regime has emerged for UK companies. The UK's regulatory structure has been adapted to reflect the growing importance of IFRS. In 2012, the old regulatory system for the UK, which had included the Accounting Standards Board, was restructured and a new set of Financial Reporting Standards (FRS 100, 101 and 102), based on the IFRS for SMEs, have been issued. In his presentation, Rob Harvey shows the tax implications of these.

The UK regulatory bodies are also working to implement the new EU Accounting Directive. This Directive aims at simplifying the accounting requirements for SMEs, improving the clarity and comparability of companies' financial statements within the EU and reducing the administrative obligations for small companies. Issued in June 2013, the Directive must be incorporated by the EU member states within their national law by July 2015. In August 2014, a proposal outlining how to implement the Accounting Directive was released by the Department for Business, Innovation and Skills (BIS). In response to this, the FRC issued its Consultation Document on the development of the UK accounting standards. In this context, Vickie Wood's presentation is particularly interesting as she illustrates the main changes of regulatory burdens for SMEs.

Many of these issues were directly or indirectly addressed in the symposium. The issues specifically addressed are now briefly presented to contextualise the subsequent commentaries on the presentations.

Table 1.1: Overview of key symposia themes, 2008–14

2014	2013	2012	2011	2010	2009	2008
Conceptual Framework, measurement EU Accounting Directive for SMEs UK FRS: tax implications The use of information by capital providers Compliance with mandatory disclosure requirements	Conceptual Framework, recognition and measurement Regulatory Framework, governance and 'balanced reporting' IFRS adoption and national accounting practices Nature and complexity of crises	Asset and liability recognition Measurement, fair value and confidence accounting Regulatory Framework and complexity of financial statements Fraud and accounting scandals	Complex financial instruments, asset and liability recognition and measurement Regulatory environment, complexity of financial statements IFRS adoption and political interface Carbon accounting	The role and need for global accounting standards Understandability and usefulness Political concerns Sustainability accounting	Regulatory change The convergence of global standards through IFRS. Fair value Corporate governance Asset securitisation and credit crunch.	Conceptual Framework Income measurement Fair value Financial communication

Source: Jones and Slack, 2008; 2009; 2010; 2011; 2012, 2013

The IASB's existing Conceptual Framework, which is largely considered dated and incomplete, continues to provide us with a contentious debate. After the interruption of the project carried out with the FASB on the development of a joint comprehensive Conceptual Framework, the IASB decided to reactivate the Conceptual Framework project on its own and issued a discussion paper (DP/2013/1) with the purpose of giving users and preparers of financial statements an opportunity to provide feedback on the main areas in which, the IASB believed, the Conceptual Framework should be improved. The Discussion Paper proposes revised thinking on the reporting of financial performance, the measurement of assets and liabilities, and presentation and disclosure. The main issue raised by IASB stakeholders concerns the need to put more emphasis on the importance of exercising prudence and stewardship (or accountability) (ACCA 2014; Financial Reporting Council 2014). Moreover, they also ask for a deeper analysis of measurement issues, a clear definition of the objectives of the profit and loss statement and of the recognition/de-recognition criteria for financial position elements (assets and liabilities). The key problems with the Discussion Paper are discussed in depth by Andrew Lennard in his presentation.

Following on from the international debate concerning the IASB Conceptual Framework, the symposium also debated the future of UK GAAP. Over the next few years UK companies will face changes in the accounting practices used to prepare their financial statements. Indeed, for accounting periods commencing on or after 1 January 2015, the new Financial Reporting Standards (FRS 100, 101 and 102) will come into force. Those companies that will apply FRS 102 or have already applied it (as early adoption was possible) face related changes. FRS 102 is derived from the IASB's IFRS for SMEs. It reflects a simplified version of the full IFRS, but also incorporates changes made by the regulators.

FRS 102 will introduce significant changes to UK accounting. Among the most important is the introduction of a new accounting regime for financial instruments, including the recognition of derivatives at fair value and the possibility of recognising more intangible assets in a business combination. Some of these changes will have tax implications and companies should be aware of them. To assist companies in easing the tax impact of the accountancy changes, HM Revenue & Customs (HMRC) has published draft legislation and undertaken several supporting actions. These together with an overview of the key accounting changes and the key tax considerations that arise for those companies that will adopt the new standards are discussed by Rob Harvey, an HMRC accountancy adviser, in his presentation.

In order to simplify further the requirements for SMEs and create a harmonised SMEs accounting regime, the European Commission has started a review process of the Accounting Directives based on the 'think small first' principle. The new Directive has largely been welcomed, but not without some concerns. The main reservations concern the Member State Options left within the Accounting Directive, which according to most stakeholders reduce the level of consistency and comparability across Europe. Other stakeholders address the tension between whether it is more important to increase the quality of accounting or to seek reductions in costs and the so-called administrative burden. Vickie Wood, Assistant Director for the UK Department for Business Innovation & Skills (BIS), provided an overview of the new Accounting Directive and illustrated the main changes in the regulatory burdens for SMEs.

The disclosure of financial information within the corporate annual report is also an important and highly debated issue. There are concerns about the quality and quantity of financial reporting disclosure. Regulatory bodies are seeking to address the problem of poor communication by clearly defining the overall objective of disclosure requirements. They are also reducing the disclosure requirements, particularly for small companies (see the new UK Financial Reporting Standards and the EU Accounting Directive). Mark Clatworthy and Ioannis Tsalavoutas addressed this theme of financial information disclosure in their presentations. Mark investigated the information needed by companies' capital providers in their decision-making processes and the importance for them of audited financial reporting information, while Ioannis provided empirical evidence on whether mandatory disclosures are really mandatory.

Overall, therefore, the symposium questioned and re-questioned some of the basic accounting regulatory and technical issues. The five speakers provided a range of informed, interesting and, above all, provocative opinions. These are now presented, and then discussed, in more depth in the following chapters.

The Use of Information by Capital Providers: An Academic Literature Review

Written and presented by Mark Clatworthy and based on the EFRAG report of the research team composed of Stefano Cascino (London School of Economics), Mark Clatworthy (University of Bristol), Beatriz García Osma (Autonoma University of Madrid), Joachim Gassen (Humboldt-Universität zu Berlin), Shahed Imam (University of Warwick), Thomas Jeanjean (ESSEC Business School, Paris)

That financial reporting information is now designed and prepared for investors in large public companies is now almost axiomatic. Despite this, important questions surrounding the information used by capital providers remain. First of all, who are the most important capital providers for large public companies? Second, what decisions are these capital providers making and what information do they need? For example, are they looking for information purely to estimate future cash flows or do they need information for evaluating the effectiveness of management as part of a stewardship assessment? Third, how important a part of the wider investor information set is audited financial reporting information, particularly the financial statements? A considerable amount of research has been conducted on these questions and this literature formed the basis of the academic literature review commissioned by the Institute of Chartered Accountants of Scotland (ICAS) and the European Financial Reporting Advisory Group (EFRAG) (Cascino et al. 2013). The review focused on providers of capital to large European public companies and the pan-European nature of the team meant that the literature reviewed was not confined to the English language.

Although there seems to be a general tendency to emphasise equity providers in much of the academic literature (and to an extent, in standard-setting debates), an examination of the typical European company balance sheet shows that a large proportion of capital is provided in the form of credit. For example, shareholders' equity is often less important than short- and long-term debt and, in some countries, shareholders' equity is well below 40% of total capital provided. Similarly, in most European countries, credit markets are much more important than stock markets when measured as a proportion of GDP. The review indicated that the importance of credit markets is also underrepresented in the academic literature: the vast majority of research in this area focuses on equity markets, though this has started to change in recent years.

Appreciating the importance of credit markets is essential because the academic literature shows quite clearly that debt providers and equity providers often have very different needs. One reason for this is the asymmetric payoffs to debt providers where the upside is limited to the redemption value of the debt, whereas the downside is only limited by the value of their investment. The literature also reveals that the interests of debt-holders and shareholders can sometimes conflict, so the information needs of creditors sometimes reflect their aim of reducing such potential conflicts. Potentially problematic behaviour by shareholders includes the potential payment of excessive dividends, raising more debt of similar or higher seniority, investing in more risky assets and under-investing in profitable projects. In this context, audited financial reporting information can form the basis of contracts between companies and their lenders (eg in the form of covenants that limit dividends paid, restrict borrowing through maximum leverage ratios or require a minimum level of interest cover) and this use of the information may lead to competing pressures being placed on the information. For instance, consider the possibility that the asymmetric payoff to debt providers leads to a preference for conservative accounting data. This may conflict with a preference for unbiased information in the context of equity valuation decisions.

As well as potential differences between debt and equity providers, the literature also reveals potential differences within investor types depending on the nature of the decision. In particular, if investors are making 'stewardship'-oriented decisions, their information needs and preferences can differ from when they are making financial investment decisions. An example of this is where information that does not reveal managers' capabilities or actions may still be very useful for firm valuation decisions. Moreover, more conservative accounting policies may be preferred for evaluating managerial performance, whereas neutral accounting is typically preferable for valuation decisions. The idea that the stewardship role of accounting can be subsumed by a 'financial decision-making' role is therefore generally not supported by the academic literature.

The review revealed that capital providers can be further separated into professional equity investors, private (or retail) equity investors, inside (normally family) equity investors, public (eg bond) debt investors, private debt investors and trade creditors. This categorisation formed the basis of the review. The available evidence for each category was gathered and analysed.

In the case of professional equity investors (often the most important group of equity providers), two main sources of information dominate: direct contact with management and audited financial statements. Empirical research from various countries confirms this, though there is some disagreement over which source is most influential. Trying to rank these two sources may be futile, however, because they are interdependent and each is rarely used in isolation. In particular, the information provided directly by management (eg management forecasts) may be more timely and perhaps more relevant than audited financial statements, but it is also less reliable and often uses accounting data as a benchmark. For instance, management profit forecasts are of very limited use without an eventual independently verified earnings number. Importantly, there is abundant theoretical evidence showing that accounting information is relevant and can be linked to economic fundamentals through valuation models. An example of this is the residual income model, which expresses equity value solely as a function of book value of equity and discounted expected income. There is also evidence (though this is less abundant) showing that professional investors use accounting information for stewardship purposes, for example by linking managerial compensation to accounting data (eg earnings per share).

