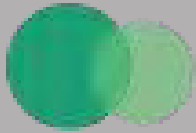


Issue No.15 Winter 2023



*Think***TWENTY20**

The Magazine for Financial Professionals



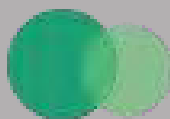
COP27, A Case of Looking Forward?

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OpenAI – A new Frontier

Lease accounting - the state of play

For Profit: A History of Corporations



Number 15, Winter 2023

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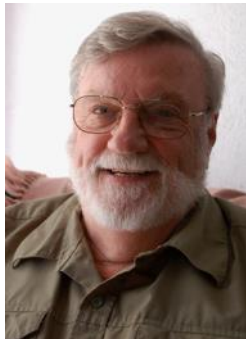
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Editorial



Gerald Trites, FCPA, FCA, CISA
Editor-in-Chief

Artificial Intelligence has been capturing more attention in recent times and becoming much more pervasive in numerous applications and corporate systems. During the past couple of years, AI has become more visible to the average person, through the advent of OpenAI and such applications as ChatGPT, which was introduced last November. In this issue, Eric Cohen writes about this application – what it is and what it can do – and explores the potential ramifications for the accounting and financial profession.

Those potential ramifications are indeed profound. That can already be seen in its impact on education, because ChatGPT can write papers for students in a matter of minutes. The papers can look quite good and it is difficult for professors to determine the source of the student submissions. Up until this point, professors have been able to use Google or even plagiarism detection software to check sources. Those options are far less effective with ChatGPT.

Of course, Apps like ChatGPT will have very positive effects as well, by facilitating analytics, speeding up reports, developing customized documents and much more. Moreover, it is rapidly evolving, and will be a lot more powerful over coming months and years. In future issues and on our website, we will be tracking this amazing new development.

-GDT

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ThinkTWENTY20

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ThinkTWENTY20: Up Front and Personal

In brief:

What it is: A new series of monthly webcasts from *ThinkTWENTY20*, featuring the editors, special guests, and you.

When: Starting February 13

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Now there is a new way for our community to interact.

On **February 13**, join us for the first of a new series of interactive webcasts for our subscribers, which we are calling ***ThinkTWENTY20: Up Front and Personal***. Each month, our Editors will join the *ThinkTWENTY20* community to share more information on what they have written, inform the community on what they are researching, and receive feedback on the priorities of the community. In addition, special guests – our writers, our sponsors, and other interesting and informative speakers – will join in future sessions. **For this inaugural session, we will kick off with a discussion between you and our editors - Eric Cohen, Gerald Trites and Gundi Jeffrey - on current issues they have been researching and writing about. This will include major developments such as OpenAI, the Changing Role of Corporations in Society and Cryptocurrency/blockchain audit implications.**

You can learn more about our Editors at <https://thinktwenty20.com/index.php/about-us> - they bring a wealth of experience, knowledge, communications skills, and grasp of the history and potential future of the profession.

While the first session is free for all, each month thereafter our premium subscribers will have the opportunity to join our speakers, ask questions, and directly influence the direction of *ThinkTWENTY20*. The sessions will also be available on delay for the general *ThinkTWENTY20* community. We are working on other benefits for our premium subscribers, including continuing professional education credits.

You will hear about the latest on topics of interest to financial professionals, with a special concentration on topics like AI, blockchain, cryptocurrency and digital assets, ESG/sustainability, robotic process automation, and XBRL. Issues might include:

- Will ChatGPT change Internet search ... or accounting?
- How will ethics impact services that provide assurance on ESG reporting if the service providers aren't traditional auditors?
- How do the FASB board's tentative decisions that are related to cryptocurrencies impact business?

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COP27, A Case of Looking Forward?

By *David Wray, ACA, CPA, CGA*



David Wray, ACA, CPA, CGA, MBA, BFP, President, DFCG International Group & co-founder of the DSD-Lab, has held finance executive roles in the technology industry for 25 years. He is a transformation expert, sharing his views on accounting governance, organizational impact, change management, digitization and large-scale transformation. David recently published his Amazon best-selling book The Power of Potential: A Straightforward Method for Mastering Skills from Personal to Professional.

The 27th Conference of the Parties to the United Nations Framework Convention on Climate Change, more fondly known as COP27, yielded much optimism albeit was peppered with a few ongoing concerns.

Let me elaborate...



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Optimism Underpins COP27

The ISSB

The International Sustainability Standards Board (ISSB) was announced just about a year ago during COP26 in Glasgow. And what a year it has been!

Meaningful progress has been made toward the goal of developing and maintaining IFRS Sustainability Disclosure Standards that meet capital market and investor information needs. To that end, the 14-member Board, chaired by Emmanuel Faber, represents all major regions with offices in Montreal, London, San Francisco and Frankfurt in place. Additionally, a memorandum of understanding was signed in late December (2022) with the Chinese Ministry of Finance (MoF) to establish an inaugural three-year ISSB office location in Beijing. Discussions are actively underway for offices in Tokyo, and to evaluate opportunities to further engage with developing and emerging economy jurisdictions.

A purpose-driven approach for inclusion underpins the ISSB location strategy. It is a refreshing approach to change the long-standing social equality challenges surrounding the historical “we know best” approach to standard setting affecting a diverse international community. This change was widely applauded in Egypt by emerging and developing countries, countries that have historically felt excluded from international body debates and decisions.

Meaningful progress has been made toward the goal of developing and maintaining IFRS Sustainability Disclosure Standards that meet capital market and investor information needs.

The ISSB actively integrated the Value Reporting Foundation and the Climate Disclosure Standards Board (CDSB) into the organization. Existing sustainability standards and frameworks were built into their standards’ development work. Those include the Sustainability Accounting Standards (SASB) and the Taskforce on Climate Related Financial Disclosures (TCFD) recommendations. The result of these efforts was the issuance, in March 2022, of two draft proposed standards – the *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1) and *Climate-related Disclosures* (IFRS S2). These exposure drafts generated more than 1,300 stakeholder comment letters. The key messages were clear:

- Broad support for the ISSB and both exposure drafts, IFRS S1 and IFRS S2.
- Strong support for a baseline of sustainability standards applicable to global capital markets.
- Importance of connecting sustainability reporting to the financial statements.
- Reflect further on the scalability of the standards to global preparers’ sustainability reporting maturity curves (e. g., SMEs versus large corporates, developing economies versus mature economies, etc.).

As if these accomplishments alone were not enough, the ISSB announced other important commitments and partnerships during their COP27 events.

Three are particularly important for CFOs and capital market participants:

1. A new Partnership Framework to assist jurisdictions around the world to prepare, adopt and implement the ISSB sustainability-related disclosures. Through this partnership the ISSB will drive a coordinated effort to support preparers, investors, and other capital market stakeholders to improve collaboration at the regional and international level.
2. The ISSB announced an alliance with CDP, a non-profit organization that offers a global environmental disclosure platform to support companies in managing their sustainability-related risks and opportunities. The intent of the alliance is for CDP to incorporate the IFRS S2 requirements into its platform to reduce fragmentation and the disclosure burden on companies while simultaneously increasing consistency of information for investors.
3. The Financial Reporting Council of Nigeria (FRCN) announced that it intends early adoption of IFRS S1 and IFRS S2 standards, which Emmanuel Faber said “.... is yet a further signal of the momentum behind the ISSB’s objective to deliver a common language for sustainability-related disclosures worldwide. ” Unlocking the largest

economy in Africa has the potential to materially change the region's economy by attracting more regional investment and boosting the private sector.

What do these announcements mean in practical terms for the chief financial officer and the finance team?

Integration & Implementation

At its core, the ISSB intends to publish its first two International Reporting Standards (IRS): *General Sustainability-related Disclosure (S1)* and *Climate-related Disclosures (S2)* in 2023. The standards will provide guidance on when, what, why and how companies report on sustainability-related matters. Implementation guidance will greatly aid in adoption and application of these standards. The result will be much greater clarity for preparers and assurers alike on the sustainability-related reporting requirements.

The ISSB announced an alliance with CDP, a non-profit organization that offers a global environmental disclosure platform to support companies with managing their sustainability-related risks and opportunities.

Building the connectivity between the International Accounting Standards Board (IASB) and the ISSB will ensure that the standards are compatible and avoid inconsistencies, which would be a significant step toward process simplification, integrated reporting, and quality and usefulness of the information itself.

The benefits for preparers will be both internal and external in nature. Internally, there will be benefits in process efficiency and effectiveness, and better data for management decision-making purposes. Externally, the benefits will include a cost of capital rate that reflects the preparer's decisions, impacts and strategy. It will also facilitate access to international capital markets not previously accessible, particularly for developing and emerging economy companies. External regulations will also be powerful levers for internal organizational change as we've previously seen with new revenue recognition accounting standards, market regulation or governance requirements, among others.

