

The ACCA logo is a red square with the letters 'ACCA' in white, bold, sans-serif font. It is positioned in the top left corner of the page.

ACCA

A low-angle, upward-looking photograph of several skyscrapers against a clear blue sky. The central focus is a tall, blue-glass skyscraper with a curved facade. To its left is a classical stone building with many windows. To its right is another modern glass skyscraper. The perspective creates a sense of height and scale.

Tenets of good corporate reporting

Think Ahead

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants, offering business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its **200,000** members and **486,000** students in **180** countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of **101** offices and centres and more than **7,200** Approved Employers worldwide, who provide high standards of employee learning and development. Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

ACCA is currently introducing major innovations to its flagship qualification to ensure its members and future members continue to be the most valued, up to date and sought-after accountancy professionals globally.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability.

More information is here: www.accaglobal.com

About this report

This report sets out ACCA's views on the characteristics that make for good corporate reporting and on some key general issues that also affect it, including the need for global standards, for a mixture of fair value and historical cost, prudence and the need for reporting to cover more than the financial statements.

Tenets of good corporate reporting

Corporate reports can affect share prices, help businesses access finance, contract with customers and suppliers and attract employees.

Corporate reporting comprises officially promoted and documented communication from companies; it is intended to provide a comprehensive picture of their performance and position to interested external parties. Corporate reporting therefore includes annual reports, financial statements sustainability, corporate social responsibility and interim reports. It covers reporting in paper-based and online forms.

In this report a distinction is drawn between financial reporting focused on monetary amounts and reporting that concentrates on other narrative, non-financial issues.

Corporate reports form an important source of information about a business for its stakeholders. They are important in helping businesses access equity, debt and trade finance; they can affect a firm's share price; they can assist with contracting with customers and suppliers; and help with recruiting and retaining employees.

OBJECTIVES OF THIS REPORT

There are a number of well-established frameworks for corporate reporting, which establish the objectives of the reporting and the qualitative characteristics of good corporate reporting. These include the Conceptual Framework of the International Financial Reporting Standards (IFRS) Foundation, the Practice Statement on Management Commentary of the International Accounting Standards Board (IASB), the International Integrated Reporting Framework and the principles of good reporting from the Task Force for Climate-related Financial Disclosures. See the Appendix for the details of these.

ACCA supports these frameworks and the qualitative characteristics of good reporting that they set out. Many of these characteristics are common across these frameworks, are widely accepted and can be applied to both the financial and non-financial elements of corporate reporting.

A key characteristic of a good corporate report is that the highest levels of management take clear responsibility (evidenced by specific approval statements, for example) for its contents. This gives users confidence in the information reported. Independent assurance of corporate reports is a similarly significant enhancing factor. Neither of these important aspects are covered further in this report.

The present document sets out ACCA's views on:

- a synthesis of desirable qualitative characteristics as they can be applied to good corporate reporting
- a number of general issues that affect the quality of corporate reporting.

Together these form the tenets of good corporate reporting.

QUALITATIVE CHARACTERISTICS OF GOOD CORPORATE REPORTING

As noted above, many of these qualitative characteristics are widely accepted and more fully explained in the framework documents issued by the various bodies and so need little further explanation here. See the Appendix for details of the relevant publications.



Qualities applicable to corporate reporting generally

Relevance and materiality

A report should include relevant information, that is, information that is capable of making a difference to decisions made by the users of the report: for example should they buy or sell the company's shares, or contract with the company? Materiality is a measure of relevance specific to the reporting entity. Information would be 'material' if its omission or misstatement would influence the decisions that users make on the basis of that report. Different corporate reports may be intended for different user groups, which can mean that what is relevant and material information may vary between them. Reports are improved if immaterial information is excluded from them, as there is a risk that much immaterial information may obscure the significant relevant information in the report.

Completeness

A report should contain all relevant information allowing a user to understand the position, performance and, where appropriate, the prospects of the reporting entity. As with relevance and materiality, because separate corporate reports may be produced for different user groups, what constitutes 'completeness of information' may differ from one report to another.

Reliability – neutral and free from error

For users to be able to rely on the information in the report it should be unbiased in its presentation. A report will most often have to include estimates. Some of those may turn out to be inaccurate, but to be free from error those estimates should be based on the best evidence available at the time. Significant estimation uncertainties should be disclosed.