As might be expected, professional equity investors are relatively sophisticated users of accounting data and sometimes use the notes to accounts to study accounting data in more detail. This is not always the case, however, as some evidence suggests that information disclosed in the notes receives less weight than that which is disclosed is recognised in the financial statements. Professional investors often prefer 'non-GAAP' measures to standardised ones owing to a need for measures of persistent, or recurring, profits. Importantly, even professional investors do not analyse all the information themselves; rather, they rely on information intermediaries – particularly sell-side analysts – to assist them.

The literature on private investors shows that they rely even more heavily on information intermediaries and rarely analyse financial reporting data directly. Most of the information these investors receive is 'filtered' and they often ignore complex (but relevant) information. In contrast to professional investors, retail investors do not use sophisticated valuation models and private shareholders do not, typically, analyse the notes to the accounts.

An interesting observation is that the review revealed in numerous ways the idea that the demand for accounting information reflects not just the amount of capital contributed by a given user group, but also the ability of such groups to demand information directly. Consequently, inside equity investors – where ownership and control overlap significantly – are often major capital providers, yet they are given less priority in accounting debates, which is reflected in the scarcity of accounting research into their information needs. What research there is suggests that companies with inside equity investors use accounting information for internal planning and control and in executive compensation contracts. Perhaps unsurprisingly, therefore, the information is used more to resolve 'moral hazard' problems, rather than 'adverse selection' ones.

Although it is less voluminous, the literature on debt providers' information needs is very well established. Studies over the last three to four decades have shown that accounting data are useful for predicting default and for estimating credit ratings. Credit rating agencies are important information intermediaries and even a relatively small number of accounting ratios can capture a significant proportion of default probabilities; market-based data (such as option-based models) often add little explanatory power. The more dominant use of accounting information by debt investors is in contracting. Debt contracts – both public and private agreements – rely extensively on accounting data for loan covenants and more recently for performance-pricing arrangements, where the price of debt is often tied to values of accounting ratios. Interestingly, however, adjustments are often made to GAAP numbers (eg to strip out intangible assets from 'net worth' covenants), indicating that figures principally developed for equity investors are not necessarily useful to credit providers. Moreover, and as suggested above, a considerable body of research indicates that lenders often prefer more conservative accounting figures, meaning that conservative accounting can lead to more favourable lending terms.

The final group of capital providers – trade creditors – is often overlooked by academic researchers investigating the use of accounting information, yet this group also represents a significant source of finance for European firms. The existing literature suggests that accounting information plays a relatively limited direct role in creditors' decisions, particularly after the initial decision to offer credit has been made. Importantly, however, the intermediaries (credit bureaus) that are highly important in this market do rely on financial statement data – alongside other non-financial information. As is the case for other user groups, therefore, information intermediaries are important in this market and financial statements form an important basis for these intermediaries' decisions.

The implications of the review for standard setters are that different capital providers use information in various ways and have different objectives, creating considerable heterogeneity in the demand for accounting information and thus requiring a need to balance different users' needs. This may require balancing these needs on an individual standard-by-standard basis, or by focusing on a particular user group when developing standards. Moreover, accounting information is rarely used in isolation and standard setters may therefore benefit from focusing on the comparative advantages of accounting data. Although it is often criticised for being late and backward looking, it is unique in being independently audited, standardised, verifiable, recurring and regular. The importance of information intermediaries also deserves attention, since standard setters may needlessly be addressing the perceived demands of capital providers who receive accounting data through more sophisticated analysts and agencies. Finally, the heavy reliance of various users of accounting data in contracting has important implications for standard setters, since there can be high costs for renegotiating when accounting standards change.

Although the literature in this area is rather extensive, there remain important gaps and the review revealed many opportunities for further research. The studies cited in the report rely on some countries and methodologies more than others and many empirical analyses are now becoming dated. This is important because investors' information environment is likely to be changing rapidly, given the internationalisation of financial markets, the increasing influence of the IASB and major advances in information technology. In summary, though the academic research can reveal important insights for standard setters' decisions, more needs to be done before it offers comprehensive direction comparable to some of the disciplines outside accounting.

QUESTIONS

At the end of Mark's presentation there was a lively question and answer session, with questions from Innocent Okwuosa (Reading University), Ioannis Tsalavoutas (Stirling University), Vickie Wood (BIS), Richard Martin (ACCA) and Susan Hardman (Brunel University). A range of issues was discussed, such as decision usefulness and stewardship, the role of fair value, banks' discount, information of capital market providers, and evidence from US debt markets.

Accounting Transition and Tax: The Case of FRS 102

Rob Harvey – HMRC (Her Majesty's Revenue and Customs)

INTRODUCTION

Rob works as an accountant in HMRC's Large Business (LB) division, which deals with the tax affairs of over 2000 of the largest and most complex businesses in the UK. He specialises in accountancy advice in financial instruments, and specifically for banks. He was thus well placed to talk about the major forthcoming changes to UK GAAP in the form of FRS 102 and the associated accounting and tax consequences.

Rob started his presentation by providing a background to his work at HMRC. HMRC accountants provide advice across a wide range of areas, such as compliance, policy and litigation issues. They are often involved in the resolution of disputes that arise because of different interpretations of tax laws in the courts. The accountants may advise the HMRC's case team, as the case may require expert witnesses to give evidence to tax tribunals, such as in the Bristol and West, P&O and Greenbank examples. In Bristol and West, the tribunal found that the accounting for the transactions in question did not accord with UK GAAP. The company transferred, for tax purposes, some interest rate swaps to another group company, but failed to account for the gain on disposal correctly, leading to a profit understatement. In P&O, HMRC accountants explained to the tribunal a series of transactions in which the company issued 193m shares, cancelled them and paid a $A193m dividend out of the reserves created, all in the space of a few days. In Greenbank, accounting evidence was required on the accounting meaning of goodwill and specifically whether it included internally generated as well as purchased goodwill. The Bristol and West and P&O cases were part of £1bn corporate tax avoidance wins in the courts for HMRC in 2013, reflecting an 80% success rate before the courts.

HMRC, as a taxation authority, needs to be aware of future accounting changes. In several areas of financial reporting the tax treatment follows the accounting treatment. So changes may have potential tax impact. HMRC aims to ensure that any accounting changes will be appropriately dealt with by the tax system, especially those with a significant impact (upon either tax revenues or taxpayers). As well as monitoring future tax changes, Rob specified that HMRC ensures that appropriate provisions are in place for dealing with the unexpected (eg the IAS 39 reclassification changes in 2008, during the financial crisis). Indeed, HMRC has regulation-making powers to enable legislation changes outside the normal finance bill legislative timetable.

THE NEW STANDARDS: FRS 102 AND ITS KEY DIFFERENCES FROM UK GAAP

Rob first briefly illustrated FRS 100, which sets out the framework for the new UK GAAP, and then FRS 101, which introduces a new reduced-disclosure framework that enables most subsidiaries and ultimate parents to apply IFRS in their individual financial statements, but with significantly reduced disclosure requirements. He then focused on FRS 102, the single standard that replaces the 3,000 pages of the previous UK standards with 330 pages. All previous SSAPs, UITF abstracts, and FRSs are withdrawn (except FRS 27 Life Insurance, which remains in place until a new insurance standard is finalised). He underlined that a number of statements of recommended practice (SORPs) will remain in place but be updated, if necessary, to ensure that they do not conflict with the requirements of FRS 102. No early adoption is possible where there is a conflict (eg charities' SORP). Rob focused in particular on the accounting changes that are likely to affect those businesses moving from old UK GAAP (excluding FRS 23; FRS 26) to FRS 102. He stated that FRS 102 could affect tax in the following areas:

- financial instruments
- foreign currency translation
- lease accounting
- employee benefits
- goodwill and intangibles.

FINANCIAL INSTRUMENTS (FRS 102 CHAPTERS 11 AND 12)

Rob stated that the change of the accounting treatment of derivatives will have a major impact for those businesses that will adopt FRS 102 for the first time. Under UK GAAP most derivatives are held off balance sheet. Indeed, despite disclosures or accounting policies that might reveal that companies hold significant interest rate swaps and/or forex contracts for hedging purposes, the fair value of such instruments is not currently included on balance sheets. By contrast, under FRS 102 many derivatives are required to be held at fair value, with any change in value being reflected through the profit and loss statement. Although, in accordance with Section 12 of FRS 102, it is still possible to apply hedge accounting to such arrangements, it is less likely to be adopted as the documentation and the complexity of the rules and disclosures are much more onerous than under old UK GAAP. Thus, for many businesses there will be significant new assets/liabilities on the balance sheet, increased income statement volatility, and significant transition adjustments.

Moreover, Rob pointed out that a number of other financial instruments (including publicly traded ordinary shares – see Chapter 11 of FRS 102, asset-backed securities, convertible instruments) will have to be held at fair value, with gains and losses reflected in the profit and loss statement, where previously there had been no requirement to do so under UK GAAP. This may also include more standard debt instruments, such as loans with an interest rate collar (ie cap and floor), which do not currently meet the definitions of basic financial instruments in Chapter 11, and so would not qualify for amortised cost accounting.

Rob also illustrated changes for loans and basic debt instruments (Chapter 11 of FRS 102), which are initially measured at the transaction price and subsequently amortised. An exception arises, however, in cases that constitute, in effect, a financing transaction (eg a sale not on normal trade terms, or an interest-free loan). In such cases, they will be measured, initially, at the present value of the future payments discounted at a market rate of interest for a similar debt instrument, and subsequently at amortised cost. This means that, for example, interest free intercompany loans might be required to be recognised at a discounted value (different from transaction price), with interest accounted for on the loan. Any initial differences arising on such balances may represent distributions or capital contributions, which can cause complications (eg regarding distributable reserves).