Interoperability Through Building Blocks

Aligning and connecting with jurisdictional initiatives, such as those of the SEC or EFRAG, and the Global Reporting Initiative (GRI) will facilitate a building block approach. A building block approach is a dimensional and connected one that shines a light on both downstream and upstream results of the standard. The downstream results within the IRS context include reference to the assessment and reporting of an entity's past period sustainability performance, and the impact that it has on its stakeholders (primarily oriented toward investors and capital markets). Upstream includes reference to the assessment and disclosure of the company's future (or planned transition) actions, and may include supplier transitions, product design changes (toward more sustainable sources, manufacturing techniques, etc.), innovation, flexibility and resource utilization.

Using this approach allows international sustainability standards to build on what already exists, help create or contribute to a global system, and accommodate different views of what information stakeholders require. A good example is the importance of internationalizing SASB Standards, a specific comment from many respondents given their proposed applicability to IFRS S1. Building blocks can help accelerate the coordination and

harmonization of sustainability reporting, while offering a baseline of requirements that result in the dissemination of information that is relevant in assessing a preparer's value. Perhaps most importantly, this approach to interoperability will also aid in jurisdictional acceptance of international sustainability-related reporting requirements through its collaborative and progressive change approach.

Notwithstanding the incredible progress and promise from the heavy lifting done by the ISSB, it is not without its critics.

Climate is Not Enough

The pressure on the ISSB to include nature in disclosure requirements mounts. Critics want to see reporting and disclosure standards that help companies articulate how they use and affect resources and relationships for creating, preserving and eroding value over time. For instance, what about biodiversity, human capital, human rights and just transition? All recurring themes throughout the COP27 events.

This criticism was addressed head-on at COP15 in Montreal in mid-December (2022) when the ISSB agreed "...how to describe sustainability and clarified that a company's ability to deliver value for its investors is inextricably linked to the stakeholders it works with and serves, the society it operates in, and the natural resources it draws on."

What should we expect from the ISSB acknowledging that nature and climate are inextricably linked?

We can expect to see an improvement to the IFRS S2 proposed standard to include information disclosures relating to the connection between climate and the natural ecosystems (e. g., water, biodiversity) and the human capital aspects of the climate resilience transition (i.e., just transition).

We can also anticipate further exploration and development of additional standards to address more widely the topics of biodiversity, human capital, human rights and the specific connectivity between financial statements and sustainability reporting.

We can also anticipate further exploration and development of additional standards to address more widely the topics of biodiversity, human capital, human rights and the specific connectivity between financial statements and sustainability reporting. For instance, the ISSB can build on the work done by the IASB on Management Commentary (fondly known as first half of the report or the MD&A section) and also on the Integrated Reporting Framework.

One organization that has long championed the importance of embedding nature into decision making is the Capitals Coalition, a non-profit organization. Their capitals approach enables organizations to understand how their success is directly or indirectly underpinned by natural capital, social capital and human capital, empowering them to make decisions that offer the greatest value across all capitals.

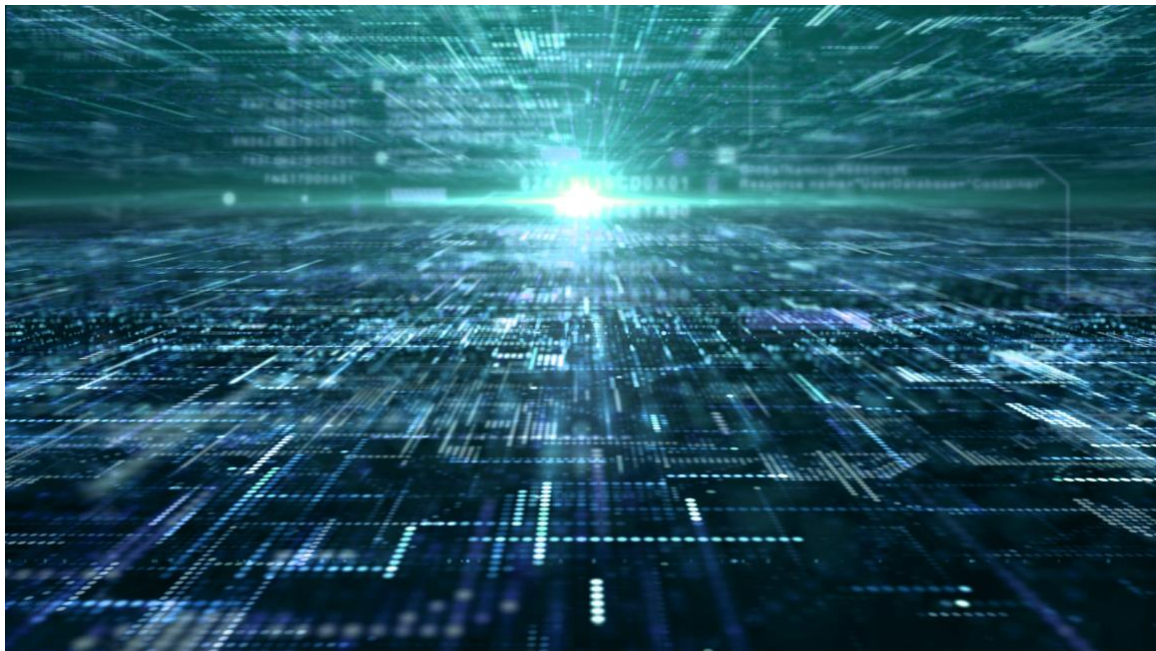
The [Natural Capital Protocol](#) is a useful "decision-making framework that enables organizations to identify, measure and value their direct and indirect impacts and

dependencies on natural capital. ” The Capitals Coalition is an active contributor and advocate in this global dialogue and will undoubtedly influence how the ISSB establishes international standards for these topical areas.

Beyond the traditional topics, another area is finally getting the COP27 airtime that it deserves: digitalization.

Digitalization

Digitalization is crucially important for companies and users alike when it comes to mandatory sustainability reporting and disclosure. To that end, Bellona hosted a Children’s Investment Fund Foundation event on this very topic: *The path to global digital sustainability disclosure*.



Source: Adobe Stock Image

Jean-Paul Servais, IOSCO Chair, opened the panel by addressing the importance of an integrated and connected digitalization approach to all company disclosures in all jurisdictions.

While it sounds easy, it is fraught with difficulty. Today, there is a distinct absence of international stakeholder agreement around several key aspects affecting the efficacy of machine-readable data.

The fundamental issue is the lack of international collaboration to establish an interoperable infrastructure that, at its most basic level, is the ability to compare, share and use information across the supporting digital data ecosystem. For instance, in the context of the greenhouse gases (GHG), interoperability means the extent to which results generated by different implementations of GHG accounting systems can be compared and/or leveraged. Today, there is a proliferation of corporate GHG reports that are using different interpretations and input data, even when following similar standards and protocols.

Interoperability does not require uniformity but, rather, requires design for the comparison and translation of digital information among different systems. This is compounded, and acknowledged by IOSCO, because differing market needs and regulatory priorities are

inadvertently accelerating development of siloed digital taxonomies around the world. This further increases the risk of a lack of global interoperability, a lack of data lineage and misaligned data definitions and taxonomy structures for sustainability-related information reporting and disclosures.

How does this issue affect the ecosystem stakeholders beyond the obvious cost impacts?

The path to global digital sustainability disclosure panel members acknowledged that the existing alphabet soup of digital taxonomies and initiatives are not easily embedded into software for multi-taxonomy reporting. In this, micros, small, medium enterprises (MSMEs) are disproportionately affected as they often lack the resources needed to bridge the data gaps - a material issue when one considers that according to the World Bank, they represent about 90% of businesses and more than 50% of employment worldwide. MSME companies are unsurprisingly often deeply embedded in global supply chains, local economies, and communities.

So, achieving a global baseline requires strong focus on supporting implementation across all economic environments so that every market participant can enjoy its benefits. This requires specific consideration to the environment and circumstances of emerging and developing economies, as well as small entities that operate within global supply chains.

The panel discussion left the audience with a clear message that solving the digital divide is critical to ensuring that no one is left behind!

How Can the Issues Start to Be Practically Solved?

Solving the challenges around digitizing sustainability information flows is larger than the industry can solve on its own. What is needed is for key players across the global system to collaborate under a common objective: actively collaborate toward an agreed global digitized data management structure for sustainability, treating sustainability data with the same control, governance, transparency and assurances as that of financial statement data disclosures.

