Financial Reporting Outlook 2013
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Introduction

Public trust in financial markets has been subject to repeated blows. Reports of foreign exchange rate fixing, insider trading, LIBOR rigging and a series of mis-selling scandals have captured press attention. Perceptions of widespread low tax payments by multinational corporations have also dented business reputations. All these factors have created an urgent need for a coordinated effort to rebuild and maintain trust in corporations and financial markets. Regulators, standard setters, preparers of accounts, auditors and advisers all have important roles to play in working together to rebuild that trust through enhanced transparency.

This was a key theme emerging during EY’s 10th Financial Reporting Outlook (FRO) conference held in November 2013 in London, where around 600 international finance and business leaders gained insights from informative speakers and shared their views on current issues through real-time polls. During plenary sessions, it became clear that regulators, preparers and auditors share common concerns though there was a view that there is a conflict of interest between reducing the volume of annual reports and accounts and the increasing disclosures required to comply with International Financial Reporting Standards (IFRS).

There is general agreement on the need for greater transparency in annual reports and accounts through the disclosure of entity-specific information that is useful to investors. Preparers and auditors must apply their judgement when determining what and how to report.

It is also clear that participants in the financial reporting system still support the goal of a single set of high quality global accounting standards. IFRS is now used extensively around the world, but the US’s reluctance to commit to convergence and the risk of carve-outs in other jurisdictions are causes of concern.

Maintaining trust in financial reporting requires the mechanisms for setting, endorsing and enforcing IFRS to be transparent and following due process. This applies to any structures needed to ensure consistent future application of standards – particularly that converged standards remain converged through the consistency of US and international application guidance.

The regulatory and reporting environment in which companies operate continues to evolve. Preparers and audit committees must seize the opportunity provided through initiatives such as the new strategic report, the ‘fair, balanced and understandable’ requirement and enhanced audit committee reporting. Global firms such as EY, with our commitment to building a better working world, must also play their part. This report captures these and other views expressed during FRO 2013 and EY’s year-end technical update seminars held across the country, aiming to stimulate further debate on how enhanced transparency can be achieved and trust maintained.

FRO 2013 speakers included:

- **Hywel Ball**, Assurance Managing Partner, UK&I, EY
- **Steven Maijoor**, Chair, European Securities and Markets Authority
- **Ian Mackintosh**, Vice Chairman, International Accounting Standards Board
- **Leo van der Tas**, Global Leader, IFRS Services, EY
- **Jim Sutcliffe**, Chairman, Codes and Standards Committee, Financial Reporting Council
- **John Dixon**, Tax Managing Partner, UK&I, EY
- **Liz Bingham**, Managing Partner, People & Talent, EY
- **Lucy Kellaway**, Associate Editor and management columnist, Financial Times
- **Robert Peston**, BBC Business Editor
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The European Securities and Markets Authority’s perspective

EU governance in the financial reporting area

The European Securities and Markets Authority (ESMA) is a strong supporter of global reporting standards, which are important for investor protection and ultimately economic growth. The financial crisis showed the truly global nature of financial markets and the need for a single set of high quality accounting standards. It is therefore disappointing that the US has not been willing to make a clear commitment to IFRS.

IFRS has wide take-up across the EU and the IASB’s governance structure needs to ensure European views are heard. Also important is the existence of a credible IFRS endorsement mechanism in the EU. The model should be similar to that for other elements of the financial markets, where advice is provided to politicians by public interest bodies, though they may gather views from private market participants.

Following the financial crisis, G20 commitments have led to fundamental changes in the way that financial markets are supervised and regulated. The establishment of ESMA in 2011 was a key development.

Paris-based ESMA has five main objectives:

1. The creation of a single rulebook for the EU financial markets
2. Direct supervision of certain financial institutions – specifically credit rating agencies and trade repositories
3. Achieving supervisory convergence in EU securities law application
4. Investor protection
5. Maintaining financial market stability

Decisions by ESMA’s Board of Supervisors, which consists of the heads of the 28 national authorities in Member States are based on a majority vote. ESMA has a number of important powers, such as writing technical standards and guidelines that are directly applicable across all EU member states. It can also take action against national regulators should market regulating rules (including IFRS) be applied inconsistently.

Financial reporting

Supervision and potential enforcement actions relating to financial reporting are carried out by national regulators. ESMA’s mandate is to ensure and enhance supervisory convergence and consistent application of IFRS in the EU. It does this by coordinating national enforcement activities, primarily through the European Enforcers Coordination Sessions – gathering national accounting enforcers together on a regular basis to discuss current issues.