Comparability

Users want to be able to understand the similarities and differences between items and between reporting entities. Consistency can be identified separately as meaning comparability between different reports of the same entity or between different reporting periods. Comparative information from previous years is often an aid to understanding trends. Standardised information (for example, the standardised content of financial statements) may provide an inherent comparability from year to year or between companies. Measuring non-financial variables and reporting on issues that are commonly covered by other businesses in the same sector in a commonly used manner can be helpful in aiding comparability beyond the financial statements.

Verifiability

Information should, as far as possible, be objective and open to testing. Knowledgeable and independent observers should be able to reach a reasonable consensus on that information, even if absolute agreement may not be possible.

Timeliness

Generally, the more up to date information is, the more useful it is.

Understandability

Reports should aim to communicate complex matters clearly. Reasonable assumptions may have to be made about the users' level of understanding.



Qualities applicable to narrative reports

Other desirable characteristics are more applicable to narrative non-financial reports than to the financial statements.

Future orientation

The financial statements are primarily an historical record of performance and position, albeit one intended to help in the estimation of future cash flows. In practice, users look for further information on the entity's intentions and outlook to help their assessment of future performance. Inevitably, such forward-looking information may be subject to greater uncertainty than historical information on performance and position.

Entity-specific

In addition to the standardised information in the financial statements the corporate report should contain an analysis of past performance, the present position and the most likely prospects for the entity, as seen from the perspective of management. Wherever possible, information reported externally should be consistent with information used internally within the company for decision-making purposes. For example externally-reported KPIs should be consistent with internal performance metrics; material issues should be consistent with the risks and opportunities being discussed in the boardroom. Standard narrative texts ('boilerplate texts') are to be avoided.

Strategic focus

Central to the information relevant to assessing future performance is the strategy and business model that management has in place for the entity to meet the objectives set and manage the identified risks.

Connectivity

The account of the entity's past performance, position and future prospects should make clear how value has been created and how management intends to create more in the future. This will reflect the interaction of various resources and capitals. For example, International Integrated Reporting Framework lists six capitals: financial, manufactured, social, human, intellectual and natural. A corporate report should show the linkages and relationships between them.

Balance

In covering a variety of factors, the report needs to maintain fair discussion of all significant aspects as well as presenting them in a neutral way.

Conciseness

A report will be more useful and understandable if only relevant matters are included and less significant matters are excluded. With online reporting, it is possible to structure the presentation in such a way that links to greater detail on any aspect can be provided for those users who want them.



Qualitative characteristics generally

There are tensions between some of these characteristics. For example, some information that is relevant may nevertheless not be sufficiently reliable or verifiable for it to be included. Ensuring that the report is complete may conflict with keeping it understandable and concise. Entity-specific information may at times conflict with comparability with other entities. It is a tenet of good corporate reporting that a reasonable balance is maintained between the various characteristics: relevance versus reliability, relevance versus comparability, and so on.

Equally, many qualitative characteristics are closely related to each other. For example, the requirements for completeness, balance and neutrality may be seen as addressing some similar issues. There will be much overlap between characteristics that make information reliable and those that make it verifiable.

An underlying principle of good corporate reporting is that the costs of providing the information should not be out of balance with the benefits of doing so.

General issues that are important for good corporate reporting



1. The users of corporate reports are not just the shareholders

Who are the users of corporate reports? The IFRS conceptual framework identifies investors and creditors as the primary users of financial reports. For Integrated Reporting, <IR>, the primary purpose of an integrated report is to inform the providers of financial capital. 'Primary users' does not, of course, mean that they are regarded as the only users.

Indeed, corporate reports are being used in practice by a much wider range of parties, including not only the contractors, customers and employees of a business, but also regulators, tax authorities, journalists and others who may be interested in companies' impacts on society and the environment. Some of these may be able to require the company to provide information directly to them, rather than having to rely on what may be in the public record, which can be an important distinction.

General purpose financial statements are primarily aimed at existing and potential investors, lenders and other creditors. On the other hand, corporate responsibility reports may be aimed primarily at a company's employees, customers, suppliers, or ESG investors.

