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Dear colleague

Welcome to our latest newsletter. We hope you had a lovely summer.

Since our last Newsletter, we have published two new research reports, one on assurance and another on small company abbreviated accounts. As always, you can view/download a copy of these reports on our website and are profiled on pages 3-6. We also have another four reports which will be published shortly (see page 7).

Applications for research funding continue to increase and competition for funding is intense but as always we are happy to provide informal feedback on any research ideas which you have. We continue to work with our technical committees within ICAS to identify ‘hot topics’ which we believe urgently require independent research. A recent call for research, drafted in collaboration with our ICAS Charities Committee, on the financial sustainability of charities, a key issue given the ongoing economic climate and the anticipated pressures on the third sector, resulted in a number of good applications. We were pleased to award the grant to a team of academics from London South Bank University.

To be notified of new reports as they are published and research funding opportunities, you can join our e-news service by emailing research@icas.org.uk.

For your information the REF draft panel criteria and working methods have now been published for consultation. They are available at www.ref.ac.uk and responses are requested by 5th October 2011. We continue to take a keen interest in these developments and will attend a workshop in September to contribute to the debate on the proposed criteria for assessing impact.

We hope you enjoy this edition of our Newsletter.

The ICAS Research Team
New reports published

Can we meet the needs? Auditor views on external assurance and management commentary

Ian Fraser and Jacqueline Pierpoint

A far reaching debate continues over the future of audit and assurance, and ICAS has contributed to it with its recent publication The Future of Assurance. Ian Fraser was a member of the working party which was responsible for Future of Assurance and brought the findings of this research report on meeting future assurance needs to its deliberations.

Exploring auditor views followed on naturally from the first phase of the research, which explored the views of users. In this research the objective was to pinpoint exactly what auditors felt about:

- the extent to which assurance is (or is not) provided on the “front end” of the corporate annual report;
- the balance between process and judgement in contemporary audits;
- the usefulness of current audit reports and ways by which these might be enhanced; and
- the adequacy of current communications between auditors and investors.

The first stage of the research identified that these were all areas where investors or other users had concerns. It was thought-provoking to talk with partners and other senior auditors from different sizes of firm and hear their views about where auditing and assurance were now and how they might (or needed to) change. The remainder of this article gives readers just a taster of a rich variety of fascinating opinions. Read the full research report or the shorter summary report to learn more.

Assurance on the front end

There is a general view that it is important for auditors to provide some assurance on the front end of company reports. One senior partner emphasised the need for auditors to engage particularly with future events:

If you look at our area of assurance, we spend 90 per cent of our time on the past and 10 per cent on the future in terms of going concern and such like and if you look at the City they spend 90 per cent on the future and 10 per cent on the past. Arguably, it’s because our job is to give them the firmness on the past and their job is to look to the future, but do we give them enough?

Future of Assurance has responded to these concerns by recommending that auditors provide opinions explicitly on both directors’ going concern judgements and the front end of the annual report. An obvious response is to question whether auditors can really contribute meaningfully in the ways envisaged here. The research brought out, however, that there are few strictly technical objections to pushing back the frontiers of assurance:

We are clearly comfortable and capable of providing assurance on any numerical or quantitative analysis...we can provide some assurance on forecasting.

Process and judgement

An appropriate emphasis on judgement is clearly key to providing meaningful assurance on the more “free form” front end and when we explored the relative current emphases placed on process and judgement, the negative views articulated by some auditors as to how their ability to exercise judgement meaningfully had been curbed were thought provoking.

There is a substantial disconnect between audit quality as perceived by the regulators and audit quality as perceived by investors.

I think that even partners are feeling less confident in their own judgements these days because they’re worried: ‘Do the ISAs let me do this?’

It was also interesting to hear some senior auditors acknowledge that it was not just the regulators who were the culprits when it came to too much emphasis on process. The business models applied by the larger firms may also not be blameless:

Yes, the judgement versus process issue is a challenge to some of our teams...you say ‘how often did you get out of the audit room’ and they’re keying away at stuff.
The younger guys... are very bright, they are not bound by anything, they learn to question because that is what higher education does to you... we come in and it’s ‘This is the methodology...’ we force that creativity out of them.