On this front, there is hope. A [project](#), “Digitalization of Sustainability Data,” hosted by the Capitals Coalition, is starting to ignite the digital connectivity change that the world needs. A consortium of international stakeholders, including XBRL International, DFCG, EDM Council and Capitals Coalition, have been working together for over a year to solve these technical issues under the DSD-Lab umbrella. A visual flow (Figure 1) was recently developed to help illustrate the global digital data interoperability challenge being tackled. The project’s purpose is within the context of the public interest and establishes a strong foundation from which to start resolving the connectivity gaps.



Figure 1: Reprinted under creative commons licence 4.0 Attribution: DSDLab. org

One of the DSD-Lab founders, DFCG, is a non-profit CFO member organization based in France with a network of peer CFO organizations throughout Europe, Africa and Latin America. Its engagement provides a direct link for cross-functional and cross-jurisdictional industry and the CFO perspective, which facilitates engagement with an experience-rich stakeholder group, an important consideration to secure preparer buy-in and acceptance of an outcome.

Three areas of focus for CFO engagement surfaced within COP27. They are also areas that organizations like DFCG and CPA Canada are focusing on for their members. They are:

1. Financial capability and mindset development.
2. Participation in international sustainability standard setting and audit and assurance standard setting efforts.
3. Strengthening data management for sustainability-related data and information.

The digitalization of a company's processing and handling of data requires additional professional finance skills and a new mindset. Understanding and valuing the intersection of people, processes and technology have never been more important in shaping the digital-related capabilities needed for achieving success. Three key digital skills are emerging as foundational: digital literacy, data management proficiency, and data science. An accelerator in the capability journey is the convergence and collaboration of three typically siloed functions: finance (CFO), sustainability (CSO) and data management (CDO).

Understanding and valuing the intersection of people, processes and technology has never been more important in shaping the digital-related capabilities needed for achieving success.

On the engagement front, within the context of digitalization, the focus is the proposed taxonomies. To date, the SEC, EFRAG and IASB have all had their own unique approach to taxonomy design and structure – that must change. We need standard setters and regulators to come together to agree on a common architectural approach and best practices that allow for interoperability (connectivity) and localization (differing regulatory speeds). Preparers can influence this in one of two ways: engaging with professional accounting association working groups (e. g., Canadian Securities Administrators ([CSA](#)), Chartered Professional Accountants ([CPA](#)) Canada or a provincial CPA body) or through industry professional networks (e. g., [DFCG](#) International Group, [XBRL](#) International or the Accounting for Sustainability ([A4S](#)) CFO Network). The key is taking concrete action within the association or body that works best to include your views on taxonomy proposals or development.

Where To Next for CFOs?

There is no doubt that international sustainability standards development is a journey, one that will take time, effort and compromise to achieve within a reasonable period. The ingredients are certainly in place to do so and do so quickly, without diluting due diligence processes.

It Is Up To Each of Us To Act

First, and most easily, we can comment in the coming months on the proposed sustainability standards and the related taxonomy to help the ISSB create the best possible

set of comprehensive international sustainability-related digital-ready reporting standards. This engagement extends to the current work by the International Audit and Assurance Standards Board ([IAASB](#)) to assess possible verifiability, auditability or assurability issues, as well as assess the auditing or assurance implications of the ISSB pronouncements.

CFOs, and other stakeholders, are wise to consider and remain abreast of other standard-setting efforts by, for instance, the US Securities and Exchange Commission ([SEC](#)) and the European Financial Reporting Advisory Group ([EFRAG](#)). In these areas, we need to influence domestic and/or regional regulatory bodies to align their sustainability standard-setting efforts with the ISSB and IOSCO. Only when there is a common set of international baseline sustainability standards will we see consistency, comparability and reduced reporting and disclosure burdens. Together, our collective voices can, and must, drive positive change.

Lend your technical standards expertise to international cross-functional and cross-jurisdictional efforts to solve the digital machine-readability challenge by engaging with the Capitals Coalition's Digitalization of Sustainability Data project.

Review the organization's data management practices against industry best practices, including practices around cleansing, modelling, business intelligence, analytics, decision-making and forecasting. Sustainability data needs a comparable quality data management and governance approach to that in use for financial data.

The organization's data management approach needs to embody capabilities required to establish, enable and sustain a mature data management discipline. It must embed the organization's strategy, organizational structure, technologies and operational best practices to ensure data readiness for digitalization. Last, but certainly not least, it must include data ethics which will be essential in sustainability data and information management given that much of it is generated externally.

A useful tool to consider in completing an organizational data management assessment is The Data Management Capability Assessment Model ([DCAM](#)) developed by the EDM Council. EDM Council is a non-profit industry group dedicated to "elevating the practice of Data Management as a business and operational priority."

A Final Call to Action

While, in many ways, the COP27 events and call to action messages are not new, they are becoming more pronounced and louder. We each stand in a position of influence and at an inflection point.

As finance professionals we have a pivotal and trusted role to play to help steer our organizations through the winds of change as sustainability reporting is elevated in importance and value to all stakeholder groups. The changes demanded by markets, societies and consumers give us an opportunity to rise to the challenge. Attending COP28 in the UAE this year could be a personally energizing step to see, feel and hear firsthand the urgency, need and passion to solve the planetary issues we all face, both as finance professionals and global citizens.

It is well within our grasp to choose a path that unlocks greater equality, fairness and inclusion for all companies, stakeholders, and societies while actively respecting and protecting the planet that we all depend on for our lives!



Expect More Major Audit Failures

By Gregory Shields, CPA, CA



Greg is a member of the board of directors of the University of Waterloo Centre for Information Integrity and Information Systems Assurance (UWCISA). Before retiring, he was CPA Canada Director, Auditing and Assurance Standards. He has since undertaken numerous projects to develop non-authoritative auditing guidance on various topics, such as data analytics and audit of accounting estimates.

Successive sudden and major corporate collapses have caused serious economic and social damage in the UK and elsewhere. While auditors are not responsible for corporate collapses, they are increasingly being blamed for failing to do their job by not alerting stakeholders to matters that may indicate an impending corporate failure. All too often, a collapsed company has provided misleading information to stakeholders that its auditors failed to detect and report.

The UK government has recently started various initiatives, including changes to regulations, to help build trust and credibility in that country's audit, corporate reporting and corporate governance system.¹ Large auditing firms indicate that they are continuing to improve their quality control processes and use more sophisticated and effective automated audited procedures, including data analytics. Quality control standards for firms have also recently changed. While no doubt helpful, will these efforts prevent the most egregious headline grabbing failures? Likely not. These failures, while devastating, are rare and hard to prevent – behavioural and audit firm cultural factors will always cause a few auditors to ignore rules, codes and quality controls and behave unethically.

Major Audit Failures Are Rare but Devastating

Major audit failures are rare. The top 20 stock exchanges worldwide have a total of over 30,000 registrants (ranging from a few very large companies to many smaller ones) that must be audited.² Out of all these audits, there are less than a handful of major audit failures that make headlines each year. However, corporate stakeholders and regulators quite rightly view even a few major audit failures as too many because of their devastating large scale financial and social effects, including a loss of trust in capital markets. Arguably, these failures are similar to “black swan events” – rare, unpredictable events that have severe negative consequences. Regulatory and audit firm initiatives will not eliminate major audit failure but may help turn them into “grey swan events” – still catastrophic but more predictable and less likely to occur. The reason is that various initiatives cannot effectively address all significant factors that underlie audit failures.

Factors Underlying Major Audit Failures

Audit failures often go hand-in-hand with corporate failures. In their meta-analysis, Kish-Gephart, Harrison and Trevino suggest that corporate failures result from factors relating to

*bad cases, bad apples and bad barrels.*³ Bazerman, Lowenstein and Moore propose a number of factors that lead to unethical behaviour by auditors.⁴ Table 1 shows some of both sets of factors.

Table 1 – Examples of Factors Contributing to Unethical Behaviour by Auditors

BAD CASES (<i>Characteristics of specific circumstances encountered that may provoke unethical choices</i>) *	
Ambiguity	Significant judgments required by accounting and auditing sometimes allow for considerable interpretation and leeway.
Approval	Self-serving bias of auditors and management are more likely to align since auditors do not make original accounting judgments (they either approve or reject those of management).
Attachment	Auditors are under significant pressure to retain important clients to avoid loss of audit and consulting fee revenue and to help advance their public accounting careers.
Discounting (temporal immediacy*)	Potential negative consequences for auditors of standing up to management pressure are viewed as clear and immediate (e.g., loss of the client, loss of employment). Potential positive consequences are viewed as distant and uncertain (e.g., avoiding a lawsuit against the firm and maintaining its reputation).
Escalation	Auditors may decide to conceal a matter that is now material when it results from an accumulation of matters previously ignored because they were mistakenly interpreted as being immaterial.
Familiarity (proximity*)	Auditors are more likely to decide to risk harming faceless corporate stakeholders than harming their relationship with client management with whom they are familiar.
Minimizing the magnitude of consequences	Underestimating or ignoring the potential total amount of harm that could result from unethical choices. *
BAD BARRELS (<i>Organizational environments that have negative characteristics</i>) *	
Poor ethical climates and cultures	Environments that reduce or negate the effectiveness of codes of conduct and other policies, procedures and controls. *
BAD APPLES (<i>Psychological characteristics of some members of management or the audit engagement team</i>) *	
External locus of control	<i>Tendency to offload blame to someone or something else.</i> *
Low level of job satisfaction *	
Low level of moral development *	
Machiavellianism	An aptitude for deceiving people for personal gain. *
Moral relativism	An attitude that an unethical act is acceptable because of a perception that everyone else does it too. *

Notes:

1. *Source: Kish-Gephart, Harrison and Trevino (see reference in endnote 3). Other factors noted were identified by Bazerman, Lowenstein and Moore (see reference in endnote 4).
2. Descriptions of factors have been significantly abbreviated and simplified from the original material.