As noted above, the relevance and materiality of information depends on the intended users of the reports. Nonetheless, identifying providers of financial capital as the primary users of reports has, on the whole, resulted in general-purpose corporate reports that have proved useful and relevant to this much wider range of users. The information provided for these primary users has generally satisfied many of the requirements of other users. One reason for this is that if there are significant concerns among employees and customers about corporate activities these will tend to have a potential impact on the financial performance of the business and thereby have become interests of investors.

Where the needs and views of other stakeholder groups are particularly important to the entity, the company should seek to engage with them through the most appropriate channel for that group, which may or may not be in the form of a corporate report.

Identifying investors and creditors as the primary users is a practical way of setting standards and regulations, but other users need to be recognised as stakeholders in the process.



2. Standards for reporting should be global

ACCA supports the development of global standards for corporate reporting.

The benefits of global standards are that:

- the consistency of accounting treatments and disclosures leads to greater comparability between different reporting entities
- the accounting treatments and disclosures required by those standards are of high quality and provide relevant and reliable information to the users
- the combination of consistency and quality will reduce the uncertainty for investors in relying on the reporting and will improve their understanding of the business and of its performance, position and prospects
- participants in the markets will be able to make better risk assessments, resulting in better allocation, and reduced cost, of capital, attracting a wider base of investors and giving greater liquidity to the markets.

These effects will most affect listed companies and others attracting funds on an international basis, but other businesses, including SMEs, may also benefit. The effects of adhering to global standards will also be most evident in combination with other factors and incentives encouraging good reporting, such as measures for ensuring investor protection, good corporate governance and independent audit.

Global standards need to be comprehensive and cover not only listed companies, but also SMEs and the not-for-profit sector.

National standards should be substantially consistent with the principles of global standards, subject to the constraints of the needs of different users and the cost/benefits of preparation by entities other than listed companies.

The development of global standards of reporting will help to simplify the education and training of accountants and to enhance the mobility of accountants between both entities and countries.

For financial statements, the International Financial Reporting Standards (IFRS) developed by the IASB are the global standards.

Financial statements alone may not provide all the information and context that users of corporate reports may need. For the other components of corporate reporting, some global frameworks have been developed, for example the IASB's Management Commentary Practice Statement and the International Integrated Reporting Framework. Much of the regulation is set at a national level and the current lack of a recognised global standard-setter to cover corporate reporting outside financial statements is regrettable. While other bodies may contribute more detailed guidance, ACCA argues that the IFRS Foundation's scope of competence should be extended beyond financial reporting so that it is the ultimate authority on corporate reporting as a whole. The IFRS Foundation's international influence, independence and accountability (see below) make it best placed for this role.



3. Global standard setting needs good governance

ACCA supports the IASB as the global standard-setter for accounting standards. The IASB came into existence in 2001 because it was agreed that an independent standard-setter, free from political interference, would be the best model for establishing a credible international set of accounting standards, ie IFRS.

There has to be a balance between independence and accountability. The IASB, as the independent standard-setter, does nevertheless have to consult its stakeholders on:

- its agenda of work
- proposals for the direction of new or amended standards
- assessment of the impact of its proposals
- drafts of new or amended standards
- the practical effectiveness of the amendments.

The current structure of the IFRS Foundation as a whole strikes about the right balance, with standard setting by the IASB, and oversight and budget responsibilities by the IFRS Foundation trustees and the Monitoring Board, which forms a link to the public authorities that authorise the use of IFRS.

Moving the funding to publicly organised levies and away from contributions by individual entities is important so that the independence of the decisions of the IASB can be seen to be secure.

The members of the IASB should most importantly be selected to reflect a range of relevant backgrounds with recent practical experience, predominantly of preparing or auditing corporations' financial statements, or of using such statements in managing investments.

The composition of the trustees, given their oversight and fundraising roles, requires a comparable range of backgrounds, but needs to reflect more closely the geographical use of the standards and the sources of funding of the IFRS Foundation.



4. Global standards are needed for SMEs

Full IFRS are essentially designed for businesses with significant public accountability, such as listed companies. In most countries it would be inappropriate to require smaller and unlisted companies to use the full IFRS.