Transparency

The financial crisis showed that there was, and in some cases still is, little visibility of the risks to which companies are exposed. Transparency is therefore one of the most important principles guiding securities regulators in their response to the financial crisis.

Securities regulators and accounting enforcers are criticised for asking companies for more disclosures and thus making reports too long and inaccessible to investors. However, the emphasis on disclosure is not because regulators think it can replace measurement and recognition principles, but because it allows issuers to provide investors with high quality information within a principles-based environment.
Common enforcement priorities

On an annual basis ESMA issues common EU enforcement priorities on which all national enforcers should focus when reviewing financial statements. The issues for 2013 year-end financial statements cover five themes.

1. Impairment of goodwill and other intangibles
   An ESMA study published in 2013 found significant shortcomings in relation to impairment tests. Investors need more information on the reasonableness of cashflow projections and key assumptions used by management in determining value in use. Sensitivity analysis would also be helpful.

2. Measurement and disclosure of post-employment benefit obligations
   Continued numerous debt downgrades fuelled the debate on the existence of a deep market in high quality corporate bonds to which market discounted post-employment benefit obligations should be referenced. The IASB’s amendment of IAS 19 clarifies that the depth of the bond market should be assessed at the currency level (for the entire eurozone – the euro) not at the country level. This is helpful. Preparers should also present actuarial assumptions used in their valuations and sensitivity analysis.

3. Measurement of financial instruments and disclosure of related risks
   A principles-based environment can only survive if clear and entity-specific disclosures bring useful information to investors by presenting the judgements that have had most significant effect on the amounts recognised in the financial statements. Issuers should avoid boilerplate information. Clear and decision-useful information is required to achieve genuine transparency.

4. Fair value measurement and disclosures
   Preparers need to increase transparency over the measurement bases they use in their financial statements. IFRS 13 should help to improve the situation. Users of accounts need to understand the uncertainties around the inputs used in the measurement of fair values.

5. Disclosures related to significant accounting policies, judgements and estimates
   This is particularly relevant for financial institutions. In December 2012, ESMA issued a statement on the importance of correct measurement and additional transparency on the impact of forbearance activities. This has been a priority for European enforcers. ESMA has studied the financial statements of 39 European financial institutions to assess their overall transparency and compliance with IFRS requirements. It found a disappointing lack of information and divergent treatments in some areas:
   - There is wide variability in the quality of information provided and sometimes insufficient information to enable comparability between financial institutions, for example, on the impairment of equity instruments classified in the available-for-sale category.
   - Financial institutions need to provide more granular quantitative information on the effect of forbearance on financial assets to help investors understand associated credit risk.
   - Issuers should enhance their disclosures on exposure to credit risk, for example, in relation to their impairment policies.
The IASB continues with technical projects to improve and enhance its standards, but also retains a strategic eye on developments around the world. There is widespread support for IFRS, but achieving consistent implementation and maintaining stakeholder confidence in standard-setting is the continual challenge.

**Technical matters**

**Conceptual framework**

The International Accounting Standards Board (IASB) has resumed work on the Conceptual Framework. Its July 2013 discussion paper (DP) will be followed by an Exposure Draft (ED) in 2014, with a target finalisation date of 2015. The DP covers many topics, including:

- Definitions of assets, liabilities and recognition and derecognition
- The distinction between liabilities and equity
- Measurement
- Presentation and disclosure
- Profit or loss, other comprehensive income (OCI) and recycling

The IASB has not revisited the previously finalised chapters (1 to 3) of the framework, though has asked for constituents’ views. It is aware of some strong opinions relating to chapter 3 in particular, concerning prudence, stewardship and reliability. Some MEPs, for example, have called for future IASB funding to be predicated on the reintroduction of prudence into the conceptual framework. Similarly, some people argue that stewardship should be given more explicit prominence. The IASB is open to hearing views on such topics.

Preparers are encouraged to respond to the IASB’s discussion paper, rather than waiting for the ED in 2014. Important matters are being considered, particularly around asset and liability definitions and debt-equity classification – which will ultimately have an impact on accounting for financial instruments.

**Disclosure overload**

The IASB has an initiative focused on trying to improve disclosure in financial statements, tackling clutter, complexity and poor communication. Annual reports and accounts (ARAs) need to tell the story of a business – so that investors can understand how it is developing and its strategic ambitions.