In rare circumstances, a bad case may be concurrent with an audit firm having a bad barrel culture and the audit engagement team being led by a bad apple. The accounting profession is

not rife with crooks, however, and audit failures sometimes result because factors make auditors vulnerable to unconscious bias.⁵ A major audit failure, when the engagement partner is not necessarily a bad apple, might look somewhat like this:

- The company being audited is far from meeting marketplace expectations regarding its financial or other performance targets. Senior management (some of whom are bad apples) decide to fraudulently manipulate financial results to present a picture that will help ensure that the prices of the company's stock do not decline. In particular, they take advantage of areas of accounting that involve estimation uncertainty, complexity and subjectivity (i.e., areas of ambiguity). Examples include when and how much revenue to recognize on long-term contracts, determining cost allocations, making estimates such as those related to credit losses, inventory obsolescence and determining whether goodwill or intangible assets have been impaired. Management uses a combination of biased assumptions, methodologies and selection of data in determining amounts to be recorded and presented in its financial statements. As a result, the company's financial statements are not prepared in accordance with generally accepted accounting principles and are, therefore, misleading.
- Audit and other fees earned from this client are very large, not only for the particular office undertaking the engagement, but for the firm as a whole. Therefore, the engagement partner and other firm personnel are under significant pressure to not risk losing this client. Resisting how company management proposes to account for various transactions would greatly increase this risk. As directed by the engagement partner, the audit team is not very skeptical about some key aspects of management's accounting. Management's rationalizations are accepted on the basis that there are many judgments involved. The team relies heavily on management's representations without obtaining sufficient appropriate evidence from other more persuasive sources.
- Previous audits led by the same engagement partner identified similar dubious approaches to accounting by management but they were judged to be immaterial. For the current year, the immateriality argument is no longer valid. Management points out, however, that the auditor has accepted the proposed accounting treatments in the past, so it is not reasonable to change course now.
- Under significant pressure from company management, and a strong desire to retain the client, the engagement partner does not raise any concerns with the audit committee, agrees to issue a clean audit opinion on the financial statements and not mention in the auditor's report, as key audit matters, significant debates held with management regarding aspects of their accounting. The engagement partner convinces the engagement quality reviewer (who also does not want to risk losing the client), to concur with her decisions.
- The company's efforts to pretend it is successful fail and it collapses. Subsequent investigations determine that, in the view of regulators, the audit failed. Lawsuits against the company and auditors ensue.

No firm wants audit failures and their codes of conduct prohibit bowing to undue client pressure. But, because of factors like those in Table 1, some of their assurance personnel may be highly motivated to go along with what management wants, even when they know, or should know, that this decision would contravene generally accepted accounting principles, generally accepted auditing standards, rules of professional conduct and their firm's code of

conduct. A key question, then, is whether these factors can be mitigated so that the number of major audit failures, if not entirely eliminated, can be significantly reduced.

Reducing the Attachment Factor

The attachment factor often means putting an accounting firm’s business interests (i.e., making sure to keep audit clients who pay high fees) ahead of professional interests requiring independence from the client. The view has often been expressed that the best way to eliminate this attachment factor would be to replace the current “client-pays-the-auditor” model. The Project on Government Oversight (POGO) provides reminders of other models that have been suggested, including risks that likely would make them unworkable (see Table 2).⁶

It seems highly improbable that legislators, regulators and auditors would cooperate to undertake a high-cost, very complex initiative to change the current model when its outcome might not improve auditor objectivity. To paraphrase Winston Churchill’s comment on democracy, the current model is the worst, except for all the others.

Table 2 – Possible Alternatives to “Client-Pays-Auditor” Model

Options	Risks
1. Government regulator performs the audits. Funding provided by taxation.	<ul style="list-style-type: none"> • Political interference (including withholding adequate funding) as result of lobbying. • Many qualified auditors may not want to become public servants.
2. Government regulator assigns and pays auditors. Funding provided by audited companies.	<ul style="list-style-type: none"> • Lobbying risk (see above). • Complexity in determining appropriate audit fees.
3. Stock exchanges assign and pay auditors. Funding provided by audited companies.	<ul style="list-style-type: none"> • To attract and keep listed companies, exchanges may have a strong incentive to make audits less costly or burdensome. • Complexity in determining appropriate audit fees.
4. Insurance companies provide policies to pay investors if, post-audit, audited financial statements are found to be false. The insurance company hires and pays auditors, with fees recovered from the insured companies.	<ul style="list-style-type: none"> • Highly complex issues around wording of terms of insurance policies and assignment of auditors. • Insurance company and auditors could have a strong incentive to hide problems discovered after completion of an audit that would result in large claims having to be paid.
5. Companies periodically engage third party “red teams” paid on a contingency basis, depending on the size of any required restatements they identify. These engagements would be in addition to traditional annual audits.	<ul style="list-style-type: none"> • No incentive for companies to engage “red teams.” • Business model would not work for “red teams.” If they found a significant problem resulting in a company’s collapse, they likely would not get paid.

Changing the Culture of Audit Firms

Negative views on the ethical culture of audit firms can be quite extreme. For example, in their 2018 submission to the UK CMA's *Statutory Audit Market Study*, a group of academics and audit experts asserted that the culture and ethics of auditing have failed miserably at too high a cost to society. In their view, the Big 4 firms have become entirely profit-oriented commercial entities, helping clients to secure public contracts and assets while avoiding taxes on an industrial scale, producing a generation or more of professional accountants who have gone on to run big corporations with this culture and values, so spreading the virus.⁷ Even those with more moderate views, however, were likely taken aback when regulators fined some large firms millions of dollars because personnel, including auditing professionals, cheated on training exams (including ethics-focused training).^{8 9 10}

Maintaining independence and objectivity are fundamental to an effective culture for audit firms. The UK CMA Market study revealed some troubling information about criteria used by companies to select auditors. In a sample of FTSE company audit committees, 23 out of 24 explicitly used criteria such as "fit," "cultural fit" and/or "chemistry." Only nine explicitly included "exercising skepticism" and/or "challenging management" as criteria.¹¹ Descriptions of "cultural fit" included having closer affinity, being relationship focused, showing a strong desire to work with the company and not being too difficult in discussing accounting treatments. Only rarely did good cultural fit refer to being able to effectively question and challenge management.¹² Some auditing firms took the position that use of terms like "chemistry" and "cultural fit" simply reflect the role of important service quality factors, which are key parameters of competition in an industry like auditing.¹³

The CMA study concluded that the weight attributed to factors like "cultural fit" and "chemistry" calls into question whether the current tendering approach rewards auditors for being close to management, rather than providing independent challenge.¹⁴ Also, the CMA concluded that, despite input received from firms to its study, audit appears to have a relatively weak voice within these firms in driving culture and values.¹⁵

But, while firms are working to improve their cultures, major accounting failures continue to occur.

The concern that auditors may have too weak a voice in large firms is leading regulators in some jurisdictions to urge firms to split into two separate entities. One would provide assurance services (e.g., audits, reviews), the other advisory and consulting services. The SEC believes that auditor independence is grounded in an understanding of accounting as a profession rather than an industry, which is critical to serving the public interest.¹⁶ Auditors are expected to be objective and challenge clients when appropriate. Consulting and advisory services, on the other hand, are an industry entirely focused on working with clients to improve many aspects of their business. Therefore, the ethical cultures required for each of the respective types of services are, in many respects, incompatible.