FOREIGN CURRENCY TRANSLATION (FRS 102 CHAPTER 30)

Rob outlined several main differences between FRS 102 and the old UK GAAP.

Functional currency: under FRS 102, the determination of the functional currency requires consideration of the 'currency of the primary economic environment in which the entity operates'. Although this is broadly consistent with SSAP 20 in old UK GAAP, FRS 102 identifies additional factors to consider in determining the functional currency (eg the activities of a foreign operation are carried out as an extension of the reporting entity, rather than being autonomous). This could result in a different assessment of the company's functional currency and significantly affect the calculation of the profits recognised in the company's accounts. Unforeseen changes in functional currency could leave a reporting entity exposed to significant volatility on any monetary assets/liabilities not denominated in the functional currency.

Contract rate accounting: under SSAP 20, when matching forward contracts are in place for a transaction, the exchange rate fixed by the contract may be used. This option is not permitted under FRS 102. Rob commented that as a result companies will need to choose between the greater complexity provided by the hedge accounting or the greater volatility provided by not-hedging.

Net investment hedging: under SSAP 20, where foreign equity investments are financed by foreign currency, companies are allowed to re-denominate the investments in the foreign currency. Exchange differences on the loans are recognised in reserves (matching in reserves). This approach is not possible under FRS 102, where net investment hedging is available only at consolidated level and possible at company level only in respect of branches with a different functional currency.

Permanent-as-equity debt: under SSAP 20 it is possible for permanent-as-equity-debt to be either treated as non-monetary items and be carried at historic rates on the balance sheet or retranslated at the year end, with exchange movements recognised through reserves. These treatments are not allowed under FRS 102, and as a result such instruments are treated as monetary assets and retranslated at the year end.

LEASE ACCOUNTING (FRS 102 CHAPTER 20)

Both SSAP 21 in the old UK GAAP and FRS 102 define a lease as a finance lease if it transfers substantially all the risks and rewards of the leased asset, but SSAP 21 includes a presumption not contained in FRS 102. If the present value of the minimum lease payments is 90% or more of the fair value of the leased asset than the lease would typically be classified as a finance lease. Rob outlined the possibility that leases classified as operating leases under SSAP 21, because they fall just under the 90% cut-off, could be reclassified as finance leases under FRS 102. He then illustrated the differences for operating lease incentives (eg the rent-free period on a property lease). UITF 28 requires that operating lease incentives are spread over the shorter period between the lease term and the period at which it is expected that market rent will become payable. Under FRS 102, the lease incentives are spread over the lease term on a straight line basis unless another systematic basis is more representative of the time pattern of the lessee's benefit.

EMPLOYEE BENEFITS (FRS 102 CHAPTER 28)

In this area, the main difference arises for holiday pay. Nothing within UK GAAP prohibits making an accrual/provision for paid holiday accrued but untaken by employees at the year end. FRS 102, however, spells out that the cost of holiday pay should be recognised when the employee renders the service that increases their entitlement. The effect of this may be significant where employees have a right to carry forward unused leave to future periods – ie the holiday year and financial year differ.

GOODWILL AND INTANGIBLES (FRS 102 CHAPTERS 18 AND 19)

The main difference for goodwill concerns its maximum economic life, while for intangibles it is recognition when acquired in a business combination. FRS 10 sets out a rebuttable presumption that goodwill is assumed to have a maximum economic life of 20 years, over which it is thus amortised. By contrast, FRS 102 states that, unless it is possible to make a reliable estimate of the economic life of goodwill, the amortisation period shall not exceed five years. Intangibles acquired in a business combination were rarely recognised as separate assets under FRS 10, and they did not meet the recognition criteria because they could not be disposed of separately. In business combinations in future, however, it is probable that more intangible assets will be separately recognised under FRS 102, rather than being subsumed within the goodwill figure as under old UK GAAP (eg customer lists).

TRANSITIONAL PROVISION

FRS 102 will be effective for the accounting periods commencing on or after 1 January 2015. Early adoption was possible. Transitional provisions are contained in Chapter 35 of FRS 102. Within the mandatory provision, Rob illustrated the case of financial assets and liabilities derecognised under the old GAAP before the date of transition that will not be recognised upon adoption of FRS 102, even if they would not have qualified for de-recognition under FRS 102. If any pre-transition business combination is restated, the treatment must be applied consistently to all combinations after that date.

TAX IMPLICATIONS

Transition differences will be taxable on the first day of a new accounting period under FRS 102. Despite this general rule, Rob highlighted a number of exceptions where care will be needed. These include the spread of the transitional adjustments arising in respect of loan relationships or derivative contracts over 10 years. There are also specific rules that apply to derivatives held for hedging purposes – the 'disregard rules'. In this case, the taxation on some hedging arrangements is deferred. Thus, the items may not be taxed on transition but will have to be tracked and brought into charge in a subsequent period.

HMRC INITIATIVES TO HELP PEOPLE TO DEAL WITH THE ACCOUNTING CHANGES

Rob illustrated the initiatives that HMRC has undertaken to ensure that correct advice is provided to deal with the accounting changes appropriately. As at January 2014 HMRC has a training programme underway to train 140 accountants and 7,000 tax specialists. It is revising several manuals that give guidance on accounting and tax in a variety of areas, to reflect accounting changes, and publication of transitional guidance is imminent. HMRC is also seeking to simplify the tax rules relating to hedging derivatives on transition, for example about the time limits within which people can opt out of the rules.

PRACTICAL ISSUES

Rob concluded by identifying three main areas where practical problems might arise. First, unexpected functional currency changes can cause some unpleasant surprises leading to significant volatility. Second, interest-free intercompany loans may need to be reconsidered if they are financing transactions. There may be a need to revise the terms of such loans or face the potential complexity. Third, tax issues may arise on hedging derivatives if they are not reflected with back-to-back contracts within a group, potentially exposing companies to significant changes in profits and losses and unnecessary tax volatility.

QUESTIONS

Richard Slack (University of Durham) asked what tax implications had arisen in cases such as those that Rob had mentioned and that were decided in HMRC's favour: were the implications different for a mass market avoidance scheme compared with individual cases? Rob stated that HMRC must distinguish between mass-market avoidance schemes and individual cases. Mass marketed schemes were often ones that were disclosed under the disclosure of tax avoidance scheme (DOTAS) rules, which meant that, when HMRC challenged such schemes, all users of a particular scheme might be bound by the tribunal findings (subject to any right of appeal). For one-off cases – either avoidance or non-avoidance cases where interpretation of tax law differs – the tribunal findings may establish precedent, but not always with such direct consequences for other taxpayers.

Mike Jones (University of Bristol) asked who the tribunal members are. Rob answered that tribunal chairs are usually very experienced in tax law (eg former partners with major law firms). HMRC accountants' role as independent expert witnesses is to advise the tribunal members on accounting aspects of cases they are considering.

Richard Baylis (University of Cardiff) wondered whether a qualified audit certificate would set the alarm bells ringing. Rob stated that HMRC would scrutinise any audit qualification they encountered to understand the reason for it – and assess whether it might give rise to a risk of underpayment of tax.

Chris Nobes (Royal Holloway) wondered which policy change has the greatest tax risk. Rob said in his view the financial instrument changes relating to derivatives posed the most significant change, both in terms of accounting impact and potential tax impact, but that other areas such as holiday pay could have tax wrinkles (eg if holiday pay was not paid within nine months of the year end).

Reflections on Measurement: How Conceptual Should a Conceptual Framework Be?

Andrew Lennard, Director of Research, Codes & Standards Division, FRC

Andrew provided a personal view on the need for a conceptual framework in the context of the IASB's Discussion Paper '*A Review of the Conceptual Framework for Financial Reporting*'.

WHAT SORT OF A CONCEPTUAL FRAMEWORK DO WE NEED?

Andrew posed the general question of why we need a conceptual theory at all. One reason is that provides legitimacy. Perhaps more fundamentally, intuitive answers are not obvious, may not be the best, may not be consistent and may limit improvement. Rigorous thinking, based on a Conceptual Framework, is a valuable alternative approach. Nonetheless, while a Conceptual Framework provides one way of looking at things, it was dangerous to see it as the only input to standard-setters' decisions: there are obviously other considerations, such as the undesirability of unnecessarily disruptive change.

He noted that R.H. Coase, in introducing the notion of opportunity costs, had written: 'Much that I have to say may appear obvious, but it is necessary to secure agreement on simple matters before proceeding to more complex questions' (Coase,1938) He suggested that even a cursory acquaintance with standard-setting debates would show that standard setters were often far from agreement on simple matters.

It was also Coase (1937) who had drawn to his attention the words of Joan Robinson: 'the two questions to be asked of a set of assumptions…are: Are they tractable?; and: Do they correspond to the real world?'. He suggested that these were cogent questions to ask of a Conceptual Framework. Some examples illustrate their power.

For instance, some theories are tractable but not realistic, for example, engineering that ignores friction, and the Modigliani and Miller hypothesis in finance, which assumes, for example, a world without taxes. He was not suggesting such theories were without value: it helps, for example to understand the real world by drawing attention to where it departs from the assumed world. But such theories cannot help directly in addressing real-world problems such as designing an efficient machine.

Other theories are realistic but not tractable. An example is a map on scale of 1:1, which has been contemplated by many writers. Such a map would be as big as what it represented: it would be entirely realistic, but not very useful.

Third, he cited theories that were tractable and sufficiently realistic to work, but were not, in fact, entirely true. Einstein's theory of relativity contradicts Newtonian physics, but the latter works well enough for many purposes, even including moon landings. We use Euclidian geometry to calculate the number of rolls of wallpaper to buy, making the assumption (which we know is not strictly true) that the walls are flat and square. Similarly, architects assume that the earth is flat, even though they are fully aware that it is not. Indeed, they do not make that assumption when working on a very large building, such as the shopping centre in Milton Keynes.

Andrew suggested that by analogy with the above examples, the challenge for the Conceptual Framework was to be sufficiently realistic to offer workable solutions for real-world problems, but not so complicated that it was impossible to use for that purpose: it had to find the right balance between being realistic and being tractable.