It is important not to overemphasise the negatives here, and it is praiseworthy that auditors are aware of the need to enhance the judgement emphasis of the audit, but these images do resonate with the recent joint call by the Financial Reporting Council and the Financial Services Authority for auditors to exercise more scepticism and challenge management more rigorously.

**Audit reporting**

Judgement is the essence of the audit report; it was this area of the research which exhibited the most obvious difference of view between auditors and the users we spoke to during the first research stage. Auditors seem more wedded than users to generic style reports where details of key judgements, other than the overall judgement as to whether or not the financial statements give a true and fair view, remain hidden from users.

As was the case for those auditors who were less enthusiastic about extending the scope of assurance beyond the financial statements, reservations about more expansive audit reporting are largely non-technical. A perceived need to reform the existing auditor liability framework, and perceptions that management and auditor responsibilities may become conflated and the dynamics of governance affected adversely, are issues for some auditors.

Governance issues are seen as especially important with the view that the most appropriate conduit for more detailed reporting by auditors is via the audit committee. Future of Assurance has opted for this more conservative option. Nevertheless, some auditors stand alongside users in believing that radical reform of audit reporting itself is needed.

...audit reporting is a wasted opportunity at the moment. I am not talking about the work that has gone into it but about the actual report. What is the point of spending millions and millions of pounds to have something that is just a form of words?

One of the more radical audit reporting suggestions envisaged:

...a report of the audit process, what we started with, the information that management presented for audit, what we considered a risk, and how those risks were subsequently resolved through discussion with management, what issues we disagreed with and the quantification of those issues which remain unresolved, but didn’t affect our binary opinion... a very different audit environment.

**Auditor-investor dialogue**

The jury is still out, then, on the question of the most appropriate audit reporting model. Similarly, for the final issue discussed: the nature of auditor-investor communications and how these might be enhanced. There is some sense that existing communications between auditors and investors via AGMs are lacking.

It’s always struck me as slightly odd that people don’t stand up and ask us what we think about this or that.

Some believe that auditor-investor communications need to be enhanced more radically, perhaps by making information initially restricted to audit committees available to investors who ask for it. Still more radical is the suggestion that the best way of enhancing communications might be for auditors to provide a commentary on the management commentary.

So what is the future? Some things are clear: matters such as the scope of assurance, the audit approach, the reporting model and auditor-investor dialogue are connected. Similarly, these issues lend themselves to alternative solutions of varying radicalism. The debate goes on.

Download this report at: www.icas.org.uk/fraser-auditors

Download the ICAS technical report Future of Assurance at: www.icas.org.uk/futureofassurance
New reports published

Small company abbreviated accounts: A regulatory burden or a vital disclosure?

John Kitching, Robert Blackburn, Eva Kašperová and Jill Collis

New European Commission proposals permit member states to abolish or reduce accounting obligations for micro companies, and the UK Government has indicated a willingness to move in this direction. For policy makers, there is a trade-off between reducing the regulatory burden on micro companies in order to stimulate growth, and increasing financial transparency in order to reduce business uncertainty and improve credit allocation throughout the economy.

This policy context formed the backdrop to our research, looking at the value small company preparers attach to the option to file abbreviated accounts and whether users value the information they provide. Many small companies in the UK file abbreviated rather than full accounts at Companies House in addition to the full accounts lodged with HMRC.

We were interested in preparers’ reasons for filing abbreviated accounts, in users’ reasons for accessing them, in the role of accountants in filing and using abbreviated accounts, and in users’ views of alternative filing arrangements.

To carry out the study, we talked to small company directors/managers and a wide range of users of accounts. These included ICAS members working in practice and for large organisations, Companies House, a small business membership organisation, and a number of finance and credit managers, including those working in banks, commercial credit reference agencies and credit insurers. Data was collected using postal and online survey methods, plus face-to-face and telephone interviews.