EY has indicated that its partners will be voting on whether to split that firm. Other firms have not said whether they will follow EY's lead. Even if they do, effects could be temporary. After the collapse of Enron and implementation of the Sarbanes Oxley Act in

the US over 20 years ago, some firms split out their consulting arms but, like starfish, they regrew them. That is not surprising since the audit process often provides insights into where a company could improve aspects of its operations. Also, a service such as recommending how to address weaknesses in internal control identified during the audit is an important by-product of the audit, clearly in the public interest and, therefore, allowed by rules of professional conduct. Other advisory services are also allowed if the firm has implemented appropriate safeguards to ensure its independence. Therefore, auditors are likely to continue to be tempted to expand services beyond auditing. But questions arise as to how effective safeguards can really be. For example, it would likely be quite difficult to design and implement effective safeguards when a firm is providing business acquisition advisory services to a non-audit client and one or more of current or potential acquisition targets are audit clients. Therefore, splitting auditing from consulting is, at least temporarily, likely to help implement an audit-focused culture in a new separate assurance services entity.

Changing audit firm culture is not easy. A recent study (a synthesis of previous research) indicates that the culture of an audit firm is most oriented toward quality if its leadership emphasizes professionalism over commercialism, promotes ethical judgments and facilitates learning through systems, integration of specialists and interpersonal interactions among auditors. This involves embedding mechanisms (organization conditions) such as rewards, training, resources, organizational design, systems and procedures. Those mechanisms influence perceptions of audit firm culture, auditor behaviour, work attitudes and audit quality.¹⁷ But, while firms are working to improve their cultures, major accounting failures continue to occur.¹⁸

Recent changes in standards for quality management of firms providing assurance services mirror the above, and will help firms address complexities related to cultural change. These new standards specifically recognize, for example, that audit quality management is not a separate function of the firm – it is the integration of a culture that demonstrates a commitment to quality with the firm's strategy, operational activities and business processes. Also, the standards contain specific requirements and supporting guidance to establish quality objectives, systems and processes that recognize the importance of maintaining professional ethics, values and attitudes.¹⁹

As well as continuing to making significant technical advances, auditing firms must, at the same time, firmly commit to putting ethical conduct ahead of business considerations

Nevertheless, cases will no doubt still arise where the integrity of audit personnel will be severely tested by client pressure, and pressure from within the firm, to put the firm's and personal financial interests ahead of professional interests. Realistically, personnel may focus on trying to avoid putting their household finances in jeopardy. A strong desire to continue putting food on the table will sometimes win out.

Brace for More Scandals and Audit Failures

The Economist suggests that if, as expected, the global economy sours, we should brace for a wave of scandals as a result of corporate fraud – “The big scandals play out like tragic dramas: when the plot twist arrives, it seems both surprising and inevitable.”²⁰ Major audit failures are often linked to corporate collapses, so more are likely on the way. Most recently (at time of writing), the crypto world was rocked by the collapse of FTX, with a complaint alleging audit failure.²¹

Going forward, some firms may still put much of their effort into improving audit quality by continuing to design and implement more effective and efficient automated audit procedures. But as famous physicist and author Arthur C. Clarke said, “As our own species is in the process of proving, one cannot have superior science and inferior morals. The combination is unstable and self-destructing.”²² As well as continuing to making significant technical advances, auditing firms must, at the same time, firmly commit to putting ethical conduct ahead of business considerations. Otherwise, the profession may as well push a self-destruct button on its credibility and the esteem in which it would like to be held.

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 - ¹⁵ CMA *ibid*, para. 3.208.
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AI and the Future of the Profession: The Emergence of ChatGPT and Seeing the Potential

By *Eric E. Cohen, CPA*



Eric E. Cohen, CPA, is a technologist with a passion for collaboration toward the goal that “a piece of business information, once entered into any system, anywhere, never needs to be retyped as it moved through the business reporting supply chain.” He’s also a prolific author, engaged in virtually every effort to standardize accounting and audit data, a national expert to a wide variety of standards efforts, and co-founder of XBRL.

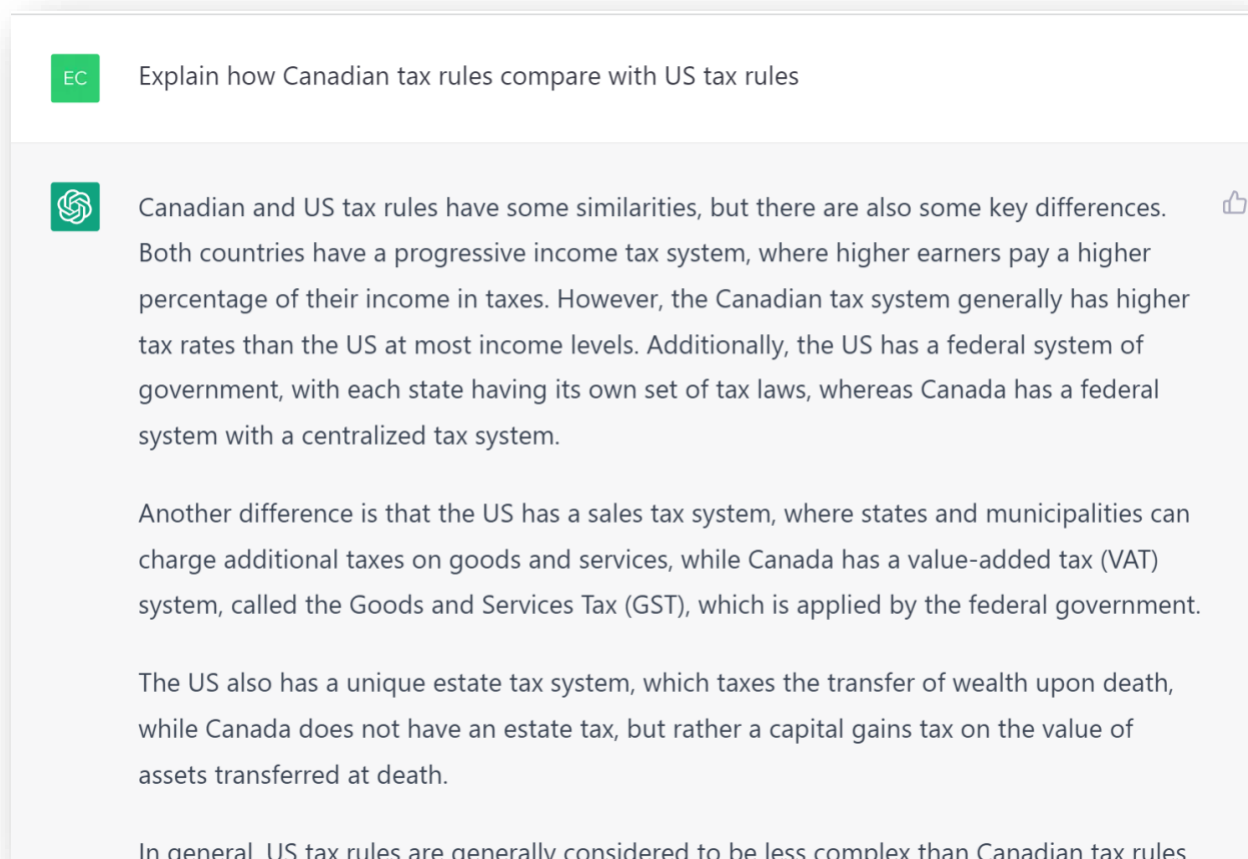
ChatGPT: An introduction

In November 2022, a new conversational artificial intelligence (AI) tool known as ChatGPT¹ was unleashed on the world. Millions of people have become obsessed – or at least are wowed – by what this AI application can do. In its brief public lifetime, it has already brought tens of billions² of dollars in investment offers and had an incredibly disruptive impact on education³ and publication forums. Writers, marketers, advisers and researchers muse on whether they will soon be out of a job. What about the direct impact on the financial profession?

On the surface, ChatGPT is like having a really, really, really smart and incredibly knowledgeable (but still fallible) friend who can type very, very quickly, is moral but doesn’t bear a grudge, and has an incredibly wide range of knowledge. It is as facile with 1980 British comedy shows as with US GAAP and IFRS, with theology as with taxation. See Figure 1.