It is not enough simply to be descriptive. Accounting standard setting seeks improvement, not merely consistency. As is well known, you cannot derive an 'ought' from an 'is'. The Conceptual Framework therefore needs to specify objectives. Agreement on the objectives helps to specify what counts as an improvement in financial reporting. In other words, the Conceptual Framework needs to be normative, and not merely descriptive.

Turning to measurement, Andrew referred to a view of the world as being populated with complete and perfect markets (all assets are traded, and all information is included in prices) as being highly tractable, but not realistic. In such a setting, accounting is very easy but provides no useful information. This was demonstrated in Beaver and Demski (1979).

WHAT THE DISCUSSION PAPER SAYS, AND WHAT IT DOES NOT

Andrew briefly summarised what the IASB's Discussion Paper says about measurement. It refers to the three main measurement bases. First, 'cost-based measurements', which seem in practice to be historical cost (that is the message of paragraph 6.44, and footnote 52 on page 123); second, 'current market prices' (including fair value); and third, other cash-flow-based measures. These may be 'custom-designed' and may have various objectives (paragraph 6.119ff). Andrew reflected that it might be expected that the Conceptual Framework should tell us what the measurement objective should be, but there was little clue in the Discussion Paper.

The IASB's Preliminary views were that there was no single measurement basis for all circumstances. 'Relevance' depends on how an asset (or liability) would contribute to cash flows (be settled). 'Operational assets' (Andrew's term) are at cost and assets that will be sold are at current selling price (perhaps after deducting costs of selling). Oddly, inventory is to be classed as an operational asset rather than an asset held for sale. Financial assets held for collection and where cash flow variation is insignificant, should be valued at cost. If there is a variation in cash flow, current market value should be used.

Andrew put forward the Accounting Council's tentative view that the Discussion Paper lacks depth: 'The Discussion Paper's treatment of measurement fails to provide the depth of conceptual analysis that is necessary if the Conceptual Framework is to provide useful guidance to the IASB in the development of accounting standards'. There were some basic problems with the Discussion Paper and often the reasoning lacked justification. It was also incomplete, eg transaction costs and changing prices were not fully discussed.

Andrew believed four key issues were not addressed: the nature of value; the difference between entry and exit prices (which includes the issue of transaction costs); changing prices; and deprival value. He then considered these in more detail.

WHAT IS VALUE?

Good markets make value clear. He cited a paper by Stephen Penman (Penman 2007) that sets out some useful ideas. Penman argues that it is reasonable to use fair value assets where shareholders value changes one-to-one with market prices. For example, investments in financial instruments (securities and equities), assets held for pensions by insurance companies and real estate held for speculation rather than occupation. In other words, where held for investment, fair value is appropriate.

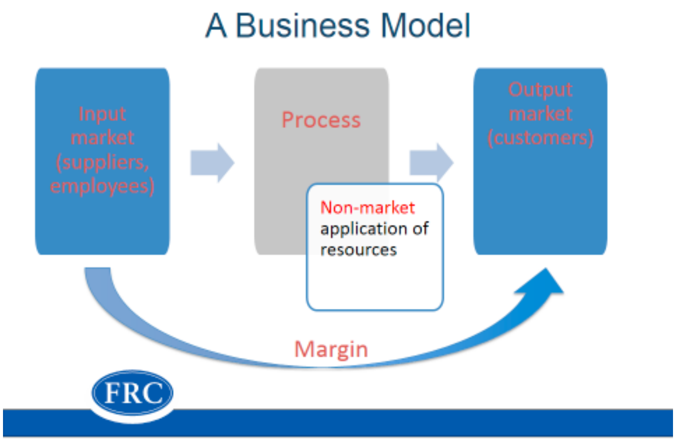
In the absence of good markets, however, value depends on the owner: the value of an asset will be greater for an entity for which the asset offers many profitable opportunities than it will for another. Apparent objectivity is deceptive: by necessity, values are entity-specific. Furthermore, many markets are incomplete and in that case, hypothetical market values will be unsatisfactory.

ENTRY AND EXIT PRICES

Second, Andrew looked at entry and exit values. These differ. Andrew cited the buying and selling prices of new assets such as cars. Typically, assets are purchased from specialist suppliers but, once they have been purchased, the purchaser does not have the same selling ability as the specialist supplier. The price that the purchaser can obtain for his asset (his exit price) is much lower than the entry price he has just paid, which was also the dealer's exit price. He suggested that the difference between entry and exit prices, and the fact that values are entity-specific are important ideas that could be useful in the Conceptual Framework.

Penman (2007) states that historical cost is appropriate for operational assets (including inventory, warranty liabilities), including financial assets that involve customer relationships, such as commercial loans and core deposits. Penman's rationale for historical cost is that earnings show success in arbitraging input (supplier) markets and output (customer) markets. This is the success of the business model where profit is the difference. Andrew observed that Penman's views seem consistent with the IASB Discussion Paper and that this provides a convincing reason for treating inventory as operational rather than as held for sale.

Andrew provided a diagram of a business model



Andrew suggested that in order to reflect the margin, it was necessary for assets that are input to a business to be reported at entry values, ie cost, either historic or (better) current cost. Because there are typically no markets for work-in progress, there is little point in trying to determine fair value in any case. This was entirely consistent with Penman's view.

CHANGING PRICES

Andrew considered the reasons why the Discussion Paper does not consider current values. The Discussion Paper suggests that this is only an issue for hyper-inflationary economies, but is this really true? Even moderate levels of inflation can have a significant impact on reported results. Moreover, the issue was not only that of general inflation: specific prices, ie prices for specific kinds of asset, also change, and indeed there has been great volatility in such prices recently, oil being just one example.

He noted that IASB's Discussion Paper states that holding gains confuse people 'unless those gains and losses are disaggregated in an understandable way' (paragraph 6.16(c)).

He would agree with this: it was vital that, if current costs were used, holding gains and losses should be presented separately from the costs of consuming an asset. That, however, did not provide sufficient justification for the implication that we should stay with historical cost.

DEPRIVAL VALUE

Deprival value provides a rationale for selecting a measurement basis that represents 'value to the business'. In summary, it requires the use of replacement cost for assets you want to keep, and exit value for those you want to sell. The IASB seems to prefer deprival value except that: (i) there is no role for value in use and (ii) cost is historical, not current.

In fact, the Discussion Paper rejects deprival value (paragraph 6.43). The reasons given are: replacement cost may be expensive and subjective; value in use is also subjective and requires internal assumptions. In addition, value in use can only be applied to groups of assets. Andrew suggested that these considerations were insufficient for thinking about measurement through the lens of deprival value. He accepted that it could be the case that deprival value might well suggest a measurement basis that would be difficult to apply in the circumstances that a standard was attempting to address. But it could provide a sound basis for discussion at the standard-setting level. Such discussions would need to consider whether there were acceptable proxies for the measurement bases suggested by deprival value. Or perhaps wholly different measurement bases could be used, but thinking about deprival value might suggest that an additional disclosure would be useful. It cannot be expected that the Conceptual Framework can be applied easily in every case, or that it can address what to do where it cannot: but it should be clear as to what the aspiration is.

As a concluding thought, Andrew questioned the cost–benefit considerations that were set out in the IASB's Conceptual Framework. Although their importance is unquestionable, he questioned whether their inclusion in the Framework was appropriate, as they were really a practical issue, not a conceptual one. Including cost–benefit considerations in the Conceptual Framework gave rise to a risk that a standard might be claimed to be in accordance with the ideals set out in the Framework when in fact it fell short of those – possibly perfectly reasonably – for cost–benefit reasons.

Andrew considered that complete, perfect markets and 'fair value' are tractable, but not realistic. More real-world factors must be considered to develop a Framework that is useful and persuasive. He had tried to identify some of those issues and suggest how they might be reflected in the Conceptual Framework. The good news for IASB was that the existing literature can assist in this.

QUESTIONS

Mike Jones (University of Bristol) questioned whether the conceptual framework discussion document was a waste of time, whether the final version would reflect the responses adequately and whether the final version would be published in a reasonable time. Andrew replied that accounting standards will be improved so it will not be a waste of time. Further, this is not a popularity poll. Nonetheless, establishing the final framework by the end of 2015 was a very real challenge.

Innocent Okwuosa (University of Reading) argued that the business model was incomplete and, therefore, flawed, but Andrew said it would provide a basis for assessing the business model.

Richard Martin mentioned that deprival value was not included and that cash flow in use challenged equity. Andrew stated that the Discussion Paper had provided a solution not a justification.

Are Mandatory Disclosures Really Mandatory?

Ioannis Tsalavoutas, Lecturer in Accounting, University of Stirling

Focusing on the disclosures mandated by various accounting standards, Ioannis first provided a summary of research findings on whether companies comply with these disclosure requirements. Second, he provided some empirical evidence on whether variable levels of compliance with mandatory disclosures in relation to goodwill, in particular, relate to companies' cost of equity capital. Most of the arguments discussed in the first part of the presentation reflected on recent evidence provided in the ACCA monograph Ioannis and his co-authors recently published (Tsalavoutas et al. 2014). The second part of the presentation reflected on a working paper that Ioannis and his co-authors have been working on for some time now (Mazzi et al. 2014).

VOLUNTARY VS MANDATORY DISCLOSURE

Ioannis started by highlighting the features of mandatory disclosures compared with those of voluntary disclosures. Mandatory disclosure is the minimum information that accounting standards or other promulgations require from a reporting entity. Voluntary disclosure is 'any disclosure by companies not mandated by law and/or self-regulatory bodies' (Owusu-Ansah 1998: 154). Voluntary disclosures' level and quality are the result of decisions of managers, based on perceived (direct and indirect) costs and benefits (Gray et al. 1990). This allows for substantial room for discretion. On the other hand, mandatory disclosures are a standardised framework that aim to result in comparable information. Where a standardised framework is in place, it enhances the identification of failure to publish mandatory information.