ACCA therefore supports a set of international reporting standards specifically for small and medium-sized enterprises (SMEs) and believes that the IASB's standard for SMEs will ultimately have a significant positive impact on millions of companies around the world.

The use of international standards by SMEs should:

- add credibility to the financial statements of unlisted companies for potential investors and other users who want to be able to rely on the figures they see
- enhance comparability of SME accounts between countries and with those of larger or listed companies using full IFRS
- simplify the training of accountants.

The current version of IFRS for SMEs was first published in 2009 and is largely based on the same accounting principles as the full IFRS, with some simplifications in

accounting treatments and some reductions in the disclosure requirements. These simplifications should only reflect the different cost/benefit effects for SMEs and the different needs of the users of their financial statements.

Nonetheless, as full IFRS change there is a risk that IFRS for SMEs will increasingly diverge from them. There is a case for gaining the experience of the larger listed companies with new standards. ACCA considers, however, that the two systems should not diverge unnecessarily but continue to be based on a common platform of accounting treatments, subject to appropriate considerations of cost/benefit and different user needs.

With the IFRS for SMEs, countries will not need to operate two significantly different systems of financial reporting, with one international system for large listed companies and another national system for smaller or unlisted, privately owned companies.

Together with the Charity Commission for England and Wales, ACCA has developed a companion guide for not-for-profit entities in using the IFRS for SMEs as the basis of their reporting.¹

¹ ACCA, *Companion Guide for Not-for-profits to the International Financial Reporting Standard for Small and Medium Sized Entities (IFRS for SMEs)*, 2015. <http://www.accaglobal.com/content/dam/ACCA_Global/Technical/smb/companion-guide-for-not-for-profits.pdf>, accessed 21 January 2018.



5. National standards should converge on global standards – IFRS and US GAAP

As a global accountancy body, ACCA strongly supports the move to one system of worldwide accounting standards. A key part of this process is convergence between IFRS and US GAAP ('generally accepted accounting principles').

Considerable progress has been made in the convergence process between IFRS and US GAAP in recent years. IFRS have been permitted for foreign companies with US listings without the need for reconciliation to US GAAP. The Financial Accounting Standards Board (FASB), the US accounting standard-setter, and the IASB have jointly developed a series of important new standards on financial instruments, revenue recognition and leases.

As was urged by the G20 in its summit meetings after the global financial crisis began, ACCA would support the adoption of a single set of global standards.

Despite this, after decisions by the main US regulator, the Securities and Exchange Commission (SEC), the adoption of IFRS by US domestic filing companies does not seem possible except in the longer term.

In the shorter term, ACCA considers that the SEC should allow US issuers the option of preparing financial statements using solely IFRS. This could either be a general option, or might be restricted to those internationally focused sectors where IFRS are already adopted by the majority of businesses that investors are likely to compare with one another.

ACCA hopes that, having achieved a considerable degree of convergence, FASB and IASB will continue to collaborate to try to prevent significant new divergence developing on any major standard-setting issues – for example, on performance reporting, improving disclosures and the debt–equity distinction. This means some alignment of the work-plan and then of the solutions developed.



6. National standards should converge on global standards

The advancement of global standards and their increasing adoption raises questions about changes in the role of national standard-setters (NSS). ACCA considers that the need for different national standards should decrease over time because global standards make sense for most circumstances, from listed companies to SMEs. On the other hand, NSS now have an important role in implementing IFRS in their respective jurisdictions in a consistent way.

Where NSS endorse global standards, such as IFRS or IFRS for SMEs, they should aim for this to be complete and timely, allowing users to claim compliance with global standards (eg IFRS as issued by the IASB) as well as national standards. To retain the comparability and advantages of global standards, NSS should refrain as far as possible from amending the global standards or providing their own authoritative guidance on its interpretation or implementation in their national context. In a similar way, when implementing IFRS or IFRS for SMEs, NSS should keep any additional accounting options to a minimum.'



7. Reporting should be timely, within limits

Timeliness is a desirable quality in corporate reporting and, for example, is recognised as an enhancing characteristic in the conceptual framework underpinning IFRS. Investors, analysts and other users will understandably want to have the most up-to-date information about a business that they can get. There is a tension between satisfying users' demands for up-to-date information and ensuring its reliability and quality.