Figure 1: How ChatGPT Is Trained On Theology And Taxation, Poetry And Pro-Formas

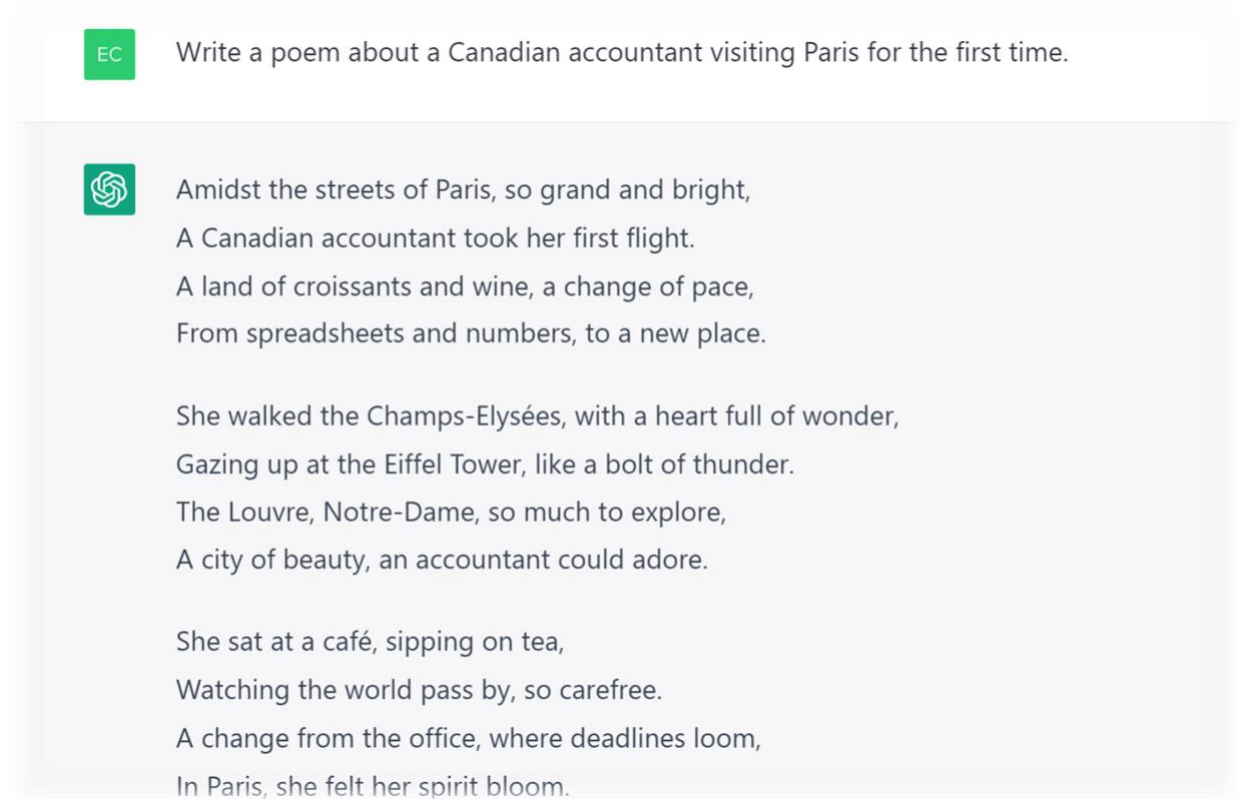


It interacts with the user conversationally. You have a dialogue with it, giving it information, asking it questions and seeking clarification or fine tuning the interaction. It admits mistakes, challenges inappropriate requests, and programmatically has a bit of sharp wit to it. ChatGPT does not have access to the Web to look up information it has not already been trained on, and the vast knowledge it has currently ends in 2021. While interaction is enormously simple, getting the right answer often depends on the user tweaking the conversation just the right way.

The GPT part of ChatGPT stands for “Generative Pre-trained Transformer.” Perhaps oversimplified, that means it takes your text prompt as input and uses the information it was trained on to create responses. That response may be a simple answer, and ChatGPT as a better front-end for search engines is broadly contemplated. However, ChatGPT has been trained on how to produce more specific kinds of responses, able to produce song lyrics, poetry (See **Figure 2**), advertising copy⁴, contract templates, financial statements, and many other specific document formats. In two months, the power of ChatGPT in creating content has been

so evident, there is already controversy about ChatGPT being listed as co-author on research papers. While AI and IP is a longstanding issue⁵, ChatGPT has brought the issue to the forefront.

Figure 2: Poetic style or legal contracts – ChatGPT Can Create It



The screenshot shows a chat window with a white background. At the top left, there is a green square icon with the letters 'EC' in white. To its right, the user's prompt is written in a grey font: "Write a poem about a Canadian accountant visiting Paris for the first time." Below this, there is a green square icon with a white circular logo (the OpenAI logo). To its right, the AI's response is written in a grey font, consisting of a poem about a Canadian accountant in Paris. The poem is formatted with line breaks and includes a stanza with a larger indentation.

Write a poem about a Canadian accountant visiting Paris for the first time.

Amidst the streets of Paris, so grand and bright,
A Canadian accountant took her first flight.
A land of croissants and wine, a change of pace,
From spreadsheets and numbers, to a new place.

She walked the Champs-Élysées, with a heart full of wonder,
Gazing up at the Eiffel Tower, like a bolt of thunder.
The Louvre, Notre-Dame, so much to explore,
A city of beauty, an accountant could adore.

She sat at a café, sipping on tea,
Watching the world pass by, so carefree.
A change from the office, where deadlines loom,
In Paris, she felt her spirit bloom.

At the present time, exploring the basic power of ChatGPT is free to users, with paid options. Access to the free version is often limited, as so many people are trying to use it that the system is often over capacity. Other options to access ChatGPT are already being announced, including Microsoft announcing plans to incorporate it into Azure OpenAI Service.⁶ While the online version has been trained with a huge amount of background information, users can create their own instance of ChatGPT, although collecting and preprocessing a huge amount of information is necessary for that to be successful.

Above all, it is important to remember ChatGPT is a tool that can accelerate many human endeavors. In the right hands, it can facilitate creativity, accelerated learning, and rapid publication. In the wrong hands, bad things can happen. It is a *conversational* tool – as the pandemic brought insulation and interpersonal challenges, it can be very satisfying for those insulated by circumstance to have an incredibly knowledgeable, non-judgmental, conversational partner as ready to discuss philosophy as technology, the arts and accounting.

Interacting with ChatGPT

As you have seen in the illustrations, ChatGPT interactions begin with the user making a statement, posing a request, or asking a question. The statement can be to add context, such as “Let’s pretend you are a staff accountant at a CPA firm,”⁷ that will drive the conversation. ChatGPT interprets the request and responds. During the course of a conversation, ChatGPT “remembers” what was discussed earlier in the conversation, so topics can easily be built-upon or otherwise tweaked.

It is important to remember, however, that it is a “large language model trained by OpenAI.”⁸ That means it has limitations. These include:

- It is not itself connected to the Web. However, it can work with programs, leverage APIs, and act beyond its native capabilities. It can interact with UiPath and other Robotic Process Automation tools.
- It does not experience time or perceive the world outside of text-based interactions. You can’t ask about your weather today.
- It does not have personal preferences or opinions or make judgements about questions asked of it – however, clever queries get around that limitation. Ask it if Kirk or Picard was the better Star Trek captain, and it will push back. But ask why people might prefer Kirk to Picard or the other way around, and it won’t shut up.
- It is highly literal. I asked it “where the kookaburra sits,” referencing the song “Kookaburra Sits in the Old Gum Tree.” The initial response ignored the song, but when I followed up, it told me about the background of the song, its inaccuracies (“while the song is a fun and catchy tune, it is not entirely accurate when it comes to the kookaburra's diet and behavior”) and schooled me on my question.

For those of us accustomed to working with an AI agent like Siri, Google Assistant or Alexa, there is a small learning curve. The personal assistants open applications, update your calendar, and dim the lights while changing the television channel. ChatGPT is like conversing with a person, meant to engage in long conversations. ChatGPT can create a financial statement from underlying data (see the Addendum for a simple example of that process), provide a draft outline for an article, presentation or seminar, and lead the user through the thought process on just about any topic.

What the user gets out of it, however, is highly dependent on what they put in; the experienced user will get different results than what a newcomer would. Ask ChatGPT a general question (e.g., “What might a sales agreement between an agricultural firm and a nursery look like?”), you get a general answer. But push the point (e.g., “What might the agreement actually look like?”), and it prepares the document for you. (See **Figure 3**).

My experience is that ChatGPT pushed back when asked to create or provide feedback on Python programming code or XML instance documents but, when pushed, did an admirable job at these tasks. The potential for ChatGPT to perform an initial review of smart contract code or track changes may be useful in accelerating a blockchain-enabled business world.

Figure 3: Agreement for The Sale Of Plants

AGREEMENT FOR SALE OF PLANTS

This Agreement, made and entered into on the date of acceptance of this agreement by the buyer, by and between (Agricultural firm name) (hereinafter referred to as "Seller") and (Nursery name) (hereinafter referred to as "Buyer").

1. Parties: The parties to this Agreement are the Seller and the Buyer.
2. Description of Goods: The Seller agrees to sell and the Buyer agrees to purchase the following plants (hereinafter referred to as "Goods"):

(a) Type of plants: _____ (b) Variety: _____ (c) Quantity: _____ (d) Any other relevant details: _____

3. Price and Payment Terms: The price for the Goods shall be (insert price) per unit and the Buyer shall make payment as follows:

(a) _____ percent upon acceptance of this Agreement (b) _____ percent upon delivery of

Potential Benefits of ChatGPT for the Financial Professional

The broad availability of ChatGPT has made the potential of AI to help the financial professional in many ways far more obvious. We will cover the risks ... such as whether the professional will rely on AI and especially the amazing but limited ChatGPT rather than engaging a human expert where the expert is the far better answer ... below. But first, we should examine the possibilities.