Preparers of abbreviated accounts

Small company directors valued highly the option to file abbreviated accounts. Many were keen to maintain the confidentiality of financial information for both business and personal reasons. Other small companies simply followed their accountants’ recommendations as to the kind of accounts to file.

The paradox for small companies is that both confidentiality and transparency potentially serve their interests. Confidentiality offers protection against users of accounts – for example, competitors, suppliers, customers and employees – who might exploit information for their own benefit and to the company’s detriment. At the same time, it limits the support that other stakeholders – financiers, suppliers, credit reference agencies and insurers – might provide.

On the other hand, transparency potentially enables small companies to win new business and secure credit, but at the risk of making it easier for accounts’ users to exploit financial information for their own benefit.

Users of abbreviated accounts

Users, particularly finance and credit managers, took a more critical view of the value of abbreviated accounts than small company preparers. Users typically look at abbreviated accounts to monitor the creditworthiness and financial position, of their key customers, suppliers and competitors, in order to decide whether they, or clients, should initiate, continue, terminate, or renegotiate relationships with particular companies.

An estimated 900,000 small company abbreviated accounts are downloaded annually from Companies House. Many more users access abbreviated accounts indirectly via third parties such as credit reference agencies.

Users examine abbreviated accounts to monitor companies viewed as risky. Users paid greater attention: to companies whose directors had dubious reputations or were unknown to them; where companies were engaged on larger contracts or performing critical roles; or where credit relationships were uninsured.

Users consider abbreviated accounts valuable – but only up to a point. They are better than nothing! Abbreviated accounts provide some useful information on balance sheets and equity, and permit estimates of the value of items excluded from the accounts. Trends can also be tracked over time. Such information permits a preliminary assessment of credit risk. Abbreviated accounts are of value to users as a low-cost and easily accessible filtering mechanism, to decide
whether to increase or discontinue information search activity in relation to particular companies. Used in combination with other sources, they provide part of the information “jigsaw” that supports decision-making.

Yet because of their limited content, abbreviated accounts also constrain business decision-making. Limited transparency encourages finance and credit managers, for example, to act cautiously regarding credit decisions, with potentially adverse consequences for small companies – as seekers/beneficiaries of finance, credit ratings, and credit insurance decisions. Interestingly, small companies themselves did not report such problems, but they might be unaware that others are making credit and business decisions to their disadvantage.

At the macro level, credit constraints are potentially a major barrier to economic growth. Greater financial transparency arguably allows superior assessments of credit risk and, thereby, contributes to more efficient credit allocation, better supporting economic activity. In the aftermath of the financial crisis, and the part played by poor credit risk assessment, users of accounts are increasingly demanding more detailed and timely information as a condition for supplying credit, credit ratings and insurance cover.

**Alternative filing scenarios**

Comparing the likely impact of two alternative filing scenarios – filing full accounts and total exemption – users strongly argued for the benefits of greater disclosure. Benefits include increased access to credit, winning more business and the encouragement of sound financial management practices. Lacking any obligation to make information publicly accessible, exemption might encourage financial indiscipline and increase the risks of transacting business with such companies.

**Policy implications**

Reducing financial reporting obligations might save small companies time and money. But it might also generate unintended consequences – principally, lost business and reduced access to credit – that undermine small company ambitions for growth and survival in what remains, for many, a difficult trading climate. In a risk-averse environment, businesses, financiers, credit reference agencies and insurers might be less willing to do business, grant credit, provide satisfactory ratings or offer adequate insurance cover to small companies and those who trade with them. Critical of the current position that permits small companies to file abbreviated accounts, what many see as a further diminution of financial transparency would only make a poor situation worse and might even encourage poor financial management.

It is true that many micro companies do not seek to grow or take external finance, and trade mainly with businesses uninfluenced by credit reference agencies or insurers. For these companies, exemption from reporting obligations might offer time and cost savings. Such gains, however, seem likely to be marginal and such companies are unlikely to be the growth engines of tomorrow that the government is seeking to support. One might propose, therefore, to retain the present position with regard to small companies’ reporting requirements. This will avoid imposing additional regulatory burdens on businesses in difficult times, while at the same time resisting the temptation to abolish micro entities’ current obligations.