One challenge is that investors and regulators may criticise ARAs for their length and complexity, but also argue against proposals to reduce or simplify disclosures. Some appear to want ever more disclosure – sensitivity analysis, for example, or the reasons behind valuations.

The IASB’s disclosure initiative overlaps and adds to its Conceptual Framework project. Some short-term quick wins include amendments to IAS 1 to provide guidance on materiality – clarifying that only material issues should be disclosed. In the medium term, the IASB will look in depth at a number of standards (IAS 1, IAS 7 and IAS 8) and financial statement presentation itself, with a view to removing or simplifying some requirements. This could ultimately lead to the creation of a disclosure framework.

There is general consensus that disclosure overload remains a problem for many in the financial reporting arena – users, preparers, auditors and standard setters. All must play their part in trying to ensure disclosures are clear and useful.

Given that disclosure overload is perceived to be a problem, there is considerable interest in seeing how technology could be used to make it easier for readers of accounts to handle the volume of information, and perhaps improve the way it is presented. International finance leaders are interested in such new ways of reporting information. The majority of those attending the FRO 2013 conference thought Annual Reports could be improved if some information was presented only on the company website.
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This idea has been considered in the past, but concern has been expressed that it could prevent some individuals, such as small shareholders, from accessing all relevant information. However, the merits of such approaches are likely to be discussed further in future.

Recent standards and current projects

Entities are coming to grips with a number of recent standards – on employee benefits (IAS 19R) and fair value measurement (IFRS 13) – identified by many participants in EY’s 2013 year-end technical update sessions as likely to have the biggest impact on their organisation’s next financial statements. Also of note are the standards relating to consolidation, joint arrangements and associates (IFRS 10, 11, 12, IAS 27, 28). Outreach activity has identified 21 issues with the way entities are applying IFRS 11, and additional guidance from the IASB could be helpful.

Would Annual Reports be better if recurring information (e.g., accounting policies and biographies) was just on the website?

| Yes | 72% |
| No  | 28% |

Source: FRO 2013

Which of the following IFRS changes will have the biggest impact on your company/group’s next financial statements?

<table>
<thead>
<tr>
<th>Standards</th>
<th>Impact</th>
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<tbody>
<tr>
<td>IAS 19 Employee benefits</td>
<td>25%</td>
</tr>
<tr>
<td>IFRS 13 Fair value</td>
<td>22%</td>
</tr>
<tr>
<td>IFRS 10 Consolidation</td>
<td>9%</td>
</tr>
<tr>
<td>IFRS 11 Joint arrangements</td>
<td>6%</td>
</tr>
<tr>
<td>All of the above</td>
<td>8%</td>
</tr>
<tr>
<td>None of the above</td>
<td>30%</td>
</tr>
</tbody>
</table>

Source: Year-end technical updates 2013

Work continues on convergence projects. The IASB will be coming under increasing pressure to take decisions on its final approach to financial instruments and insurance contracts, where reaching agreement with the US Financial Accounting Standards Board (FASB) is proving difficult.

Work on a large number of narrow scope amendments and annual improvements is also being requested from the IASB via its Interpretations Committee. Many are designed to help achieve consistent IFRS implementation. Post-implementation reviews are also important elements of the IASB’s work, with a review of segmental reporting completed and work underway on IFRS 3, which will include the impairment of goodwill.

The IASB also has a large number of research projects underway, has developed an interim standard on rate-regulated activities, and is reviewing the IFRS for SMEs, which is becoming an increasingly important standard around the world.
Strategic matters

Widespread IFRS take-up

To clearly demonstrate the spread of IFRS, the IASB has been compiling jurisdictional profiles. Of 81 completed profiles, 78 jurisdictions have publicly committed to a high quality set of global standards (Albania, Macao and Switzerland being the exceptions). Of the 81 jurisdictions profiled so far, 70 have adopted IFRS for at least some companies – and with very few modifications.

Nevertheless, although IFRS has wide coverage and support across the world, the goal of creating a single set of high quality global accounting standards has not yet been achieved.

G20 and FSB pressure

Sustained pressure for further progress continues to come from the G20 and the Financial Stability Board. The G20 has expressed repeated support for a single set of high quality global accounting standards and urged the IASB and FASB to complete their convergence work.

Much of the G20 request has been achieved. Agreement between the IASB and FASB has now been reached on revenue recognition. Discussion of the converged ED on leasing is hoped to result in a converged standard. The leasing proposals could have a substantial business impact, as identified by participants in EY’s year-end technical updates: 39% expressed concerns about their initial lease inventory, data collection and ongoing data management, whilst 20% were concerned about needing to implement new systems, processes and controls.