Almost an expert system

ChatGPT is trained on a wide variety of topics, including accounting and auditing ... although only through 2021. In seconds, ChatGPT can provide a starting point for research on any topic. The profession has researched expert systems for years, the pandemic made it difficult for juniors to get in touch with managers for direction, and ChatGPT has quickly led forward on three of the four components of expert systems (the knowledge base, the search/inference system, and the user interface); the knowledge acquisition cannot be far behind.

ChatGPT can be used to help prepare users with knowledge specific to the work they need to do (see **Figure 4**), develop specialized audit checklists, assisting in the development of the audit documentation and outlining the presentation to the audit committee, and otherwise streamline work flows. The dialogue approach, combined with the ability to establish a context, could lead to ChatGPT being used to interview clients, their experts, or other third parties.

Figure 4: Specialized Audit Guidance

When auditing inventory for an agricultural organization, there are a few key things to pay attention to:

1. Accurate counts: Ensure that the physical counts of inventory match the recorded quantities in the organization's inventory management system.
2. Valuation: Check that the organization is valuing its inventory correctly, in accordance with generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS).
3. Aging: Review the organization's aging report to ensure that slow-moving or obsolete inventory is identified and properly accounted for.
4. Documentation: Make sure that proper documentation, such as purchase orders, invoices, and receiving reports, is on file to support the organization's inventory counts and values.
5. Compliance: Verify that the organization is compliant with any relevant laws, regulations, or industry standards related to inventory management and storage.
6. Pest Management: verify that the organization have implemented pest management system and have records of it.
7. Temperature control: verify that the organization have implemented temperature control systems in storage area and have records of it.

Enabling The Knowledge Worker

I have only begun to find the ways ChatGPT can help me in my everyday work. It can create presentations, it can do so in different languages (“how would I say that in Chinese, Japanese and Russian?”) and assuming different tone (“how would that sound if spoken by William Shakespeare, e.e. cummings or Robert Frost?”) and in brief or more detailed iterations.

ChatGPT may help in understanding the company and its environment and other due diligence tasks. For example, it may help the user find interrelationships between organizations about which the user was unaware.

I was watching a, older British comedy show, “Father Ted”, which included a fake funny commercial. During the fake commercial, a phone number was given: 0898 333 201. Over to ChatGPT. I asked ChatGPT if it was familiar with a different phone number first –0118 999 881 999 119 7253⁹. Initially, ChatGPT just replied why it is not a valid phone number but - given additional context that it was from “The IT Crowd” - it offered a bit more background. Then on to 0898 333 201. It offered that the phone number was used on the BBC Radio 4 comedy series "I'm Sorry I Haven't a Clue". The number is the fictitious "Answerphone" number. When I asked about “Father Ted”, ChatGPT let me know it was indeed also used on “Father Ted”, that it was broadcast on the same network and written by the same team as “I’m Sorry I Haven’t a Clue”, a relationship of which I was unaware.

Risks

There’s an old adage that every change brings loss, and every loss has risks. Reiterating a prior point, ChatGPT is an incredible opportunity to sit down with a powerful and broadly user-friendly tool to be able to see what it can do and begin to think through the potential benefits, the related risks, and consider the means of remediating the risks to be able to enhance the

benefits. Most of the general risks people are talking about are not new because of ChatGPT, but the availability of this powerful tool has exacerbated them.

Students are using ChatGPT to cheat. They are submitting essays that ChatGPT prepared instead of creating their own work. They are doing homework and taking tests and having ChatGPT come up with the answers. While ChatGPT makes it easy, however, students have gotten copies of homework and tests from students who took the course before, subscribed to services like Chegg, Course Hero or Quizlet, or went online to Reddit's r/Accounting forum for help for years.

White hat hackers (the good guys) have been exposing that ChatGPT gave them guidance on how to hack a web site or create malware,¹⁰ under the pretense that it was information to help a company prepare itself against hackers. I tried to have ChatGPT tell me how my clients might seek to fool me with ChatGPT ... I was *not* able to convince it to help me, so they may have altered their algorithms.

Client Privacy and Confidentiality Issues

Users are encouraged to be careful not to type confidential information into the tool. The financial professional has legal and ethical responsibilities related to privacy and confidentiality, and the allure of the tool may lead to information being disclosed that should not be disclosed.

The same power that may make ChatGPT great or interviewing means that employees might be directed with falsified emails to a ChatGPT instance where they are interrogated and confidential information is extracted. Social engineering attacks may lead to breaches in cybersecurity.

Misinformation And Inability to Properly Interpret Appropriate Information

So, it becomes obvious that ChatGPT can be an engaging way to get answers to questions and scenarios where developing the background and expertise would take a great deal of effort. That in itself means that misinformation may be missed and even correct information might be out of context. The OpenAi folks themselves note that ChatGPT can produce "plausible-sounding but incorrect or nonsensical answers."

When I teach about how the Extensible Markup Language (XML) and the Extensible Business Reporting Language (XBRL) reduce ambiguity in business communication to students, I ask them if they can find ambiguity in the business request to "Please deposit \$50,000 into my CA bank account on 02/02/23." I asked ChatGPT if there were ambiguities to be cleared up in that statement, and it initially said "No." But as I pushed – is "\$" unambiguous? How about the date 02/02/23? How about CA? (Canada, California, or some other identifier?) – it capitulated that these were issues with regional and other challenges.

Undermining The Quality of Audit Evidence

ChatGPT accelerates the process of creating any number of customized documents. Frauds involving the creation of customized documents polluting the audit trail fill the textbooks. Certainly, this isn't new – malfeasance using falsified documents has been around a very long time. However, documents, reports and other content created with AI can make identifying falsified documents more difficult than ever before.

Combinations of DeepFakes and conversational AI like ChatGPT can make video more difficult to trust than ever before.

Where Does it Go from Here?

In a very brief period of time, ChatGPT hit one million users within five days, and is now a constant topic of discussion in the news. It is at the same time simple and yet filled with layers of possibilities, able to accelerate learning and publication, limited and seemingly limitless. It is a tool that has inspired interest from Microsoft, which has already announced incorporating it into its toolset.

Universities and school systems are trying to figure out how to block it or identify when students are providing their own work. Those who make money creating and publishing the printed word are concerned ChatGPT is the most disruptive technology in 100 years, a virus let loose.¹¹

For the financial professional, it is one more emerging technology that can impact education and training, communication and messaging, facilitating our daily tasks, but accelerating the threats and risks of which we need to be aware.

The profession has spoken about the potential of AI for decades, but had little tangible, to touch and taste and see, to experience the possibilities. With ChatGPT, the opportunity to experience the future is here.

Addendum:

Following is another example dialogue, where ChatGPT takes simple information for an Income Statement, formats it, and facilitates analytics and enhancement:

If you receive a simple financial statement like the following, what are some analytics you might perform? 2022 2021 Sales 150 100 Cost of sales 50 40 Net Income 100 60

Some analytics that could be performed on this financial statement include:

- Calculating the gross profit margin by dividing net income by sales
- Comparing the net income and gross profit margin between 2022 and 2021 to determine if there has been an improvement or decline
- Comparing the cost of sales as a percentage of total sales in 2022 and 2021
- Calculating the average sales per day or month
- Calculating the sales growth rate between 2022 and 2021.

Can you turn that data into a financial statement format, and include the gross profit calculation?

Sure, here's a financial statement format that includes the calculation of gross profit:

Income Statement

Year ended December 31, 2022 and 2021

2022 2021

Sales \$150 \$100

Cost of sales \$50 \$40

Gross profit \$100 \$60

Net Income \$100 \$60

Gross profit margin: $\text{Gross profit} / \text{Sales} = 100/150 = 66.67\%$ (2022) & $60/100 = 60\%$ (2021)

Thanks! Can you add a column showing the percentage increase or decrease from 2021 to 2022?

Sure, here's the financial statement with a column showing the percentage increase or decrease from 2021 to 2022:

Income Statement

Year ended December 31, 2022 and 2021

2022 2021 % change

Sales \$150 \$100 50%

Cost of sales \$50 \$40 25%

Gross profit \$100 \$60 66.67%

Net Income \$100 \$60 66.67%

Gross profit margin: $\text{Gross profit} / \text{Sales} = 100/150 = 66.67\%$ (2022) & $60/100 = 60\%$ (2021)

It is worth noting that to calculate percentage change we use the following formula: $(\text{New value} - \text{Old value}) / \text{Old value} * 100$

Please present it in a tabular format, with a bold underline under Cost of Sales, and a bold double underling under Net Income.