In many countries, listed companies are required by the securities regulators to report at least quarterly. In others there is a requirement for half-yearly reporting overlaid by a requirement to report on an interim basis if there are significant changes in prospects or position. There are arguments in favour of both approaches and the choice should reflect users' expectations. More regular

reporting is not of itself the main cause of 'short termism' among investors. Any investor would want to be updated regularly so that they can consider progress against longer-term objectives and the implications for the longer-term performance of the business.

Some parties advocate real-time reporting. Investors and other stakeholders want timely reports but they also want the considered opinion of, and evidence from, the board and any independent provider of assurance. The financial information provided also needs context if it is going to be reliable. Consideration of the information and its presentation may involve judgement and that cannot be instantaneous, but requires time. Real-time reporting would therefore raise significant risks and might not be beneficial.



8. Requirements for small entities' reporting need to balance costs of preparation with transparency

It is becoming common practice, in many parts of the world, for governments to seek radical reductions in the accounting obligations that have been imposed on small companies. This is often justified on the grounds that such obligations are effectively administrative burdens, which bring no benefits to the companies concerned or their stakeholders. In other words, the obligations amount to 'red tape', which can be abolished to save companies money, and allow them to concentrate on running their businesses.

ACCA's position on the regulation of small company accounting is pragmatic. ACCA recognises that, as in other areas of regulation, there may be a point where the cost of regulation exceeds its usefulness.

Nonetheless, the removal of requirements for the smallest companies to prepare and publish accounts would mean that stakeholders, including current shareholders, potential investors, trading partners, creditors and tax authorities would no longer be guaranteed access to credible accounting information on those companies. That would make it more difficult for them to protect their financial interests and, as a consequence, make it less likely that potential lenders or investors would risk their money, and

less likely that individuals and businesses would trade with the smallest companies. The lack of credible accounts could also drive tax authorities to increase compliance activity focused on small businesses, thus ultimately increasing the administrative burden rather than reducing it.

ACCA also considers that effective requirements for companies to publish accounts, by a set date, act as a discipline, ensuring that companies produce reliable accounting information at least once a year. This decreases the scope for financial mismanagement and the potential for corruption and fraud.

In some contexts, the development of simplified versions of small company accounting standards – i.e. simplification of the basic accounting treatments – may be appropriate. In countries where the accountancy profession is well developed and more complete reporting is well established, then such micro-entity reductions are not necessary. Reduced disclosures will not lead to a real reduction in the burden of preparation and compliance because financial statements are a useful discipline for managing a business and are needed for tax or borrowing purposes. Reduced disclosures will represent reduced transparency by such companies.



9. Accounting standards should be based on principles and not merely comprise rules

ACCA supports accounting standards that are based on principles. A rules-based approach can lead to complex and cumbersome standards that try to cover all possible circumstances and issues, and that encourage a mechanical 'tick-box' compliance mentality. Stricter rules do not even reduce the risk of manipulation of the numbers. They can encourage organisations to search for loopholes that will achieve compliance with the rules while giving a misleading impression, as was demonstrated in the Enron case. Accounting standards, especially global ones, will not be able to provide precise directions for the accounting of all the different business circumstances that may be encountered over time and in different jurisdictions.

Standards should largely set out the objectives and description of the accounting treatment to be followed. Guidance and illustrative examples may be useful, giving readers a clearer understanding of the principles, but must not be interpreted as providing rules that must be followed.

In many cases, however, companies and their auditors will need to apply professional judgement to discern how the principles should be applied to the particular facts that they encounter, in order that the result is a fair presentation of economic substance for users of the financial statements. The approach has to go beyond 'where does it say I must/cannot do that?'



10. Accounting needs a mixture of fair value and historical cost

Fair value will provide, in some instances, the most relevant information to users of the accounts, particularly where assets are being held for trading, or for realising investment gains. It is the only realistic method of accounting for derivatives. With long-life assets, historical cost may significantly understate economic values, especially when there has been significant inflation.

While fair value accounting has significant advantages, illiquid market conditions or fair values that have to be determined by model simulations, have highlighted the problems of attributing reliable values to assets such as investment properties, agricultural assets and some financial instruments. For many businesses, using historical cost may give a more useful picture of performance where individual assets are held for use in conjunction with others, given that it is based on actual cash flows.