What concerns you most about the business impact of the implementation of the lease accounting proposals?

<table>
<thead>
<tr>
<th>Concern</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>A need to implement new systems, processes and controls</td>
<td>20%</td>
</tr>
<tr>
<td>Initial lease inventory, data collation and ongoing data management</td>
<td>11%</td>
</tr>
<tr>
<td>Impact on financial ratios including KPIs and profit measures</td>
<td>11%</td>
</tr>
<tr>
<td>Impact on procurement decisions</td>
<td>3%</td>
</tr>
<tr>
<td>Implementation resource requirements</td>
<td>7%</td>
</tr>
<tr>
<td>No concerns</td>
<td>10%</td>
</tr>
<tr>
<td>Not applicable</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: Year-end technical updates 2013

Agreement between the IASB and FASB is proving hard to achieve, however, in relation to insurance contracts and financial instruments. On the latter, work is ongoing in relation to classification and measurement, impairment, general hedge accounting and macro hedge accounting.

Looking ahead, the IASB would like the G20 to acknowledge that global standards promote growth, and recognise that the IASB is working in a multilateral way to develop IFRS. It would also like the G20 to recognise that IFRSs are international standards and that the IASB needs support so that it can retain its independence – which is vital for ensuring that its standards are fit for purpose.

Consistent implementation of IFRS is an important issue for the IASB. The Board has no power in relation to implementation or enforcement. It is working closely with other parties such as the European Securities and Markets Authority and the International Organisation of Securities Commissions, as illustrated by the joint protocol signed by the IASB and IOSCO.

The US factor

Where the standards issued by the IASB and FASB are converged, they need to remain converged. This could be a challenge if the US and international interpretations committees publish differing guidance. Such issues are already arising, with the US and IASB currently coming to opposite viewpoints on an aspect of share-based payment. The IASB and FASB have set up a joint body to consider implementation issues in connection with revenue recognition but the concern would be that this would happen for every standard.

Though there are convergence issues, IFRS has substantial take-up in the US. Foreign Private Issuers using IFRS have a market cap of around $5.7 trillion, for example. US multinationals use IFRS extensively for their subsidiaries. The US therefore has a strong interest in IFRS and its future development. Nevertheless, the Securities and Exchange Commission has not made any public statements about IFRS since 2012, much to the disappointment of the IASB. However, the SEC has a new chair, as has the FASB, and their views are awaited with interest.

As the bilateral convergence projects come to a close, the IASB’s multilateral approach will come further to the fore. The IASB has set up the Accounting Standards Advisory Forum (ASAF) involving 12 major standard setting and regional bodies, including FASB. ASAF meets monthly and discusses issues on the agenda of the IASB. The IASB wants to receive real-time advice based on views from around the world.
Other countries

From the IASB’s perspective, Japan is a source of both positive and negative signals on IFRS. On the positive side, a new stock exchange index is limited to companies applying IFRS – those using US GAAP are excluded. However, the intention in Japan is to introduce a new set of accounting requirements that is close to IFRS, but where certain elements may be carved-out, such as impairment of goodwill. This does not support the creation of a single set of global standards around the world. Meanwhile developments in China are encouraging in terms of national accounting standards being substantially converged with IFRS.

In Europe, the suggestion that IASB funding be linked to the protection of EU interests is a concern, although a sensible resolution is anticipated. The IASB also has two concerns in relation to the Maystadt report on the EU’s IFRS endorsement mechanism. The first relates to the potential lengthening of the endorsement process. The IASB is also concerned by the suggestion that economic effects and financial stability be considered, as this would open the door to political pressure and lobbying.

International finance leaders attending the FRO 2013 conference do not want the EU to have more influence over IFRS development. When polled, a clear majority of delegates voted for the EU to have less say in setting IFRS.

**Do you think that the EU should have more or less say in setting IFRS?**

<table>
<thead>
<tr>
<th></th>
<th>More</th>
<th>Less</th>
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<tbody>
<tr>
<td>Percentage</td>
<td>33%</td>
<td>67%</td>
</tr>
</tbody>
</table>

Source: FRO 2013

Has the success of IFRS triggered a counter reaction?