Theoretical papers argue that mandatory disclosures provide more transparent financial statements, resulting in a reduction in economic uncertainty. Additionally, mandatory disclosures force companies to 'talk about current cash flows, profits, net assets and ownership claims rather than firms' aspirations for future success' (Leuz and Wysocki 2008: 68). This type of disclosure may not necessarily reveal positive information. Mandatory disclosures compel companies to make public both proprietary and non-proprietary information and both 'good' and 'bad' news.

ASSUMING THAT MANDATORY DISCLOSURES REALLY ARE MANDATORY, DO COMPANIES COMPLY WITH THEM?

If enforcement is lax and no sanctions exist, managers can exercise discretion on which requirements to follow and to what extent. In essence, compliance is 'the management of regulatory risk' (Adams 1994: 279). Managers observe and assess this risk before making decisions, developing a 'compliance culture'.

With this in mind, Ioannis argued that it is not surprising that the findings of various studies from professional bodies have consistently indicated that there is a problem with mandatory disclosures. Ioannis highlighted that the following statement (ICAEW 2013: Executive Summary) depicts the current situation very accurately: 'There have been widespread complaints of information overload in financial reporting and there is a widely-held view that financial reporting disclosures need to be reformed. Views differ on what exactly the problem is, but few people seem to be happy with the current position.'

In October 2013, the IASB announced the formation of a new staff group that focuses on the 'Disclosure Initiative'. The focus of this initiative is to:

- clarify the meaning of the materiality requirement in IAS 1, Presentation of Financial Statements
- review and replace IAS 1, IAS 7, Statement of Cash Flows, and IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, 'in essence creating a disclosure framework'
- develop educational material or guidance on materiality
- review the disclosure requirements in all standards in the light of the revised Conceptual Framework
- draft future disclosure requirements using less prescriptive language.

Ioannis reported a summary of the findings of 11 academic papers that have examined companies' compliance levels with national accounting standards' disclosure requirements, along with a summary of the findings of 18 studies examining companies' compliance levels with IFRS disclosure requirements. These findings provide ample evidence that companies have not fully complied with (IFRS) mandatory disclosure requirements, before or even after 2005. Hence, it is not necessarily the quality of the accounting standards that affects compliance. The focus should probably be on training enforcement bodies, preparers and auditors on what is actually mandated and what companies are expected to disclose, as well as on enforcement.

ACCA RESEARCH REPORT 134: WORLDWIDE APPLICATION OF IFRS 3, IAS 38 AND IAS 36, RELATED DISCLOSURES, AND DETERMINANTS OF NON-COMPLIANCE

Ioannis first summarised the objectives of this study:

- to hand-collect information directly from the companies' financial statements and identify the accounting for related information disclosed under IAS 36 Impairment of Assets, IAS 38 Intangible Assets, and the revised IFRS 3 Business Combinations across countries and industries
- to investigate international compliance with the mandatory disclosure requirements for IFRS 3, IAS 36 and IAS 38, and
- to investigate firm- and country-level determinants of the company compliance levels.

More specifically, a sample of 544 non-financial companies were selected from the EU, Australia, China, Hong Kong, New Zealand, Brazil, South Africa and Malaysia. The companies were constituents of their countries' premier stock market indices as at 1 June 2011. For the EU, constituents of the S&P Europe 350 index as at 1 June 2011 were also used. This allows a focus on the companies that are the most likely to be followed by a significant number of investors (foreign and domestic).

As far as IFRS 3 is concerned, companies provide significantly disparate information about business combinations, resulting in a lack of comparability. It is difficult to determine whether this disparity is because firms do not view their acquisitions as material, do not understand the mandated requirements and/or simply do not follow the standard to the letter. For IAS 38, intangible assets account for a large proportion of companies' assets and yet relevant mandatory disclosures are not provided in full. For IAS 36, the analysis illustrates the disparities between companies in the amounts and types of information actually provided. This reinforces the need for a review of the disclosures mandated by IAS 36 along with provision of specific guidance on when this information is expected. Beyond the need for promoting better guidance about the disclosures mandated by the standard in general, the use of post-tax discount rates in the impairment testing calculations and the options companies have in reversing impairment losses need to be improved.

Drawing on the second and third objectives, Ioannis highlighted the following findings. The mean overall compliance score is 83%. Interestingly, 75% of the sample firms have at least 75% compliance levels. Firms with the lowest compliance scores (ie the bottom quartile) report minimum compliance levels of 33%. At the other end of the spectrum, those in the top quartile (25%) of highly compliant firms comply with at least 93% with the requirements of the three standards.

For the 23 countries examined, this report documents average compliance scores ranging from 77% to 90%. Specifically, New Zealand is the country with the highest average compliance, at 97%. Ireland is the country with the second highest average disclosure score, 91%. UK follows with 90%. In contrast, some countries report much lower compliance levels. Greece is the country with the lowest compliance score, at only 67%.

- Less variability on average compliance levels is seen at the industry level.
- Firms reporting impairments comply less with mandatory disclosure requirements of IFRS 3, IAS 36 and IAS 38 than do firms without impairments.
- Cross-listing in the US increases compliance levels, which is consistent with the bonding and signalling hypotheses.
- The stronger the enforcement mechanisms in a country, the higher the compliance levels.
- Compliance levels are lower when a company is from a country with a legal system of French origin.

GOODWILL-RELATED MANDATORY DISCLOSURE AND THE COST OF EQUITY CAPITAL (COC)

Theoretical academic papers indicate that the effects of enhanced disclosure on CoC can be direct or indirect. It is argued that greater disclosure enhances stock market liquidity, reduces estimation risk and reduces covariance of a firm's cash flow with the cash flow of other firms. The empirical evidence from a series of relevant studies shows that disclosure and high-quality accounting information reduce adverse selection, increasing liquidity. Additionally, higher disclosure levels result in a reduction in cost of capital.

Ioannis argued that on the basis of these studies, the IASB and other standard setters have included a series of mandated disclosures in accounting standards. He also presented some key findings of their study, exploring the effects of the varying levels of goodwill-related mandatory disclosures on companies' cost of equity capital. The study employs 779 observations from Standard and Poor's Europe 350 (S&P EU350) non-financial constituents, over a period of four years (2008–2011). The focus is on goodwill since it is a significant amount on a company's balance sheet and it conveys current and forward-looking information relevant to a firm. For example, the mean (median) ratio of goodwill to book value of equity for the sample firms is 72% (52%). Assuming that existing disclosure requirements in the Standards improve users' understanding of these issues, one would expect a negative relationship with increased levels of compliance with IFRS mandatory disclosures and cost of equity capital.

The results indicate a mean compliance level of about 82% and a high variation among firms' disclosure levels. In-depth analysis reveals that non-compliance relates mostly to proprietary information and information that reveals managers' judgement and expectations. These are the paragraphs in which companies tend to fall short of the standards' requirements:

- a description of each key assumption on which management has based its cash flow projections (IAS 36-134-d-i)
- a description of management's approach to determining the value(s) assigned to each key assumption (IAS 36-134-d-ii)
- the gross amount and accumulated impairment losses at the beginning (and end) of the period (IFRS 3-B67-d-I; IFRS 3-B67-d-viii)
- the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities (IFRS 3-B65-i)
- the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/ forecasts (IAS 36-134-d-iv)
- the period over which management has projected cash flows based on financial budgets/forecasts approved by management (IAS 36-134-d-iii)
- the main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses (IAS 36-131-b)
- a qualitative description of the factors that make up the goodwill recognised…(IFRS 3-B65-e).

Provision of this information reveals managers' expectations and assumptions in recognising and valuing goodwill. This type of mandatory disclosure can provide insights for assessing a company's sustainability of earnings (Hope 2003).

The univariate and multivariate analyses show that goodwill-related disclosure levels are negatively and statistically significantly associated with increased cost of compliance. Goodwill-related disclosure levels are not only statistically but also economically significant. Companies exhibiting high compliance levels with items that provide proprietary information and reveal managers' judgement and expectations reduced cost of compliance.

These findings support the argument that mandatory disclosures provide insights into key accounting matters and result in more transparent financial statements which, in turn, reduce economic uncertainty about companies. Finally, reflecting on standard setters' and regulators recent concerns about the usefulness of mandatory disclosures, this study informs the Conceptual Framework (CF) debate by revealing issues related to the application of existing IFRS for which specific guidance/principles of disclosures by the existing CF is absent. The findings suggest that further guidance and the existence of communication principles within the CF would be a positive step. This will contribute to the completeness of the CF and could result in the improvement of individual standards and the overall framework for financial reporting.

CONCLUSIONS AND RECOMMENDATIONS

Ioannis drew on Hans Hoogervorst's remark dated 28 May 2013, where he stated: 'It is undoubtedly true that we and others can improve our requirements to alleviate some of the difficulties. However, material improvements will require behavioural change to ensure that financial statements are regarded as tools of communication rather than compliance. That means addressing the root causes of why preparers may err on the side of caution and "kitchen-sink" their disclosures' (IASB, 2013).

From this, some questions arise.

How can one achieve behavioural change, especially when users and preparers come from a mixture of cultural backgrounds and business environments?

Is it possible that financial statements can be regarded as tools of communication rather than compliance? Why, then, do standards mandate that companies should disclose specific types of information?

Why focus only on the preparers? What would then be the role of enforcement bodies?

Subsequently, Ioannis proceeded with his personal recommendations, which are summarised below.

- Review the disclosure requirements in all standards and provide specific guidance at the Standards-level.
- Tsalavoutas et al. (2014) provide areas for improvement.
- §7.46 of the Discussion Paper on the CF indicates that 'an entity would need to assess the materiality of each disclosure requirement individually'.
- §7.48 of the Discussion Paper on the CF adds that 'The IASB should provide guidance that enables an entity to determine whether the specified information would be material in the context of an entity's financial statements.' Provision of such guidance at the standard-level, by suggesting specific thresholds, would assist firms in this kind of assessment and would also act as a safeguard for the users.

- While doing so, the IASB should reconsider the purpose and the connotation of the phrases 'a company shall disclose' and 'disclosure requirements'.
- As an example, how would the members of an enforcing body or investors, and not necessarily preparers, in Greece or Spain interpret these?