Consequently, ACCA believes that IFRS should continue to employ a mixture of cost and current-value measurement bases. ACCA considers the approach in IFRS 9, the new standard on financial instruments, to be achieving a broadly correct balance.

ACCA is sceptical that stating liabilities at fair value gives meaningful information in most cases, and so argues that this should be applied only in limited circumstances. Changes in liabilities' values tend to produce counterintuitive results – for example, as a company's credit rating declines it may report gains, and vice versa. ACCA welcomes the changes proposed in IFRS9 for removing from the profit or loss for the year those gains/losses that arise from changes in a company's own credit rating.

ACCA sees no case for the extension of the use of fair values in accounting standards at present, particularly in areas where markets are all but non-existent.

Fair value accounting requires companies to mark certain assets at market prices. This can lead to accusations that the gains recognised in good times reinforce unjustified enthusiasm. Equally, when economic sentiment is depressed, the large write-downs that may be recorded on some of the assets may seem to compound that lack of market confidence. Accounts, however, are intended to inform shareholders on the affairs of the company, not to be distorted on the grounds of preserving financial stability. Accounts cannot ignore what is going on in the market, particularly if the recoverability of financial assets is in doubt.



11. Performance may need more than one measure

Profit for the year is the most widely recognised and benchmarked measure of performance. It needs to retain its key position in financial reports. Some elements of value changes do not form part of profit, but are recorded as OCI – such as revaluation gains on property and actuarial gains and losses on pension obligations. Users of financial statements should not overlook these items. Standard-setters should aim to produce a rationale for the distinction between profit or loss and OCI to ensure that profit for the year remains a coherent measure of performance.

Nevertheless, in many cases other performance measures may be helpful for investors, but also for allowing management to explain their achievements in light of their strategy. Such alternative performance measures (APMs) may be more forward-looking non-financial measures, such as numbers of subscribers, pipeline of new products or proven reserves of natural resources.

Others may be non-GAAP financial measures that are likely to be better pointers to future sustainable earnings because, for example, they exclude one-off items.

If such APMs are used then it is important that:

- the rationale for including them is explained
- there is a clear explanation of how they are calculated
- they are consistently applied from year to year and the impacts of any changes in calculation are explained, including an explanation of any APMs that are no longer reported
- financial measures are reconciled where possible to the GAAP performance measures, such as profit for the year
- financial APMs are presented in a balanced way alongside the benchmark GAAP measures.



12. Accounting should be prudent, in some respects

There are two aspects to prudence and accounting standards: prudence embedded in setting the standards and prudence in the application of the standards by companies in preparing their financial statements.

It is the role of prudence in setting the standards in the first place that has been more debatable. Many would like to see it embedded there to act as a restraint on the anticipated over-optimism of management in reporting their results. There is an expectation that the accounting numbers should be 'hard' and reliable for the payment of bonuses and dividends, for example.

On the other hand, the accounts should be neutral and free from bias. The risks are that prudently restraining profit recognition in one year may lead to overstatement the next or mask deteriorations in performance that need to be addressed. Injecting an extra element of prudence raises the question of whether readers will be aware of how much has been added.

Whether 'prudence' is advocated or not, standard setting should provide robust recognition criteria for assets and liabilities. Caution over the recognition of gains and losses, in cases where assets may be hard to value or of doubtful existence, is evident in many places in the existing standards. For example, revenue is not recognised when there are firm customer contracts, but only when the goods or services have been delivered. For loss-making contracts, on the other hand, the full

losses are recognised up front in full. Contingent assets are to be recognised only when the inflow is virtually certain; contingent liabilities are recognised when more likely than not. Internally generated intangibles such as brands and customer relationships are not recognised.

ACCA argues that measurement bases such as fair value and net present value need to be as neutral as possible and reflect the honest application of the valuation techniques, giving due recognition to the effects of uncertainty. Standards should not require an arbitrary extra element of prudence in these valuations, as this will always lead to an element, perhaps unquantified, of bias.

The prudent application of the standards in preparing financial statements is covered by the definition in the previous conceptual framework in discussing reliability in reporting – caution when making judgements under conditions of uncertainty².

