



Financial Reporting Problems Revisited

The problem with financial reporting (particularly for smaller practitioners) is the sheer size of the burden. Over the years we have seen financial statements grow increasingly longer with more and more emphasis placed on narrative disclosures. This article will consider some more frequently occurring stumbles made by practitioners which should be avoided because, like it or not, professional regulators will pick up on these failings and could spell trouble for those accountants who consistently fail to even try to get aspects of financial reporting correct.

Failing to Depreciate Fixed Assets

Both the Companies Act and FRS 15 *Tangible Fixed Assets* require fixed assets to be depreciated. There are only two exceptions to this rule:

- Investment properties, which are not depreciated in accordance with SSAP 19 *Accounting for Investment Properties* which is achieved by invoking the true and fair override of Companies Act 2006 requirements; and
- Tangible fixed assets where it can be demonstrated that depreciation is immaterial.

If you cannot demonstrate that depreciation is immaterial, you must apply depreciation.

Depreciation on Revalued Fixed Assets

It is not uncommon for companies to revalue their buildings (or indeed any other tangible fixed assets). When an entity has revalued its fixed under the alternative accounting rules some practitioners take the view that if the revaluation is done at the year-end, then no depreciation charge should be reflected in the accounts. FRS 15 requires an entity to charge depreciation on the carrying amount of the revalued asset at the balance sheet date and to charge depreciation in its entirety on the revalued amount.

Non-Disclosure of Non-Depreciation of Investment Properties

As mentioned above, investment properties are carried in the balance sheet at their market value in accordance with SSAP 19 and as such no depreciation is charged. The fact that no depreciation is charged on investment properties means that the true and fair view override in the Companies Act has been invoked and therefore disclosure of this fact must be made in the financial statements. Lots of practitioners forget about this disclosure requirement which can be worded as follows:

No depreciation is provided for in respect of investment properties in accordance with the Financial Reporting Standard for Smaller Entities (effective April 2008). Such properties are held for their investment potential and not for consumption within the business. This is a departure from the Companies Act 2006 which requires all properties to be depreciated and the directors consider that to depreciate them would not enable the financial statements to give a true and fair view. Investment properties are stated at their market value at the balance sheet date.

Personal Guarantees Made by Directors

Personal guarantees of the directors or mortgages on their assets became disclosable under the Companies Act 2006 and they are also disclosable under FRS 8 *Related Party Disclosures*.

Changes in Accounting Estimates

Some practitioners are guilty of becoming confused between a change in accounting policy and a change in an estimation technique and getting into a muddle. Changes in policies and estimates are two completely different issues and have significant differences in the accounting for them both. If a client changes a depreciation policy (from, say, three years straight line to 25% reducing balance) this is not a change in accounting policy; it is a

change in estimation technique and is applied going forward (prospectively). Some practitioners view this as a change in accounting policy and apply it retrospectively (causing more work for themselves) which is incorrect. Conversely some practitioners consider that changing the classification of a cost from, say, cost of sales to administration expenses need not be applied retrospectively. Such a change is a change in accounting policy and needs to be treated as such. The disclosures required under FRS 18 *Accounting Policies* also need to be made.

Long-Term Grants

Some government grants which fall to be treated as deferred income are often released to the profit and loss account over a long period of time. Such grants need to be split between current and non-current liabilities. Some practitioners hold grants which will be released over a period exceeding 12 months in current liabilities in totality which is, of course, incorrect. The portion to be released to the profit and loss account after 12 months needs to be treated as a long-term liability .

Also, in respect of grants, a disclosure which is often forgotten about is the effect the grant(s) has on the financial statements. Make sure you disclose the effect the grant has on the results for the period.

Abbreviated Financial Statements

It is not uncommon (for practitioners who do not use reliable accounting software) to refer to abbreviated financial statements as 'modified' financial statements. This is not the correct terminology! Some practitioners have expressed their frustration to me during lectures about this issue when, in reality, abbreviated financial statements have been known as such for many years!

Website Capitalisation

A lot of practitioners often capitalise website development costs because they view such costs to relate to periods of (say) three to four years. UITF Abstract 29 *Website Development Costs* states that such costs can only be capitalised if such costs create an enduring asset (the term 'asset' is defined in the Statement of Principles). The UITF have concluded that in their opinion such costs can only be capitalised if the website is capable of generating revenues e.g. by way of an ordering facility.

Some practitioners have also claimed they have been criticised by regulators for classifying website costs as 'tangible' fixed assets rather than 'intangible' fixed assets. UITF 29 covers this issue at paragraph 7 where UITF concluded that websites fitted neither classification perfectly and that certain website costs were of the type considered in paragraph 2 of FRS 10 *Goodwill and Intangible Assets*. As a result, such costs are treated as tangible fixed assets.