Download this report at: [www.icas.org.uk/kitching](http://www.icas.org.uk/kitching)

ICAS research publications can be downloaded free of charge from the ICAS website: [www.icas.org.uk/research](http://www.icas.org.uk/research). If you would prefer to order a hard copy - priced £10 or £15 - please contact Angie at the Research Centre on 0131 347 0237 or email: research@icas.org.uk
Coming soon...

Risk reporting: Clarity, relevance and location
Santhosh Abraham, Claire Marston and Phil Darby

This report compares the views of users and preparers on risk disclosure resulting in recommendations for policy makers in this key area.

Asset rich cash poor: The impact of the economic downturn on the lives of retired home-owners in the UK
Sarah Hean, Louise Worswick, Lee-Ann Fenge, Charlie Wilkinson, Stella Fearnley and Steve Ersser

This report investigates the experiences of retired people in the economic downturn. It considers how financial circumstances are managed, the impact of the downturn on wellbeing and how financial services and support could be improved.

The teaching-research sans nexus in accounting
Angus Duff and Neil Marriott

This research evaluates how academic research influences what is taught in the accounting and finance curriculum and vice-versa. To be a good teacher, do you need to be a good researcher?

Major contributors to the British accounting profession: A biographical sourcebook
Robert Parker, Stephen Zeff and Malcolm Anderson

This book is a follow-up to British Accountants: A Biographical Sourcebook by Robert H. Parker. The book contains biographies of 37 individuals who have contributed to the British accountancy profession.

To be notified when any of these reports are published, please email: research@icas.org.uk

For a full list of our ongoing projects visit: www.icas.org.uk/projectsinprogress
New grants awarded

Large project grant awarded

Financial sustainability of UK charities
Nigel Scott and Kenneth D'Silva - London South Bank University

This research project arises from an ICAS call for research. The research will focus on two main areas. It will look at the financial management of charities by trustees. Within that it will seek to identify the levels of understanding of financial management by trustees and the use of that understanding in decision-making. The research will also look at reserves policies. It will look at the development of policies within charities and their use by trustees in decision-making. A further aspect of research on reserves will be to identify funders' understanding of charity finances, and the impact on grant-making and commissioning.

Small project grants awarded

Corporate governance in small and medium sized enterprises: A survey of Scottish firms
Kenneth Crossan and Thomas Henschel - Edinburgh Napier University

The aim of this study is to understand how governance is interpreted and applied in the SME sector in Scotland. Two key dimensions are considered: the role of the board of directors and the influence of ownership on corporate governance. Twenty interviews will be carried out with micro, small and medium sized companies.

Mandatory adoption of IFRS by EU listed firms: The determinants of improved comparability
Yannis Tsalavoutas and Dionysia Dionysiou - University of Stirling
Paul Andre - ESSEC Business School (Paris)

In 2005, the EU imposed International Financial Reporting Standards (IFRS) to all listed companies in Europe. The transition from national accounting standards to IFRS was complex and costly but the main arguments for it included the improvement in comparability across companies, improvement in capital markets’ efficiency and reduction in companies’ cost of capital. Surprisingly, little published research has attempted to test these assertions. This project draws on companies’ annual reports and financial databases to provide fresh insights on the benefits of IFRS. It focuses on the comparability of the financial statements of EU listed firms, before and after IFRS mandatory implementation.
Seedcorn project grants awarded

Clinical accountability and governance in the Primary Care Sector of the NHS in Dundee

Gwen Hannah - University of Dundee

This project assesses the effect of measures undertaken in the last decade to improve the clinical governance of GPs.

Investment in companies with intangible assets: What are the key issues?

Julia Smith and Renzo Cordina - University of Strathclyde

This project seeks to address whether financial statements accurately reflect and/or transparently show expenditure of intangible assets.