QUESTIONS

Michael Jones (University of Bristol) asked whether the issue is communication rather than compliance.

Ioannis stated that the relevant studies examine compliance. They take the wording of the standard(s) that a firm 'shall disclose…'. Nevertheless, what standard setters, preparers and enforcement bodies expect a company to disclose is also important. The inherent flexibility of principles-based standards can easily allow for different interpretations of an issue, depending on the culture of the standard setter, preparer and enforcement body.

Kathryn Haynes (University of Newcastle) questioned the materiality issue and whether material disclosure should be accompanied by additional disclosure via websites.

Ioannis replied by arguing that IAS1 provides a framework on the materiality issue, but different standards alone are not sufficient and guidance is needed.

Kathryn said that the onus of disclosure is on the company but is there not also an audit responsibility for ensuring disclosure?

Ioannis replied by saying that, in practice, there is a close link between companies and auditors. Nevertheless, the role and responsibility of the companies and auditors should be distinct.

Richard Martin, Head of Financial Reporting, ACCA asked about the international dimension of regulation and whether regulation differs from country to country.

Ioannis said that this is crucial issue when it comes to compliance with IFRS. The quality and requirements of the standards remains the same across countries while enforcement and auditing environments differ.

Small is Beautiful: Reducing Small Companies' Regulatory Burden

Vickie Wood – Assistant Director, Accounting Policy, Business Environment Directorate, Department for Business, Innovation & Skills

Vickie works as an assistant director for the UK's Department for Business, Innovation & Skills (BIS). She heads up a small team on accounting policy, which includes responsibility for accounting policies for small companies. BIS, which is the government department for economic growth, invests in skills and education to boost innovation, promote trade and support people to start and develop a business. BIS also helps consumers and reduces the impact of regulation. Vickie represents the UK at EU Commission meetings dealing with accounting policy. Matters dealt with range from consultations related to accounting frameworks for small companies to EU endorsement of international financial reporting standards (IFRS). She is an expert in topics related to small companies' accounting regulation, in accordance with the European Directives and the UK national accounting standards.

Her presentation focused on the importance and risks of the regulatory burdens reduction for small companies, required by the 'new' European Accounting Directive. She spoke about the impact of the new Directive on the small companies' accounting regime, with an emphasis on UK companies.

Vickie started her presentation by pointing out that small companies are the heart of the European economy and, across the EU, 99% of all firms are small for accounting purposes. Small companies grow into large companies and, therefore, should be central for policymakers and regulators. In the last few years, the European commission has put a lot of emphasis on the accounting and the simplification of administrative requirements for these companies.

A RECENT HISTORY OF THE MAIN EUROPEAN ACTS AND DIRECTIVES THAT HAVE REDUCED THE ADMINISTRATIVE BURDENS FOR SMALL COMPANIES

In the first part of her presentation, Vickie explained the journey made by the European Union through acts and Directives to create a harmonised small companies' accounting regime. The 'think small principle' was first introduced to safeguard the interests of small and medium-sized enterprises (SMEs) at the early stages of policymaking and make legislation more 'SME friendly'. The 'Small Business Act', adopted in June 2008 and revised in February 2011, followed. This act contains a comprehensive policy framework for the EU member states on small companies' regulation and applies the 'think small principle' in a series of actions. Another important act has been the Single Market Act, adopted in April 2011, which has simplified the Fourth and Seventh Accounting Directives, as regards financial information obligations, in particular for SMEs.

In October 2011, the European Commission proposed a revision of the Fourth and Seventh Accounting Directives, to reduce red tape in small company accounting and achieve an EU reporting regime that was more flexible and up to date. The 'new' Accounting Directive was then adopted, in June 2013, replacing and modernising the previous EU Directives. The 'new' Directive is predominantly aimed at increasing accounting harmonisation and reducing the administrative burden on small companies. The requirements of the Directive must be transposed into UK company law by July 2015 and be in force for accounting periods commencing on or after 1 January 2016. UK company law will, therefore, be reviewed as part of the transposition of the Directive and, in particular, the expansion in the scope of micro exemption. The Financial Reporting Standard for Smaller Entities (FRSSE) will need to be amended to reflect the changes in the UK company law.

Vickie then summarised the main distinct elements of the new European Directive: the introduction of a clearer mandatory small company regime, the administrative exemptions for micro undertakings, the revised scope for mandatory audit and the new requirement for transparency in relation to payments made to governments by companies active in the extractive industries (oil, mineral and gas extraction and the logging of primary forests).

She then focused in detail on the new mandatory small company regime and, specifically, on the following key changes: the minimum and maximum size thresholds to be met, the mandatory and optional limitations on the content of the accounting notes, and the permitted format for abbreviated accounts. The new mandatory small company regime does not affect 'public interest entities' as defined by the Directive, which are always considered to be 'large' for accounting purposes. Small firms shall be able to prepare and publish abbreviated accounts in accordance with the limited Profit and Loss statement formats and the deadline of 12 months for publication, after the end of the financial year. In the UK the limit is lower, at nine months, and is not expected to change.

THE MANDATORY SMALL COMPANY REGIME: MAIN ISSUES

Thresholds to be defined as 'small': companies can be defined as small when they do not exceed the limits of at least two of the three following criteria: 1) a balance sheet total of €4m; 2) a turnover of €8m; and 3) an average number of 50 employees.

Member states have the option, if they wish, of setting higher maximum thresholds where firms have to meet at least two of the following three criteria: 1) a balance sheet total of ≤ €6m; 2) a turnover of ≤ €12m; and 3) an average number of ≤ 50 employees.

Following these new increases, the BIS expects to propose new maximum thresholds for UK small companies: 1) a balance sheet total of £5m; 2) a turnover of £10.1m; and 3) an average number of 50 employees. [Note the actual thresholds proposed for criteria (1) and (2) in the BIS consultation document were £5.1m and £10.2m respectively.]

The annual report notes' content for small companies: the content of the annual report notes for small companies was also revised. Vickie pointed out that mandatory notes are restricted to seven items:

- accounting policies adopted
- fixed assets revaluation
- fair value of financial instruments and/or assets other than financial instruments
- financial commitments, guarantees or contingencies not included in the balance sheet
- exceptional items
- amounts due or payable after more than five years as well as the undertaking's entire debts covered by valuable security furnished by the undertaking
- the average number of employees during the financial year.

Member states may require small businesses to disclose information on any of five further items:

- fixed asset costs, value adjustments, additions, disposals and transfers during the financial year
- name and registered office of undertakings drawing up the consolidated financial statements, but only if undertakings have certain characteristics[1]
- nature and business purpose of arrangements not included in the balance sheet and the financial impact on the undertaking of any such arrangements
- nature and effect of post balance sheet events
- related-party transactions entered by the undertaking.

Companies may have to provide additional information, with special provisions, in the presence of joint (with both statutory and tax publication) filing arrangements. This additional information does not have to be published within the annual report, but only in documents related to tax collection. Vickie clarified that these special provisions are related to other European countries rather than the UK as the UK does not operate a mandatory joint filing system.

Although the content of the notes has been restricted by the Directive to make annual reports more concise, there is still an obligation on directors to monitor whether financial statements are in line with the 'true and fair' view override principle of the financial statements. Where provisions of the Directive are applied but do not give a 'true and fair' view, companies shall depart from such provisions and follow the 'true and fair' view override clause. This may require companies to provide additional notes.

'Micro' companies definition and exemptions: Vickie also focused on the definition, and on the disclosure exemptions, of micro entities. Micro entities are especially relevant for the UK economy as they represent 1.56m companies, more than half of all the UK's companies. Vickie pointed out that 45% of the micro undertakings are sole-traders where shareholders correspond to employees.

Micro-entities have been defined in Article 3 of the Directive as 'small undertakings which on their balance sheet date do not exceed the limits of two of the three following criteria: 1) a balance sheet total of €350,000; a net turnover of €700,000 and an average number of 10 employees.

Vickie outlined that micro firms could disclose less by being exempted from some administrative obligations but they could also decide to disclose as much as the other small companies, simply by preparing accounts under the existing financial reporting regime. If micro firms opt to provide more detailed information voluntarily, the obligation to provide true and fair accounts continues. The 'micros' exemption relieves obligations for individual annual accounts and permits undertakings to draw up only a greatly abridged profit and loss statement or to publish only a balance sheet with limited notes. Moreover, firms with 'micros' exemption cannot apply alternative accounting rules and fair value accounting.

Vickie clarified that there are undertakings that cannot benefit from these exemptions: investment undertakings, financial holdings, credit and insurance institutions. Moreover, in the UK, charities and companies otherwise excluded from the small company regime under section 384 of the Companies Act 2006 (ie public companies or those that belong to an ineligible group) are not allowed access to 'micros' exemptions. In order to introduce the micros exemptions to the UK, the government has published The Small Companies (Micro-Entities' Accounts) Regulations 2013. During the year,

1. For the definition of these specific undertakings, see the art. 17 (point m) of the Directive 2013/34/EU.

the Financial Reporting Council (FRC) is going to issue amendments to the Financial Reporting Standard for Smaller Entities (FRSSE) 2008 and FRSSE 2015, which will enable companies adopting the micro-entity exemptions to continue to prepare accounts that are in compliance with the FRSSE.

Abridged accounts for micro companies: Vickie described the format of the micro companies' annual reports. The abridged profit and loss statement contains at least the following items, where applicable: net turnover, other income, cost of raw materials and consumables, staff costs, value adjustments, other charges and tax. The balance sheet can be drawn up under one of two formats. The first one has two sections: assets (called-up share capital not paid, fixed assets, current assets and prepayments, and accrued income) and liabilities (capital and reserves, provision for liabilities, creditors and accruals and deferred income).

The second format comprises the following items with one broad section: A) Called-up share capital not paid; B) fixed assets; C) current assets; D) prepayments and accrued income; E) creditors: amounts falling due within one year; F) net current assets (liabilities); G) total assets less current liabilities; H) creditors: amounts falling due after more than one year; I) provisions for liabilities; J) accruals and deferred income; K) capital and reserves.