Audit Exemption Incorrectly Claimed

Another favourite up there in the ranks of the top 10! It is astonishing the number of practitioners who are compelled to explain to regulators why they have claimed audit exemption for their client when they are not entitled to do so. The failing is down to the fact that some practitioners apply the small companies test and not the audit exemption test when deciphering whether the client is able to apply audit exemption. Remember, audit exemption cannot be claimed when ONE out of the three criteria used for small companies exemption are breached. It is only the small companies exemption test that uses two out of the three.

Emphasis of Matter Paragraphs

One practitioner recently claimed that he had been criticised during a regulatory visit because his software package included an emphasis of matter paragraph before the audit opinion paragraph. Emphasis of matter paragraphs should always be placed AFTER the opinion paragraph – not before.

Another common failing amongst practitioners is the failure to cross-reference the emphasis of matter paragraph within the auditor's report to a disclosure note made elsewhere in the notes to the financial statements. Emphasis of matter paragraphs, by definition, are included to alert the user of the accounts to an issue within the financial statements (e.g. a going concern disclosure), so the paragraph should always cross-refer to a note in the accounts.

Retrospective Audits

If a client has been eligible to claim audit exemption in the prior year, but fails the audit exemption test in the current year (for example if they revalue an asset which takes them over the £3.26m gross assets test), you do not have to go back and audit the previous year. During a conversation with a practitioner it became apparent that they had gone back to the previous year and begun auditing the prior year when the prior year had been approved and signed off months ago! This was done in an attempt not to issue a qualified audit opinion in relation to the opening balances.

The major issue you need to consider in the current year when the prior year was not audited is the materiality of the opening balances and the impact of these on the audit opinion. If you cannot get sufficient appropriate audit evidence to satisfy yourself that the opening balances are free from material misstatement (and there are techniques auditors can use to gather such evidence and thus express an unqualified opinion), the audit report must be qualified appropriately. Also, even if you issue an unqualified audit report, you must make reference in the audit report that the previous year's comparatives were not audited. Many audit firms are criticised for failing to make this disclosure.

Solicitors Accountants Report

Solicitors may be required to submit a Solicitors Accountants Report and Checklist to the Solicitors Regulation Authority six months' after their year-end. The accountant signing the report must be qualified in accordance with Rule 37. Staff of firms who are not qualified in accordance with Rule 37 must not sign the report!

Provisions for Liabilities and Charges

It is worth mentioning at this point that this issue is probably one of THE most favourite of the regulators! Lots of practitioners fall foul of this trap and there is really no excuse for falling into this trap because it is one of the most simplest of traps to avoid.

Provisions for liabilities and charges are no longer referred to as such in the Balance Sheet – they are simply called 'Provisions for Liabilities' and regulators are quite hot on this issue – so be warned!

Boiler-Plate Policies

I have covered the issue of 'boiler plate' policies in previous financial reporting problems articles, but unfortunately lots of practitioners are still being slapped on the wrists for using them! For the sales policy you cannot just say "turnover is stated net of VAT and trade discounts" or for stock "stock is valued at the lower of cost and net realisable value". You need to expand further on these points by including points such as when turnover is recognised, the policies for (say) service revenue and the valuations placed on stock and how net realisable value is ascertained. Regulators are very keen on these issues so be sure to include such policies.

Citing excessive workloads or "I did not know this was required" is unfortunately not an acceptable excuse to the regulators and no amount of claims that "it's simply ridiculous" will get you out of jail!

Operating Lease Disclosure

Whilst to many accountants, such disclosures are (apparently) meaningless, the notes to the financial statements must show operating lease commitments split between 'land and buildings' and 'other operating leases' which the company is obligated to pay within one year, two to five years and more than five years. If you have rents paid in respect of buildings for a client, you will need to include these in the operating lease disclosures. Regulators often cite this issue as a main failing in their review of financial statements.

Balance Sheets

And finally, we come to the 'King' of all financial reporting stumbles (and really this should be made a criminal offence!) which is allowing the approval of financial statements and submission of these accounts when the balance sheet does not balance. It is amazing just how many times this is cited in regulators criticisms. The use of reputable accounts production software will alleviate this, but many accountants do not use such software – but this is not an excuse which the regulators will gladly accept for this failing!



Steve Collings is the audit and technical partner at Leavitt Walmsley Associates and the author of 'The Interpretation and Application of International Standards on Auditing' (Wiley March 2011). He is also the author of the AccountingWEB Guide to IFRS (Sift Media May 2011) and lectures on financial reporting and auditing issues.