Professional judgment matters: Assessing the merits of enhanced communication and collaboration

Paul-Emile Roy - Independent researcher

This project will summarise existing research on professional judgement and undertake interviews to assess the need for an internet-based professional judgement resource centre.
Small projects - research results

Corporate governance: Comply or what?
Stuart Ogden - University of Sheffield

The comply-or-explain principle has been at the heart of the UK’s Code of Practice on Corporate Governance ever since it was introduced in 1992. While we know quite a lot about compliance, little is known about what effective redress shareholders may have if they disagree with boards’ explanations for non-compliance. The Code of Practice is silent on this issue, apart from mentioning that shareholders may wish to consider their voting intentions!

For this project, I interviewed shareholders and used press reports to focus on Marks and Spencer’s (M&S) decision in 2008 to appoint their CEO, Sir Stuart Rose, as executive chairman. The board’s decision breached the Code and provoked considerable shareholder reaction. Shareholders initially expressed their discontent at the decision through a series of meetings with senior board members. While these processes of private engagement usually promote mutual understanding of a board’s decision and shareholders’ concerns, in this instance it failed to satisfy aggrieved shareholders. The board was determined to press on with the dual appointment of Sir Stuart, arguing this was the only way to retain his services at a crucial time for the company.

As two of the company’s largest investors came out publicly in support of the board’s position, there was little possibility of a successful shareholder challenge to it at the AGM. This left disenchanted shareholders with very few options as to how to press their protest. The independent directors were not standing for re-election. Lord Burns, the outgoing chairman, was not standing either, as part of the decision to appoint Sir Stuart as executive chairman. The board had agreed that Sir Stuart would himself be up for re-election but even some of those critical of the board’s decision were generally reluctant to pursue a vote against him as they thought, like the board, that he was essential to the company’s future successful performance. In any case, if he were voted out, the consequence would be to leave the company without either a chairman or a chief executive at what was proving to be a very difficult trading time.

Nevertheless, at the 2008 AGM some 16 per cent of shareholders abstained on the issue of Sir Stuart’s re-election, while 5.9 per cent cast their ballot against on corporate governance grounds. Taken together, these voting decisions were described by the Financial Times (10 July 2008) as “one of the biggest protest votes in recent City history”.

This was not the end of the matter. Shareholders continued to pressure the board to resolve the issue. A motion at the 2009 AGM urging the board to bring forward the appointment of an independent chairman attracted even more support than achieved in 2008. Later that year the board announced that Marc Boland would become the new CEO from February 2010, and a new chairman was appointed in August 2010, to start in January 2011.

Overall, interviewees thought that given the pressure shareholders had exerted, the company had in the end responded to their concerns. In this context redress can be regarded very much as a process and not an event.

Two further issues emerged from the M&S experience that have implications for the future of the comply-or-explain approach. The first relates to the need for effective communication and engagement between shareholders and companies. Without this it is unlikely that the comply-or-explain approach is sustainable. The second relates to the ways in which shareholders’ concerns about governance issues may be overwhelmed by performance considerations. Despite their concerns about the risks associated with Sir Stuart becoming both CEO and chairman, some shareholders decided to vote in favour of retaining his services, in the belief that this would most benefit the company’s future prospects. On this basis, comply-or-explain is in danger of becoming comply-or-perform!

How these issues get resolved in the future may well be affected by the new Stewardship Code. But one thing is for sure: under the comply-or-explain approach, governance arrangements are always likely to be contestable. We need to know much more about how the differences of opinion about governance, between boards and shareholders (and, as the M&S case illustrates vividly, between different shareholders), as to what is most appropriate, get resolved.
Internal control and financial auditing: Lessons from the history of building societies

Bernardo Bátiz-Lazo - Bangor University
Masayoshi Noguchi - Kobe University, Japan

This research traces the historical roots of the introduction of auditors’ duty to report on the systems of internal control of UK building societies. This duty was introduced in advance to any explicit recognition in legislation applying to companies (such as of Section 404 of the Sarbanes-Oxley Act in the USA or Principle C.2 of the Combined Code on Corporate Governance in the UK). The origin of such regulation dates back to the Building Societies Act 1960 (BSA60), with Sections 38 and 45 asking auditors to determine whether the directors of a society complied with BSA60’s requirement to maintain such systems and, if not, to report thereon.