Standards provide guidance but their application often involves a degree of judgement, which allows for a range of outcomes. This is largely because of uncertainty. In exercising that judgement, management should err on the side of caution and prudence. It is, however, important that the application of prudence by preparers of financial statements is done consistently. It is problematic when prudence is applied selectively, giving rise to issues around earnings management and profit-shifting.



13. Intangibles need to be included when appropriate

The current accounting standard for intangibles deals with assets that are internally generated very differently from similar assets purchased or acquired in a business combination.

Internally generated intangibles are restricted to the development costs of new products and services – everything else has to be written off as incurred, whether that is research, marketing campaigns or staff training. Even with development costs, there are six tests to meet before any cost is recognised as an asset. This gives considerable discretion to companies that spend on R&D about the degree to which development costs are expensed. Finally, even when the six tests are met, the accumulation of the cost of the investment only begins at that point and past expenditure getting it to that point must remain written off.

On the other hand, if intangibles are purchased directly or as part of a business combination, if they are separable or arise from legal rights then they must be recognised as an asset at their fair value at the date of acquisition. So often it is not only licences or R&D that are recognised, but also many customer-related intangibles such as brands, relationships, and customer lists are included on the balance sheet.

The trend of the modern economy in many countries is away from investment in property, plant and equipment, and inventory and towards building businesses around intangible items such as brand names, know-how, software or a skilled workforce. Many of these intangibles are hard to value, have costs that are difficult to track and may not even be controlled by the entity, which are all good reasons for not recognising them as assets. It would certainly not be appropriate to include such intangibles at a valuation that was not derived from the costs of developing them.

Given this, it may well be that reporting such information outside the financial statements will be more effective at communicating the development of a business.

There is an increasing gap between the market values of companies and the net book values as reported in their financial statements, which in some studies has been estimated as 85%. Balance sheets were never intended to be estimates of the value of businesses. Nonetheless, the scale of the difference between these two values does raise questions about whether current accounting standards could be improved. The IASB and other regulators should be addressing the implications of this, as well as some of the anomalies in the accounting for intangibles and whether standards are overly restrictive with regard to the recognition of intangibles.

² The concept of prudence was in the version of the Conceptual Framework that applied from 1989 to 2010. There has been an exposure draft of a revision to the Framework to reinstate the concept of prudence in the explanation of neutrality including this definition on page 9. <<http://www.ifrs.org/-/media/project/conceptual-framework/exposure-draft/published-documents/ed-conceptual-framework.pdf>>



14. Disclosure overload should be avoided

In some cases, corporate reports may contain insufficient relevant information and yet excessive irrelevant or immaterial information. ACCA argues that the provision of insufficient relevant information is the most pressing concern.

While the omission of material information is more serious than the inclusion of the immaterial, too much irrelevant information is nevertheless a problem. Irrelevance occurs in both the sheer quantity of matters reported and the uninformative 'boilerplate' terms in which some reporting is done. Users of the financial statements need to be able to gain an overall view of the performance and position of the reporting entity without excessive effort. While digital technology may help here it will not be the whole answer.

As noted in 'Qualities applicable to narrative reports' above, conciseness is a desirable characteristic of corporate reports. The recent growth in the length of corporate reports is as much attributable to the narrative elements as to the financial statements.

In the financial statements, much of the solution to this disclosure problem lies in changing the behaviours and attitudes of those involved with the financial reporting process – preparers, auditors and regulators, for example – to improve the quality of the reports. There are, however, further changes that the IASB can make, specifically in the development of:

- centralised disclosure objectives, in the Conceptual Framework
- the principles of effective communication, in a standard
- a general disclosure standard.

ACCA believes that changes in attitudes and behaviours are, however, unlikely to be achieved without changes in all the standards requiring disclosures. Each of the standards needs to:

- provide disclosure objectives that are specific to the subject covered by the standard
- make clear in consistent language which of the more detailed disclosures needed to achieve those objectives are always going to be required and which are needed if material
- remove any excessive, repetitive or redundant disclosures.