The growing importance of IFRS is illustrated by the IASB’s own research into its widespread use around the world, but there have been negative reactions as well. The UK has seen the challenge concerning the legality of using IFRS in financial statements, and debate about moving back to UK GAAP for banks. In Switzerland, 25 listed entities have moved back from IFRS to Swiss GAAP in the last few years, citing excessive disclosure as the main reason. The move triggered little negative comment from investors.

Consistency in application

The IASB should not ignore such developments. The creation of the ASAF is therefore welcome, providing a channel through which the IASB can stay in touch with national views. The IASB’s joint protocol with IOSCO is a positive step for the same reason, and will also enable further consistency in the application of IFRS in different jurisdictions.

Preparers will also be keen to see that due process is followed. For example, if issues are raised by IOSCO or others, they need to be discussed in an open manner, whether by the IFRS Interpretations Committee or the IASB itself. Participants in the financial reporting system also need to have confidence in the due process surrounding the IASB and FASB joint resource group set up to address matters of implementation on revenue recognition.

The stability goal

Standard setters are aware that, although preparers and users would like to see a period of stability with no further accounting changes, new and revised IFRS are still being issued. The IASB remains busy on many projects. A period of calm has been mooted – but when it might occur is unclear. Accounting standards need to evolve in line with the financial environment.
The UK perspective

The UK Financial Reporting Council is working to improve the quality of financial reporting. The application of judgement by preparers and auditors remains a vital requirement for achieving this goal.

Going concern

In November 2013 the Financial Reporting Council (FRC) published an Exposure Draft (ED) proposing changes to the UK Corporate Governance Code and the integration of guidance on going concern, risk and internal control, based on the previous Sharman report on going concern. It is proposed that boards would not have to make a going concern statement in the report and accounts, but they would need to make sure that the principle risk disclosures cover risks to liquidity and solvency – and are understandable and specific to the entity concerned.

Narrative reporting

The FRC encourages a core and supplementary approach to financial reporting and that the boards of premium listed companies should confirm that the report and accounts, in its entirety, is fair, balanced and understandable.

International finance leaders attending the FRO 2013 conference have limited expectations in terms of the likely impact of the FBU provision. When polled, over three-quarters (77%) of delegates did not expect the FBU provision to result in significant changes to their own company’s Annual Report and Accounts.

Do you think the new provision to confirm that your Annual Report and Accounts is fair, balanced and understandable will result in you changing your ARA significantly?

<table>
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<tr>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>23%</td>
<td>77%</td>
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</table>

Source: FRO 2013

New developments take time to have an effect. The FRC anticipates that the new FBU requirement should cut off extremes of reporting behavior and move people towards best practice, improving the average standard.

The FRC is aware that some preparers are having difficulties – for example, struggling with their legal advisers in the US who prefer lengthier and more detailed disclosures. Some are grappling with how to use the strategic report as a short form report.

IFRS

There was a legal challenge in the UK as to the validity of accounts prepared under IFRS. The FRC has taken legal advice, as has the government, and believes the matter is now settled. However, a number of substantive questions have been raised. For example, there is some concern over the visibility of distributable reserves and that the capital maintenance function of accounts is being overlooked.

There is also a desire for prudence to be more prominent in accounting standards. The FRC has given prudence prominence in the UK GAAP issued for smaller companies. The issue is relevant to the IASB’s Conceptual Framework project and the FRC will share its views, for example, on the importance of the business model and the need for companies to disclose information that is useful.
UK reporting framework

The new reporting framework being introduced in the UK by the FRC creates challenges for companies that have choices available. All entities (except those small enough to use the FRSSE) will be required to report in accordance with the new Financial Reporting Standard in the UK and Republic of Ireland (FRS 102) or EU-adopted IFRS. ‘Qualifying entities’ will be able to take advantage of reduced disclosure requirements under either FRS 101 (IFRS recognition and measurement with reduced disclosures) or FRS 102. Conversion to reporting under either EU-adopted IFRS, FRS 101 or FRS 102 has implications beyond an entity’s financial reporting function. Cash tax payments could be affected, for example.

A third of participants in EY’s 2013 year-end technical updates anticipate that the new UK framework will have a significant impact on their organisation.

Do you think the new framework will have a significant impact on your organisation?

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<tbody>
<tr>
<td>Yes</td>
<td>34%</td>
</tr>
<tr>
<td>No</td>
<td>50%</td>
</tr>
<tr>
<td>Don't know</td>
<td>16%</td>
</tr>
</tbody>
</table>

Source: Year-end technical updates 2013

When asked about what framework they would use, around a third (34%) of participants in year-end technical updates said their companies were considering the new UK GAAP (FRS 102 and FRS 103). A slightly smaller percentage (28%) identified FRS 101, whilst 20% said they were considering full EU adopted IFRS.