Changing the regulatory terms of the auditing of building societies came about through negotiations between professional accountants and state authorities. The former were represented by the Institute of Chartered Accountants of England and Wales (ICAEW) and the latter were represented by the Treasury and the Chief Registrar of Friendly Societies (CRFS).

A review of surviving records shows the efforts made by accountants to modernise the then out-dated form of the report by building society’s auditors to bring it into line with the Companies Act 1948. Accountants also aimed to modernise the audit process itself by removing their duty to inspect each and every mortgage deed. The latter aim was not a priority of the Treasury, because state authorities attached great importance to the auditors’ paternalistic duty to safeguard the financial assets of building societies on behalf of depositors. After prolonged negotiations, the ICAEW succeeded. It forced the Treasury and the CRFS to drop the requirement to inspect all mortgage deeds. But it was in fact a mutual concession because in exchange new regulation required the auditors to assume a new duty, namely to report on individual societies’ system of internal control.

The research also explored the role of auditors in the supervision of building societies. This was exemplified by two cases of defalcation that occurred in the late 1970s, namely those of the Wakefield (1976) and the Grays (1978). There was substantial evidence in both cases that the auditors failed to discharge their duties. They failed to report on the material misstatements in the annual returns to the CRFS and also to identify deficiencies in internal control systems. An important reason given for their failure was the lengthy association with the same client.

The CRFS responded by introducing new control mechanisms. First, pressing for alternation between auditors through a positive vote for their appointment at the annual general meeting. Secondly, the CRFS was able to examine the quality of the auditors’ work. For this measure to take effect, external auditors were recognised as officers of the societies. Professional accountants (or at least the ICAEW) initially resisted allowing authorities to examining auditor’s working papers but eventually conceded.

Overall this study indicates that negotiations with state authorities are not straightforward processes for accountants’ professional bodies. In some instances authorities will make concessions. Specially in cases where there is a need to discuss the technicalities of auditing organisational forms whose internal workings are not fully understood by the authorities. But even then, one-sided concessions by the accountants can be expected as a potential outcome of such a process.
The role of tax in the foreign direct investment (FDI) decision process: Evidence from UK companies

Jinning Hong - University of Sheffield
Jane Frecknall-Hughes - The Open University

Foreign direct investment (FDI) has attracted the attention of many researchers for several decades. However, the process by which FDI decision making takes place in practice has been relatively ignored in the literature. Taxation, as a significant element within the FDI process and its interaction with corporate strategy, has also largely been ignored.

This seedcorn study sought to reduce this gap and address the following research questions:

- Do tax incentives and corporate strategy vary with the industry sector, geographical locations and capital size of the FDI?
- How well integrated are tax and corporate strategy?
- Do tax strategy and corporate strategy vary according to the stages at which tax implications are considered in the FDI decision process?

This project included an on-line survey of ICAS members, and contributes to the first named author’s thesis.

The evidence from the overall study shows the following:

- There is no support for the view that the relative importance of tax incentives and corporate strategy varies with the industry sector and geographical locations of the FDI, while some evidence was found to support the proposition that the relative importance of the tax incentives and corporate strategy varied with the capital size of the FDI. Tax incentives are relatively more important for large sized FDI than small sized FDI.
- Tax strategy is fairly well integrated with corporate strategy in the FDI decision process.
- The relative importance of the integration of tax strategy and corporate strategy varies with the stages at which the tax implications are considered in the FDI decision process. The two particular stages – one where tax issues are considered before the FDI decisions are made, and another where tax is taken into consideration both before and after the FDI decisions are made – are relatively more important in the decision making process if tax strategy is fairly well integrated with corporate strategy.

This study helps to develop a better understanding of the stages at which tax issues are considered in the decision making process, as well as of the actual processes by which FDI strategic decisions are made. Significantly, the overall thesis provides evidence which contradicts the view often propounded in the press and other media that multinational enterprises undertake tax planning to the furthest extremes of avoidance.