IFRS may require information that could be more effectively provided outside the financial statements and, likewise, the financial statements may contain information beyond that required by the standards. A more holistic approach to corporate reporting could allow for this, enabling better understanding of an entity's corporate reporting as a whole and/or reducing repetition. ACCA supports these possibilities, but they must be subject to safeguards..

The inclusion of non-IFRS material and the cross-referring to other corporate reports also raise important issues about who is responsible for the information. Clarity is needed on the respective responsibilities of the management of the reporting entity and of the auditors and on the extent of any 'safe harbour' provisions.



15. Reporting has to go beyond the financial statements

Corporate reporting needs to provide a more holistic picture of the performance of a business, beyond just showing investors its financial performance.

Firstly, investors need more information, including:

- the business and the business model
- the management's view of the business outlook and prospects
- strategy and intentions
- performance, measured against both financial targets and the non-financial operational objectives that are used to manage the business and are often more leading indicators than the lagging financial ones.

Secondly, there are other stakeholders who are interested in the corporate track record, whether that concerns the entity's contribution to society more generally or to important societal objectives, such as limiting the effects of climate change or environmental degradation. Longer-term financial performance is influenced by these considerations.

The International Integrated Reporting Framework is a good way of providing such information, though it is not the only way of doing so.

An integrated report aims to explain to investors, in a holistic way, how the entity creates value over the shorter and longer term. The fundamental concept that should shape the report is that the business model of the entity creates value for the organisation and for other stakeholders through the interaction between the full range of capitals on which in reality it depends. The six capitals are financial, manufactured, human, intellectual, social and relationship, and natural. For example, the strategy and risks described in the report should reflect the value creation through the business model and the balance between the different capitals.

The Integrated Reporting <IR> Framework is generic. It does not, for example, require or propose specific measures for the different capitals. While requiring risks and mitigations to be discussed, it does not set out a methodology for doing so.

Other bodies are providing guidance, for example, on how to report and measure environmental impacts or the development of human or intellectual capital, which would then be included in the integrated report. Convergence on widely agreed protocols for reporting and measurement of these issues would be very helpful for users.

As a framework setting out objectives and some guiding principles for achieving them, <IR> has advantages. Given the great range of reporting entities and their activities, such a principles-based framework is the most practical route currently to improving reporting of issues outside the financial statements. It also allows the possibility of widespread adoption. In jurisdictions where there are already corporate reporting requirements beyond financial statements, the <IR> framework is likely to provide fewer obstacles to adoption than other, more detailed and specific, systems.

Companies have reported that one of the main benefits of this more holistic approach to reporting has been the development within the business of integrated thinking and integrated management to support it. To set out a strategy and business model that recognises the interaction of, and maintains the balance between, performance measures using this wider range of capitals has led to some rethinking of approach and strategy.

Appendix: Example frameworks for corporate reporting

The Conceptual Framework for Financial Reporting

Included in the IFRS Standards as issued at 1 January 2017, page A21

<<http://www.ifrs.org/issued-standards/list-of-standards/conceptual-framework/>> accessed 23 January 2018.

A new version of the Conceptual Framework is expected to be published in 2018.

Framework for the presentation of management commentary

Included in the IFRS Practice Statement 1: Management Commentary, included in the IFRS Standards as issued at 1 January 2017, page B2932

<<http://www.ifrs.org/issued-standards/management-commentary-practice-statement/>>, accessed 23 January 2018.

The IASB has undertaken a review of this Practice Statement.

The International Integrated Reporting Framework, especially Section 3 Guiding principles

International Integrated Reporting Council December 2013

<<http://integratedreporting.org/resource/international-ir-framework/>> accessed 23 January 2018.

Fundamental Principles for Effective Disclosure

Appendix 3 on page 51 of the Recommendations of the Task Force on Climate-related Financial Disclosures, June 2017

<<https://www.fsb-tcfd.org/publications/final-recommendations-report/>>, accessed 23 January 2018.

The Strategic Report – Materiality and communication principles

Sections 5 and 6 of the Guidance on the Strategic Report, Financial Reporting Council, June 2014

<<http://www.frc.org.uk/getattachment/2168919d-398a-41f1-b493-0749cf6f63e8/Guidance-on-the-Strategic-Report.pdf>>, accessed 23 January 2018.

The FRC's guidance is due to be revised in 2018.