What GAAP is your company/group considering adopting?

<table>
<thead>
<tr>
<th>GAAP Type</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Full EU adopted IFRS</td>
<td>20%</td>
</tr>
<tr>
<td>FRS 101</td>
<td>28%</td>
</tr>
<tr>
<td>New UK GAAP (FRS 102, FRS 103)</td>
<td>34%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>17%</td>
</tr>
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</table>

Source: Year-end technical updates 2013

There is strong support for applying the same GAAP for each company in the group, except perhaps for dormant companies.

Is it likely to be the same GAAP for each company in the group?

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<tbody>
<tr>
<td>Yes</td>
<td>34%</td>
</tr>
<tr>
<td>Yes, other than dormant companies</td>
<td>41%</td>
</tr>
<tr>
<td>No</td>
<td>19%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Year-end technical updates 2013

The first mandatory non-UK and Irish GAAP financial statements are required for 31 December 2015 year ends. This might seem a long way off, but the time quickly passes when all intervening steps are considered. Gaining an early understanding of the business and financial impacts of change would allow management to anticipate and resolve key strategic and operational issues in good time. Nevertheless, when asked about their organisation’s preparations, only 14% of participants in EY’s year-end technical updates said they had a conversion plan in place or underway; 35% had not started any work in terms of assessing the impact of changing the financial reporting framework.
How far is your business in the process of assessing the impact of changing the financial reporting framework?

- Not started: 35%
- In the process of assessing impact: 51%
- Conversion plan is in place or underway: 14%

Source: Year-end technical updates 2013

One advantage of early planning is that companies could choose to move from current UK and Irish GAAP in advance of the mandatory date, should there be a benefit to do so. Based on responses to live polls during year-end technical updates, however, only a minority of companies will be making an early change to a new reporting framework.

The role and value of audit

At the time of the conference, mandatory audit tendering and speculation over EC proposals for mandatory audit firm rotation were key topics of conversation.

Delegates were asked for their thoughts on tendering:

Do you prefer tendering or mandatory firm rotation?

- Tendering: 81%
- Mandatory firm rotation: 19%

Source: Year-end technical updates 2013

Will your company/group be changing to a new reporting framework early (i.e., before the mandatory date)?

- Yes: 12%
- No: 63%
- Don’t know: 25%

Source: Year-end technical updates 2013
Do you believe audit tendering will have a big impact on you?

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<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td></td>
<td>58%</td>
<td>42%</td>
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</table>

Source: FRO 2013

The FRC recognises that confidence in the audit is still lacking amongst some commentators such as journalists and academics, and that more needs to be done to address this. Action has been taken, as shown by the Competition Commission’s requirement for the FRC to extend its audit firm inspections across the FTSE 350. Many participants in year-end technical updates were sceptical about the impact of the Competition Commission’s proposals as a whole. In live polls, over half (54%) expected the competitiveness of the audit market to remain unchanged, with 44% anticipating greater competition.

Do you expect the audit market to become more competitive after the two-year Competition Commission investigation?

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<table>
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<tr>
<th></th>
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<tbody>
<tr>
<td>More competitive</td>
<td>44%</td>
</tr>
<tr>
<td>The same as before</td>
<td>54%</td>
</tr>
<tr>
<td>Less competitive</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: Year-end technical updates 2013

True and fair

The requirement to show true and fair financial statements is already contained in IAS 1. The FRC’s Conduct division has made clear that preparers are not only entitled to override standards if they believe the result is not true and fair – they must override.

Issues for concern

Overregulation is a concern for preparers of financial statements. Nevertheless, the majority of participants attending the FRO thought the current regulatory environment did support them in making effective judgements when preparing their ARAs.

Do you think that the current regulatory environment supports you in making effective judgements and estimates when preparing your Annual Report and Accounts?

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<tbody>
<tr>
<td>Yes</td>
<td>43%</td>
</tr>
<tr>
<td>No</td>
<td>57%</td>
</tr>
</tbody>
</table>

Source: FRO 2013

At the time of going to press the EC’s regulations on audit have moved forward significantly, including mandatory audit firm rotation. In response, the Competition Commission has delayed the implementation of its ‘remedies’ by a couple of months to see what finally transpires within the EU.