The ethical corporate governance system of fully employee-owned firms

Marco Guidi - University of Glasgow

What is the best corporate governance system to maximise a firm’s value to society? Can a more ethical, equitable and democratic based corporate governance system, such as that of Scott Bader Commonwealth, provide a basis to establish appropriate ex-ante and ex-post safeguards? In other words, is a democratic corporate governance system better at justly assigning, protecting, enforcing and distributing rights, obligations, benefits and costs to all stakeholders, especially insider stakeholders, so as to maximise a firm’s value to society.

This seedcorn project funded semi-structured interviews to gather operational information on the corporate governance structures, procedures and processes of a UK fully employee-owned firm – Scott Bader Commonwealth. The aim of the project was to build a case study of the internal corporate governance system of a successful employee-owned firm.

Preliminary results indicate that the interests of society and firm are compatible; however, there are major market and financial pressures that hinder a democratic governance system. Difficulties include the clash of culture and beliefs, especially where externally appointed senior management are not used to democratic corporate governance systems.
New funding brochure

If you are interested in undertaking policy relevant research which makes an impact please watch out for our new research funding brochure which will be published in late 2011. To receive notification of its publication please join our e-news service by contacting research@icas.org.uk.

In the meantime we continue to accept applications under our current funding brochure - visit www.icas.org.uk/researchfunding.

Forthcoming research events

As part of our dissemination policy to encourage debate and increase impact, research discussion events are currently being organised for autumn 2011 on the following topics:

- Work-life balance - Edinburgh
- SME assurance and reporting - London and Edinburgh
- The future of assurance - London

The events will highlight recent or forthcoming ICAS research publications and involve practitioners, policy makers and those in business. The events are free to attend.

If you are interested in receiving details of any of these events please email research@icas.org.uk.

Forthcoming ICAS conference - Principles Not Rules: A Question of Action

It is five years since ICAS published its seminal paper Principles Not Rules: A Question of Judgement. At the time, there was a general consensus that principles-based standards were the way forward for financial reporting but are we any nearer achieving that vision and, if not, why not? ICAS is currently finalising plans for a conference to debate these issues. The conference will be held in October or November 2011 and if you would like to be notified of details of this event, once available, please email accountingandauditing@icas.org.uk.

New ICAS tax qualification

ICAS has introduced a new qualification to its portfolio with the addition of the ICAS Tax Qualification. The qualification, which will be supported by the services of tax publishing and training experts Tolley, has been created to meet the changing demands and needs of employers and students in the field of taxation. The qualification structure and syllabus content has been developed in consultation with tax practices to provide the tax skills and knowledge required of a tax professional working in a mixed client environment dealing with individual, corporate and indirect tax matters.

The ICAS Tax Qualification can be taken as a standalone qualification or in combination with the CA qualification. Students will begin studying with ICAS and Tolley for the ICAS Tax Qualification in autumn 2011.

For further details visit www.icas.org.uk/icastaxqualification.

Audit and assurance conference

ICAS hosted the Audit and Assurance Conference of the BAFA Auditing Special Interest Group on the 12th and 13th May 2011 at CA House, Edinburgh. ICAS was delighted to host the conference which succeeds in bringing together academics, practitioners and policy makers with an interest in audit and assurance. David Wood, Executive Director, Technical Policy and Services at ICAS commented “We very much enjoyed hosting the conference here and were pleased to participate. The conference attracted some very good and high profile speakers and there were some excellent discussions on research projects. It was a great opportunity to bring senior academics and practitioners together and the resulting discussions were very interesting and challenging.”
ICAS news

Losing the excess baggage -
Reducing disclosures in financial statements to what’s important

Gregor Alexander, finance director of Scottish and Southern Energy, is clear about why he believes something needs to be done to reduce the sheer volume of information in annual reports.

He points to what has happened to his own company’s report and accounts: “If you look at disclosure over the past nine years, since I’ve been finance director, it’s become more rules-based rather than focusing on what really matters, which is what the users need. My first set of accounts, the year to the end of March 2003, was 52 pages. Now, in 2011, it’s 152 pages.”