The three mandatory notes to be drawn up are limited to information on key importance matters: A) commitments, when no obligation is shown as a liability in the balance sheet; and B) advances and credits provided to members of the management or administration are to be shown as footnotes to the balance sheet. The third element, the information on the acquisition of own shares, is currently provided in the UK as part of the directors' report, and remains unchanged.

A micro-entity will still be required to prepare a directors' report, applying the requirements for a small company's directors' report and the associated small company exemptions. As a consequence, the information provided within the micro-entity's directors' report will be minimal.

Other considerations: In the last part of the presentation, Vickie outlined other considerations about the small and micro companies' regime, particularly in the case of the UK. Micro undertakings, apart from their specific regulations and their permitted exemptions, continue to apply the Companies Act requirements. Moreover, they have to keep adequate records, which means records sufficient for their business needs. Issues and exemptions for micro companies may be subject to change as the UK implements new provisions in the reviewed European Accounting Directive.

In conclusion, Vickie highlighted the need to establish working groups on the implementation of the new UK GAAP and the need to continue the discussion with the accountancy profession and business. Consultation was expected during 2014.

QUESTIONS

Kathryn Haynes (University of Newcastle) pointed out that abbreviated accounts are the solution for either micro or small company filing purposes but seem insufficient for creditor protection and asked whether we should require more from regulators.

Vickie agreed that minimum information levels required might be insufficient for companies with a dependence on credit, and that such companies should consider providing more information. This greater disclosure might increase the annual report's usefulness.

Michael John Jones (University of Bristol) asked how the Financial Reporting Standards (FRS) 101/102 should tie in with the revised small company accounting regime.

Vickie stated that they will be in accordance with the Financial Reporting Standard for Smaller Entities (FRSSE), which facilitates lower levels of disclosure, and the 'micro' exemption regime.

Mark Clatworthy (University of Bristol) asked whether the unity between regulators is actually helpful.

Vickie replied that the unity is helpful in reducing the administrative burden.

Richard Martin (head of financial reporting, ACCA) questioned the relationship between micro exemptions and the true and fair view principle. In particular, the risks for directors in the absence of compliance with the micro regime are unclear and the information provided might be misleading, owing to omission.

Vickie acknowledged the risks but outlined that small and micro companies have to meet legal requirements so directors are 'safe' if they have complied fully and acted in good faith.

Ioannis Tsalavoutas (University of Stirling) wondered whether any monitoring process to conform with the disclosure regulation existed for small companies.

Vickie replied by saying that no regulatory review process is currently in place and companies will just file their accounts with Companies House.

3. Discussion

Summary of speakers' presentations

The five speakers presented a variety of diverse themes and ideas, with some commonalities in theme. A summary of their respective views is given below, followed by a brief synthesis of the themes.

ROB HARVEY – (HMRC'S ACCOUNTANCY ADVISER)

Rob spoke from his position as HMRC's accountancy adviser in the area of financial instruments. His presentation covered the recent accounting changes introduced by the new standard FRS 102 and the related tax implications. FRS 102 is the new UK Financial Reporting Standard, with effect from the accounting periods commencing on or after 1 January 2015 (with earlier adoption permitted). This replaces the majority of UK Financial Reporting Standards and UITF Abstracts. FRS 102 presents a number of changes from the old UK GAAP accounting treatment. In his presentation, Rob focused mainly on the accounting differences that are likely significantly to influence the tax payable by those companies that move from old UK GAAP to FRS 102. The most significant change concerns the new regime introduced for financial instruments and, in particular, for derivatives. It requires financial instruments to be held on balance sheet at fair value, while under the old UK GAAP they are mostly held off balance sheet. The use of fair value accounting results in more volatility through the profit and loss statement which, in turn, leads to higher tax volatility. Differences also arise for intangible assets. In particular, according to FRS 102, the economic life of goodwill shall not exceed five years when no reliable estimate can be made. By contrast, the old UK GAAP presumes that goodwill could have a maximum economic life of 20 years. This leads in an increase in the amortisation rates that could result in an increased tax deduction. Significant differences arise also for the treatment of leases. Under FRS 102, the lease incentive is spread, on a straight line basis, over the lease term rather than over the shorter of the lease term and a period ending on a date from which it is expected the market rental will be payable. This could result in a deferral of income and consequently tax. Some of the other differences outlined by Rob are related to finance leases, employee's benefits and the companies' functional currency. Rob concluded by illustrating the actions undertaken by HRMC to help taxpayers during the transition and by warning of the main potential tax issues that could arise.

ANDREW LENNARD (DIRECTOR OF RESEARCH, CODES & STANDARDS DIVISION, FRC)

Andrew spoke from his background as director of research for the Financial Reporting Council – Codes and Standards division – and provided a personal, but informed, view on the need for a Conceptual Framework. This was set against the background of the IASB's development of its Conceptual Framework. First of all, Andrew posed the general question of why we need a conceptual theory. He considered that it provided legitimacy. In addition, he argued that intuitive answers are not necessarily obvious, may not be the best, may not be consistent and may limit improvement. Rigorous thinking is one approach that he suggested for solving this. He then examined several theories, measuring them against the principles of 'tractability' and 'realism' of Ronald Coase's framework. Andrew pointed out that some theories were tractable, but insufficiently realistic (eg engineering that ignores friction); while other theories were realistic but not tractable (eg 1:1 scale map where the map is as big as 'what it represents'). He called for a normative theory because descriptive theories cannot, in his personal opinion, justify accounting standard-setting, as he argued that accounting standard-setting seeks improvement, not just consistency and its objectives need to be specified. Andrew then outlined the IASB's preliminary views on the three main measurement bases (cost-based measurements, current market prices and cash-flow based measures). Andrew reflected that perhaps the IASB's Conceptual Framework should tell us what the objectives should be. He put forward the Accounting Council's tentative view that the Discussion Paper lacks depth of conceptual analysis. Andrew outlined some key problems with the Discussion Paper and pointed out that often the reasoning lacked justification and the Discussion Paper was also incomplete (for example, transaction costs and changing prices were not fully discussed). Andrew also believed four key issues were not addressed by the IASB: first, the nature of value; second, entry and exit values (and transaction costs); third, changing prices; and, last but not least, deprival value. He then examined these issues in more detail and presented a business model.

MARK CLATWORTHY (PROFESSOR OF ACCOUNTING, UNIVERSITY OF BRISTOL)

Mark gave an academic perspective on the use of corporate information by capital providers.[2] His presentation has important practical implications. He addressed several relatively novel, yet still very interesting and actively debated, questions. Who are the most important capital providers to large public companies? What decisions are these capital providers making and what information do they need? How important a part of the wider investor information set is audited financial reporting information, particularly the financial statements? Mark presented a review prepared by a pan-European team of academic researchers published by ICAS and the European Financial Reporting Advisory Group (Cascino et al. 2013), which focuses on the academic literature – not confined to the English language – on the providers of capital to large European public companies. Mark identified different types of capital providers (eg equity-providers, debt-providers) and reported that debt-providers and, in particular, trade-creditors have been often overlooked by academic researchers investigating the use of accounting information, yet they represent a significant source of finance for European firms. They often have very different needs from those of equity-providers and their interests can sometimes conflict. Given this conflict of interest, they may require different information to protect their own interests. Mark pointed out that potential differences exist also within investor types depending on the nature of the decision (eg more prudent accounting policies may be preferred for evaluating managerial performance, whereas neutral accounting is typically preferable for valuation decisions). Importantly, capital providers, even professional investors, do not analyse all the information themselves; rather they rely on information intermediaries – particularly sell-side analysts – to assist them. Information intermediaries are influential in both credit and equity markets. He concluded with the implications for standard-setters. In particular, different capital providers are found to use information in various ways and have different objectives, creating considerable heterogeneity in the demand for accounting information, thus requiring a need to balance different users' needs. Mark showed how the main findings of the review question the underlying objective of the Conceptual Framework in guiding the development of standards for general-purpose financial statements, to provide a typical knowledgeable investor with a true and fair view about the reporting entity.

IOANNIS TSALAVOUTAS (LECTURER IN ACCOUNTING, UNIVERSITY OF STIRLING)

Ioannis provided interesting empirical evidence on whether mandatory disclosures are really mandatory. Using an international sample of listed firms across 23 countries he reported the level of compliance of firms with three accounting standards: IFRS 3 (Business combinations), IAS 38 (Intangible assets), and IAS 36 (Impairment of assets). Ioannis outlined the areas for concern as well as room for improvement for each of the three standards analysed.

First, he talked about business combinations and illustrated the lack of adequate disclosure on the qualitative description of those factors that make up recognised goodwill. He wondered whether there was something wrong with the standard or whether companies just did not follow it. He also examined the issues of pro-forma information and acquisition related costs.

Second, Ioannis tackled the key issues concerning compliance with IAS 38. He posed the question as to whether there should be consistency between IAS 38 (Intangible assets) and IAS 16 (Property, Plant and Equipment) on disclosing the item(s) of the income statement that included any amortisation of assets. He reported that intangible assets reported as a residual category ('others') are material in most of the companies analysed and wondered whether more specific disclosure should be required. Ioannis also reported that there is no evidence of companies using the revaluation model for measuring intangible assets so he questioned the usefulness of this practice by IAS 38.

Third, Ioannis examined the impairment of assets and reported a lack of adequate description of management's approach to determining the assigned value and some concerns on the justification given for the reversal of an impairment. Last but not least, Ioannis reported the empirical evidence found in the investigation on the firm- and country-level determinants of the company's compliance with the three standards examined. In particular, he reported that lower levels of compliance are exhibited by companies in environments where there are lower levels of enforcement of auditing standards (eg companies from countries with French legal origin). Ioannis also reported that cross-listing in the US tended to increase compliance levels, while firms reporting impairments usually complied less than firms without impairments.