Judgement

The FRC supports principles-based regulation, which always requires judgement to be applied. Regulators must protect those who apply judgement carefully and conscientiously. Those preparing and auditing accounts should be encouraged to make good judgements, communicate their thought processes carefully and make sure they have evidence for their judgements.
Companies need to seize the initiative and respond to the public’s call for greater transparency over the taxes they pay.

Many issues are causing concern in the press and amongst the public, including perceptions that:

► Companies are not paying a fair amount of tax in jurisdictions where they do business
► Companies are artificially avoiding tax
► International tax rules are outdated, for example, in relation to internet-based trading
► Companies are being secretive in using tax havens
► Rules are too complicated

International finance professionals attending the FRO 2013 conference also have concerns – in a live poll, the majority expressed the view that large multinationals are not paying their fair share of taxes.

Do you believe that large multinationals pay their fair share of taxes?

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<tr>
<td>Yes</td>
<td>34%</td>
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<td>No</td>
<td>66%</td>
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Source: FRO 2013

Concerns over corporate tax payments are being raised in numerous forums. Parliamentary committees (such as the Public Accounts Committee in the UK) question the activities of companies. NGOs and particularly charities are vocal in challenging corporate tax planning strategies, particularly in the developing world. The media and governments are participating in the debate. The G20 and G8 are also involved, with the G8 summit in Northern Ireland in the summer of 2013 calling for greater transparency and an overhaul of international tax rules. The OECD is at the forefront of work to look at the basis of international taxation, how the rules work and what additional disclosures need to be made to the tax authorities to ensure the tax system is properly policed.

There has been an escalation of issues over the last few years. In the US, the Dodd-Frank legislation requires extractives companies to publish data on the taxes they pay in every jurisdiction in which they do business, though the rule is currently vacated following a legal challenge. The EU accounting directive requires the same for EU extractives and logging businesses from 2016. The Capital Requirements Directive IV requires similar reporting for banks and financial institutions. Commissioner Barnier is actively calling for the principles of country-by-country reporting to be applied across all big business in the EU. The OECD is taking action with its Base Erosion and Profit Shifting (BEPS) initiative – within which EY welcomes the recommendation that any country-by-country reporting be to tax authorities rather than public. In the UK, businesses supplying services or goods to the UK government now have to provide additional reporting on the taxes they pay to
ensure they are compliant with rules on a global basis.

Given such developments, it is not surprising that a recent EY survey of 70 of the largest businesses in the UK found that transparency is now a boardroom issue. Nearly 69% of companies surveyed are actively considering exceeding legal requirements in their disclosures in order to respond to the fair tax debate. However, companies also express legitimate concerns about transparency: the burden of trying to gather the data, the issue of whether disclosures might fuel further questions because of the complexity of the subject, and the risk of disclosing potentially commercially-sensitive information.

EY’s May 2013 report Tax transparency – Building confidence stresses the need to rebuild confidence in the system. This is despite the fact that companies may have legitimate reasons for not paying tax in a jurisdiction, such as carrying forward a loss. The public also needs confidence that the tax authorities have the ammunition and power to be able to police the international tax system. In boardroom discussions, increased transparency is being considered as a powerful way to do that.

In EY’s view, a ‘one size fits all’ approach is not the solution. Mandatory country-by-country reporting in ARAs will not help rebuild confidence in the system. Companies need to consider the best approach for them in the circumstances they face. Some companies are already providing specific information such as greater analysis in their tax reconciliations, or increased description of policies or management processes. Some make disclosures in their ARAs, website or CSR report.

Some company reporters may still need convincing of the need for action. Only a small percentage of delegates attending EY’s year-end technical updates expected to gather more data or enhance their tax disclosures in order to make them more transparent.

Are you planning to provide any additional tax disclosures or undertake any additional data gathering to prepare for potential questions related to your tax transparency?

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<th>Yes</th>
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<td></td>
<td>19%</td>
<td>81%</td>
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Source: Year-end technical updates 2013

Nevertheless, there is an increasing trend in the FTSE 100 in particular for companies to actively consider the level of transparency they need to give, and where and how they report. In many cases there is more companies could do to explain their policies and procedures around their planning, why they do it, how they do it and where they pay taxes. They need to do this because of the gap between public perception and reality.

This issue will remain important not least because of the need for ongoing austerity policies. Companies need to consider the response appropriate for them, given their stakeholders, public profile and peer group activity. It is important to assess the risk of questions being asked about why corporate tax is paid in one jurisdiction but not another, or why tax paid is a relatively low proportion of profits. Some businesses in some sectors are more likely to face potential challenge than others.
**Strength in diversity**

Encouraging diversity is the ‘right’ thing to do – but above all it is an absolute business imperative.