That’s why Alexander was happy to take part in a joint exercise between ICAS and the New Zealand Institute of Chartered Accountants (NZICA), aimed at identifying what can be taken out of the disclosures required in statutory accounts, without reducing their value to users.

The report, Losing the excess baggage - reducing disclosures in financial statements to what’s important, is the result of a six month process involving collaboration between members of a joint working party, based on opposite sides of the world. Their conclusion was stark: as much as 30 per cent of the content of financial statements could be dropped, essentially without almost anyone caring about the deletions.

Isobel Sharp, visiting professor at Edinburgh University and a senior partner with Deloitte, co-chaired the working party with Tony Frankham, past president of NZICA. Sharp says: “Disclosure requirements have grown like Topsy. Whenever you get a new standard, you get a new batch of requirements. Financial statements are simply too long. They are becoming a minority sport, for a few technical people, and that is not good for the health of financial reporting generally.”

Gregor Alexander adds that excessive disclosure requirements add to the workload and the cost involved in accounts preparation, in some cases with little apparent benefit to accounts users. He says: “A good example is share-based payments for staff, which we have to disclose at the moment, and that takes four to five pages, dealing with a cost to the company of £2m-£4m. That isn’t material in the context of our overall business, and I have never had a question on that note to the accounts, ever!”

“A number of notes are provided on a strictly technical basis rather than the user finding them of any value; whereas there are some very good notes, such as pensions disclosure, which is very important, and material.”

The joint working party approached the problem by looking at all the mandatory disclosures required under International Financial Reporting Standards (IFRS). Amy Hutchinson, assistant director, accounting and auditing with ICAS, provided support for the exercise. She explains: “There are other projects looking at disclosure from a conceptual basis, but we were looking at the standards that exist now. The question was, what is the key information that users need? We wanted to emphasise materiality.”

Hutchinson adds: “If the information in the financial statements is too long and complex, it can be hard to see what’s important. Accounts should tell the story of the business.”

Paragraph 31 of IAS 1 Presentation of Financial Statements states that entities need not provide specific disclosures required by an IFRS if the information is not material. The ICAS/ICANZ report argues, however, that “this important message has been lost, or at least undermined, by the general lack of emphasis on materiality.”

In the detailed set of proposed changes to disclosure requirements, set out in Losing the excess baggage, a new approach looking at material items and material information is the key theme. For example, a requirement to report material share-based payments in IFRS 2 Share-based Payment, rather than the detailed information currently required, would make a big difference to the amount of data in that part of the notes to the accounts.
Accounting policies are another potential area for reducing the scale of the notes, argues Gregor Alexander. He says: “Every year we disclose accounting policies at the front of the notes, even though very little changes. What we are suggesting as an option is that companies can show their accounting policies on their website, and all they detail in the accounts is the changes to those policies. So the regular user can see what’s changed year on year.”

The working party also put the proposals in the report to the test, with a draft set of financial statements. On this basis, Isobel Sharp says, the claim that financial statements can easily be reduced by 30 per cent can be backed up by evidence.

She adds: “Our report contains 110 pages of amendments to disclosure requirements. I do not expect that everybody will like everything on those pages, and may be not every paragraph will survive in its current form, but I would hope people would not simply dismiss it.”

“We found a high degree of consensus, and we think many other people would agree with us in terms of the broad direction.”

The report will be the subject of debate at an event to be held in London on 14 September, to be attended by International Accounting Standards Board representatives and both ICAS and NZICA hope this will be the start of a wider debate that could eventually turn the tide back towards shorter, more comprehensible financial statements.

Download this report at: www.icas.org.uk/excessbaggage

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research@icas.org.uk
Contact

The ICAS Research Centre
The Institute of Chartered Accountants of Scotland
CA House
21 Haymarket Yards
Edinburgh EH12 5BH
Tel: 0131 347 0237 • Fax: 0131 347 0114
Email: research@icas.org.uk
Website: www.icas.org.uk/research