2. Written and presented by Mark Clatworthy and based on the EFRAG report of the research team composed of Stefano Cascino (London School of Economics), Mark Clatworthy (University of Bristol), Beatriz García Osma (Autonoma University of Madrid), Joachim Gassen (Humboldt-Universität zu Berlin), Shahed Imam (University of Warwick), Thomas Jeanjean (ESSEC Business School, Paris)

VICKIE WOOD (ASSISTANT DIRECTOR, ACCOUNTING POLICY, BUSINESS ENVIRONMENT DIRECTORATE, DEPARTMENT FOR BUSINESS INNOVATION & SKILLS)

Vickie works for the UK Department for Business Innovation & Skills (BIS) and is responsible for accounting policy. Her presentation covered the main changes in regulatory burdens for small and micro companies. She first provided an overview of the main European acts and Directives related to the small companies' accounting regimes. The European Commission recognised, with the introduction of the 'think small first' principle at the early stages of policymaking, that small companies represent the vast majority of EU companies and, therefore, need help in lowering the administrative barriers they faced. The 'new' Accounting Directive, adopted in June 2013, reduces the administrative obligations for small companies and incorporates the 'micros exemption', targeted at micro firms. In the UK, the transposition of the Directive is required by 20 July 2015. In the meantime, the new UK standard FRS 102, which has replaced the majority of UK Financial Reporting Standards, has been introduced and new amendments to this standard and to the Financial Reporting Standard for Smaller Entities (FRSSE) are expected after the new Company Law act which will be revised after the adoption of the 'new' Accounting Directive. The final plans for small company reporting are still uncertain and new consultations are encouraged.

Vickie then focused on the distinct elements of the 'new' Accounting Directive, concerned with small and micro companies' regulation. The first element is the increase in the thresholds for qualifying as a small company. The Directive provides minimum and maximum ranges between which the threshold can be set and, in the UK, the BIS has proposed new maximum thresholds to be amended in line with the Directive. The second element is the reduction of the content of the notes in the accounting reports. Mandatory notes are restricted to key items of importance and no notes to the accounts are required for micro undertakings. The third element refers to the administrative exemptions for micro companies that can draw up a simpler balance sheet and a greatly abridged profit and loss statement. Vickie compared the exemptions allowed by the Directive with those allowed by the current UK regulations. The presentation ended with a list of the next steps needed to achieve a better small-company accounting regime, particularly in the UK. This follows the need to reduce small companies' regulatory burden.

Table 3.1: Thematic overview of presentations

Presenter	Perspective	Key issues/findings
Mark Clatworthy Professor of Accounting, University of Bristol	Academic	The academic literature on the use of financial reporting information by capital providers was reviewed. Capital providers were identified. Some of them, in particular trade creditors, have been overlooked by academic researchers investigating the use of accounting information, yet they represent a significant source of finance for European firms. Capital providers use accounting information in a variety of ways, with financial reporting information competing with other sources of information. If they are making 'stewardship'-orientated decisions, their information needs and preferences can differ from when they are making financial investment decisions. This makes the identification of a typical target 'user' inherently difficult and the idea that the 'stewardship' role of accounting can be subsumed by a 'financial decision making' role is generally not supported by the academic literature. These findings question the underlying objective of the Conceptual Framework in guiding the development of standards for general-purpose financial statements to provide a typical knowledgeable investor with a true and fair view about the reporting entity. Mark identified gaps in the literature and suggested areas where future research can help inform important academic and policy debates.
Rob Harvey Accountancy Adviser, HMRC	Adviser	FRS 102 is the new Financial Reporting Standard; it replaces the majority of UK Financial Reporting Standards and UITF Abstracts. FRS 102 presents a number of changes from the old UK GAAP accounting treatment; some of them have significant tax implications. Rob described the most significant changes, which concerned the requirement to record financial instruments on the balance sheet at fair value (which leads to higher profit and tax volatility), the amortisation of goodwill for a period no longer than five years (which increases the amortisation rates and tax deduction) and the requirement to spread lease incentives, on a straight line basis, over the lease term (which could result in a deferral of income and consequently tax).
Andrew Lennard Director of Research, Codes & Standards Division, FRC	Standard-setter	A personal, but informed, view on the need for a Conceptual Framework was provided. This was set against the background of the IASB's development of its Conceptual Framework. Several theories were discussed. They were measured against Coase's framework ('tractability' and correspondence with the real world). Some theories were tractable but insufficiently realistic; others were realistic, but not tractable. A normative theory is needed, as objectives need to be specified and descriptive theories cannot justify accounting standard setting because the latter seeks improvement, not just consistency. The IASB's Preliminary views on the three main measurement bases were discussed, with further analysis on four key issues that are not properly addressed by the IASB (defining value; entry and exit values – and transaction costs; changing prices; and deprival value). A business model was presented.
Ioannis Tsalavoutas Lecturer in Accounting, University of Stirling	Academic	Compliance with the mandatory disclosure requirements under IAS 36 Impairment of assets, IAS 38 Intangible assets and IFRS Business combinations and its determinants was investigated across of 23 countries. Areas of concern are found. Lower levels of compliance are exhibited by firms in lower enforcement environments (eg firms from countries with French legal origin; the auditing enforcement environment drives this finding); while cross-listing in the US increases compliance levels. Firms reporting impairments comply less than firms without impairments.
Vickie Wood Assistant Director (Accounting Policy), Department of Business, Innovation and Skills	Regulator	The key changes for reducing the small companies' regulatory burden following the new 2013 European Accounting Directive were described. Changes will have an impact on UK company law and on the national accounting standards (eg FRSSE). The distinct elements of the Directive on the mandatory small company regime were outlined: the revised size thresholds, the limitation on the notes to the accounts and the 'micros' exemptions. UK regulators and, in particular, the Financial Reporting Council (FRC) and the Department of Business, Innovation and Skills (BIS), are expected to establish implementation working groups and undertake consultations. Several questions on the effectiveness and risks of the small company reporting regime were raised.

4. Conclusions

The symposium was held at an interesting time, both economically and politically, with continuing challenges to accounting and financial reporting. At the start of 2014, despite the existence of major economic problems, there were also signals of a recovery. The losses recorded after the 2007–8 recession were being recovered and low growth was expected. Some economies, such as those of Germany and the UK, have to date increased. In particular, the UK recorded its fastest annual rate of growth since 2007 and this growth rate is expected to continue. At a political level, there continued to be protests against austerity and government budget cut-backs. There have been some important changes for accounting. The IASB is in the midst of two major reviews. First, an Exposure Draft on the new Conceptual Framework for Financial Reporting, which takes into account the feedback received by the IASB stakeholders, is expected to be published during the first quarter of 2015. Second, a comprehensive review of the IFRS for SMEs is almost completed. The amended version is expected to be issued in the first half of 2015. In the UK, companies are going to experience the transition from the old GAAP to the new Financial Reporting Standards, which will cause not only significant accounting changes, but also have important tax implications.

There were two central themes at the 2014 symposium. The first concerned conceptual theory and the second accounting regulation. Both Mark Clatworthy's and Andrew Lennard's presentations concerned different aspects of the conceptual theory. The Conceptual Framework has been debated for over one hundred years. There are still many areas of disagreement relating to measurement and disclosure issues. Andrew provided a critical view on how a conceptual theory should be normative rather than descriptive. He also evaluated the IASB's Discussion Paper on the new Conceptual Framework. He queried whether there was a clear definition of three main measurement bases (cost-based, market price and cash flow). He reflected that it should be clear what the objective of these measures is. He also believed that certain key issues were not properly addressed by the IASB's discussion draft (what constitutes value; entry and exit values – transaction costs; changing prices; and deprival value).

Whereas Andrew Lennard's criticism was from a standard setter's perspective, Mark Clatworthy's criticism of the Conceptual Framework was more practical. He reviewed the academic literature on the use of financial reporting information by capital providers and outlined how their information needs and preferences change according to the time in which a decision has to be made. He contributed to the longstanding debate on what the objectives of financial reporting should be. In particular, he addressed the key issue of whether the purpose of financial reporting should be about decision making, as has been traditionally favoured by the FASB in the US and more recently by the IASB. From this review, he questioned the underlying objective of the Conceptual Framework in guiding the development of standards for general-purpose financial statements so as provide a typical knowledgeable investor with a true and fair view about the reporting entity. He presented the results of an EFRAG report that looked at the different type of users of annual reports. This analysis by international scholars shows that together with the traditionally recognised capital providers, such as shareholders and debt providers, creditors provided an important source of finance, particularly in many European countries. As a result, the EFRAG report concluded, that stewardship was a very important objective of annual reporting.

Against this background of the conceptual framework, the other speakers were particularly concerned with accounting regulation. Vickie Wood, in her presentation, provided an overview of the draft of the new European Accounting Directive and illustrated the main changes in the regulatory burdens for SMEs. She discussed the three main distinct elements of change: an increase in the maximum criteria for qualifying as a small company; the reduction of the notes in accounting reports and micro company's exemptions. She concluded by questioning the effectiveness of the new regime.

Rob Harvey looked at an area that is often overlooked: the tax implications of financial regulation. He illustrated the tax implications arising for the UK companies that will adopt the new Financial Reporting Standard for the first time. He pointed out that the new accounting treatment for financial instruments, foreign currency translation, lease, employee benefits, goodwill and intangibles could materially affect the taxation paid by many UK companies.

Finally, Ioannis Tsalavoutas presented an international study that looked at a practical rather than a theoretical aspect of the IASB work. He investigated the level of compliance with the mandatory disclosure requirements under IFRS and reported on areas of concern. In particular, he questioned the effectiveness of mandating information disclosure. He showed that in many cases companies appeared to treat mandatory disclosure as voluntary with an extensive lack of compliance. He also outlined the need to focus more on the role played by the enforcement bodies.

The symposium discussed issues of key importance in financial reporting. These are long-lasting problems that do not have simple short-term solutions. The objectives of the Conceptual Framework, the economic consequences of accounting, the need for more or fewer regulatory disclosure requirements and how to deal with non-compliance are all long-term issues that will be continue to be debated in future years. The conceptual theory debate that has followed the IASB's Discussion Paper shows that the fundamentals of accounting are, and will be, continuously debated and re-examined.

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