The majority of international finance leaders attending the FRO 2013 conference believe that diversity is business imperative as opposed to a ‘nice to have.’

**Do you believe diversity is a business imperative or nice to have?**

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<thead>
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<th></th>
<th>Business imperative</th>
<th>Nice to have</th>
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<td>Percentage</td>
<td>54%</td>
<td>46%</td>
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Source: FRO 2013

There are many reasons why diversity is a business imperative. Talent is important for businesses if they are to remain relevant to their customers. This requires continuous innovation, and the best innovation comes from enhancing diversity.

As the economy recovers, so competition for talent will increase. Businesses with strong reputations for supporting equality in the workplace, and taking diversity seriously, position themselves well for attracting talent. Tapping into the widest talent pool is also important because many economies have ageing populations. If businesses continue to recruit from the same talent pool, their growth will be stifled.

Diversity isn’t sufficient on its own, however. People need to feel included and that their contributions and different perspectives are valued. Research within EY has found a direct correlation between the level of engagement of EY people and the quality of the brand in the market; the higher the engagement, the stronger the brand. EY businesses with the most highly engaged people and best brands deliver substantially higher revenue per person per year, and achieve significantly higher profitability.

Developments such as Lord Davies’ call for more women in the boardroom are crystallising attention on gender diversity. Organisations such as EY appreciate the necessity of gender diverse boards in order to deliver better business performance and capitalise on opportunities. Recent global EY research suggests that by the end of 2014, the global wealth controlled by women will exceed the combined GDP of China and India.

Diversity is not just about gender, however. In fact, the real focus needs to be on ‘Difference’ – a concept understandable to people of all types in all countries because everybody is different to one another. Most people have felt like an outsider at some point – an assertion confirmed in a poll of delegates attending the FRO 2013 conference.

**Have you ever felt like you are an outsider?**

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<tr>
<td>Percentage</td>
<td>52%</td>
<td>48%</td>
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Source: FRO 2013

Many employers now provide training in unconscious bias. Every individual needs to be aware of their unconscious bias and have tactics to deal with it. EY works with its partners and senior executives to help them understand what it means to be an inclusive leader. Such initiatives are essential for achieving maximum benefit from diversity and difference in the workplace.
Economic outlook

Economic data suggests the UK economy is finally enjoying some recovery, but it is unclear whether this will be long-lasting. Many threats remain.

The UK economy appears to be growing again – and possibly faster than any other big, developed economy. Growth is due to increased household consumption, government spending and net trade – but business investment has played no part.

The recovery is not being achieved through a rebalancing of the economy. Manufacturing is recovering, but activity is still way below its level before the financial crisis. The UK’s persistent trade deficit remains an issue. 1983 was the last year that the UK did not borrow from the rest of the world. In the first quarter of 2013, the UK deficit was 5.5% of GDP – a modern record. Though it subsequently reduced to 3.2% in the second quarter, this level is still not sustainable. The persistent deficit explains why UK indebtedness keeps rising and the UK faces a long journey to mend its public finances.

Consumers have been saving slightly more than before the financial crisis, but now the trend seems to be moving back towards increased consumption. There is also a clear trend of rising house prices. The ratio of house prices to earnings has fallen from its peak, but remains high by historical standards. The ratio of household debts to earnings has fallen – but at around 140% of disposable income also remains high by historical standards. Rising interest rates would be a problem – many households would find it difficult to service their debts. The UK recovery therefore remains reliant on cheap money.

Meanwhile, the eurozone is on symptom-suppressing painkillers supplied by the central bank. Necessary reforms – such as the centralisation of decisions on tax and spending, shared funds for bank ‘resolution’ and deposit insurance – are elusive.

Further afield, the China miracle appears to be coming to an end. China has provided almost all the global growth of the last five years, so its economic health is important. But private sector lending is now 200% of GDP. Since 2008, bank lending in China has increased by $14 trillion – an amount equivalent to the size of the US banking system. Such a high rate of lending is not sustainable.

All these factors affect the UK’s outlook, so how strong is the UK recovery? The UK has too much debt and is no longer self-sufficient in energy. The UK economy is not necessarily fixed. It is vital that the consumer-led recovery encourages businesses to invest and sell more to the rest of the world. The recovery may continue through to the next UK general election in 2015 – but this is not guaranteed, and there is a risk of return to crisis thereafter.

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