Sure, here's the financial statement presented in a tabular format with the formatting you requested:

Year ended December 31, 2022 and 2021	2022	2021	% change
Sales	\$150	\$100	50%
Cost of sales	\$50	\$40	25%
Gross profit	\$100	\$60	66.67%
Net Income	\$100	\$60	66.67%

Gross profit margin: $\text{Gross profit} / \text{Sales} = 100/150 = 66.67\%$ (2022) & $60/100 = 60\%$ (2021)

It is worth noting that the tabular format is a good way to present the information in a clear and concise way, and the bold underline and double underline are used to highlight important information, such as cost of sales and net income.

Let's add management salary (which would be Operating Expense, a deduction from Gross Profit, reducing Net Income) of \$60 for 2022 and \$30 for 2021. Could you update the presentation?

Sure, here's the financial statement with the inclusion of management salary (Operating Expense) and the updated presentation:

Year ended December 31, 2022 and 2021	2022	2021	% change
Sales	\$150	\$100	50%
Cost of sales	\$50	\$40	25%
Gross profit	\$100	\$60	66.67%
Operating Expense (Management Salary)	\$60	\$30	100%
Net Income	\$40	\$30	33.33%

Gross profit margin: $\text{Gross profit} / \text{Sales} = (100-60)/150 = 40/150 = 26.67\%$ (2022) & $(60-30)/100 = 30/100 = 30\%$ (2021)

It is worth noting that the management salary (Operating Expense) is a deduction from Gross Profit, which reduces the Net Income. As we can see the percentage change in net income is different than the percentage change in sales, this is because the management salary as an operating expense is considered while calculating Net Income percentage change.

¹ <https://chat.openai.com/>.

² See, for example, Microsoft <https://www.msn.com/en-gb/money/other/microsoft-is-said-to-mull-dollar10-billion-chatgpt-creator-investment/vi-AA16c68t?ocid=up97dhp>.

³ <https://www.nytimes.com/2023/01/16/technology/chatgpt-artificial-intelligence-universities.html>.

⁴ Ryan Reynolds has a video of his use of ChatGPT to create a Mint Mobile ad at <https://www.youtube.com/watch?v=eHjifELI-k>.

⁵ Many countries have made or are considering issues of AI and patents; the United States Patent and Trademark Office active seeks to engage the AI/ET community through its AI and Emerging Technology Partnership at <https://www.uspto.gov/initiatives/artificial-intelligence/ai-and-emerging-technology-partnership-engagement-and-events> ; there has been a longer standing issue related to animals and authorship/patents, which go beyond the scope of this article, but the reader is encouraged to look up the works of F.D.C. Willard.

⁶ <https://azure.microsoft.com/en-us/blog/general-availability-of-azure-openai-service-expands-access-to-large-advanced-ai-models-with-added-enterprise-benefits/>.

⁷ An amusing conversation with this model has been captured at <https://www.goingconcern.com/chatgpt-junior-accountant/> based on the work of Jason Staats <https://twitter.com/JStaatsCPA/>.

⁸ OpenAI.com.

⁹ <https://www.youtube.com/watch?v=1gcbXly2YNE>.

¹⁰ <https://research.checkpoint.com/2023/opwnai-cybercriminals-starting-to-use-chatgpt/>.

¹¹ <https://techcrunch.com/2022/12/09/is-chatgpt-a-virus-that-has-been-released-into-the-wild/>.



Lease Accounting – The State of Play

(Sponsored article)

By Mike Roberts



Mike Roberts is Head of Strategy and Business Development for AssetAccountant™ – a cloud-based software company that provides a full tax and accounting solution for easing and depreciating assets. Mike can be contacted at mike.roberts@assetaccountant.com.au.

Lease accounting is a catch-all term for the variety of methods used to account for leases in a company's financial statements. The history of lease accounting goes back to the early 20th century, when leases were first recognized as a form of financing. Naturally, the complexity of the topic has increased as the kinds of financing available have become more sophisticated.

In the middle of the twentieth century, accounting for leases was still relatively simple. Leases were classified as either operating or capital leases, with operating leases being recorded as expenses on the income statement (e.g., rental costs) and capital leases being recorded as both assets and liabilities on the balance sheet.

This method of lease accounting was criticized, however, for allowing companies to keep leases off their balance sheets and thereby understating their debt. The airline industry came in for particular attention for this policy with many airlines not having any airplanes on their balance sheets.

A History of Lease Accounting under US GAAP up to the 2010s

In 1976, in an early attempt to address the issue, the Financial Accounting Standards Board (FASB) issued Statement 13 (which later became ASC840 in the Accounting Standards Codification) that required companies to recognize leases with a term of more than 75% of the asset's economic life as capital leases.

In the 1980s, the FASB began working on a comprehensive project to revise accounting for leases. An updated Statement 13, which was issued in 1984, retained the distinction between operating and capital leases, and required companies to recognize capital leases as both assets and liabilities on the balance sheet.

Unfortunately, this new standard failed to fully address the concerns about leases being off balance sheet, and the general sentiment at the time was that this still did not provide sufficiently useful information to financial statement users.

In the 1990s, the FASB started to work on a new lease accounting standard, resulting in further updated Statement 13, which superseded the previous standard in 1998. This version, however, still did not change the fundamental characteristic of lease accounting. While it required more information about leases to be disclosed in financial statements, many felt it did not require the disclosure of the whole picture of a company's leases.

A History of Lease Accounting under International Accounting Standards up to the 2010s

Outside the US, International Accounting Standard (IAS) 17: “Leases” was an international accounting standard issued by the International Accounting Standards Board (IASB) that provided guidance on how lessees and lessors should account for leases in their financial statements. The standard (which generally applied to non-US GAAP entities) was first issued in 1985 and, as with Statement 13/ASC 840, was subsequently amended several times over the years.

Under IAS 17, lessees were required to classify leases as either finance leases or operating leases. Finance leases were leases in which the lessee assumed substantially all of the risks and rewards of ownership of the leased asset, and were required to be recognized as assets and liabilities on the balance sheet. Operating leases, on the other hand, were leases in which the risks and rewards of ownership were retained by the lessor, and were not required to be recognized as assets or liabilities on the balance sheet. Instead, the lessee recognized lease payments as an expense on the income statement over the lease term.

As with Statement 13/ASC 840, IAS 17 was criticized for providing a less than transparent view of a company's lease obligations and assets. The standard allowed companies to keep operating leases off-balance sheet, which resulted in an understated view of liabilities and assets.

A Collaboration on A New Way to Account for Leases

In the early 2010s, the FASB and the IASB began a joint project to develop new lease accounting standards (ASC 842 and IFRS 16) that are both the most recent and the most comprehensive standard for accounting for leases that would bring leases onto the balance sheet. In 2013, they issued exposure drafts of new standards, IFRS 16 and ASC 842, to replace IAS 17 and ASC 840, respectively.

These new standards require companies to recognize almost all leases as both an asset and a liability on the balance sheet and also provide more detailed disclosures about leases in the financial statements. Both standards are seen as significant improvements over their previous versions as they provide a more accurate picture of a company's lease obligations, as well as improving comparability across companies. IAS 17 was superseded by IFRS 16 on January 1, 2019 and is considered withdrawn as of then. ASC 842 became effective for public companies for fiscal years beginning after December 15, 2018. The initial effective date for private companies was for fiscal years beginning after December 15, 2019 although this was delayed several times by the FASB but is now in force for any fiscal years starting after December 15, 2021.

The roll-out of IFRS 16, the international accounting standard for leases, has varied across different countries and regions. In the European Union, all member states are required to adopt IFRS standards, including IFRS 16, so the standard has been fully adopted across the region.

In Asia, many countries have adopted IFRS 16, including Japan, South Korea, China, Hong Kong and Singapore. The adoption of IFRS standards is not mandatory in all Asian countries, however, and some countries such as India have their own accounting standards.

In Africa, most countries have adopted IFRS 16, but some countries still use their own accounting standards. In Oceania, most countries have adopted IFRS 16, but again, some countries still use their own accounting standards.

In South America, the adoption of IFRS 16 varies by country; for example, Argentina, Chile, and Colombia have adopted the standard, but other countries such as Brazil, Mexico and Peru still use their own accounting standards.

It's worth noting that the new standards are not without criticism in that they have brought new challenges to the companies that are required to report under them. In particular, in many cases they require significant effort to upgrade accounting systems, processes and technology to gather the necessary data, undertake complex calculations and maintain the required records.

In summary, the history of lease accounting has been one of ongoing efforts to improve the information provided to financial statement users by bringing leases onto the balance sheet and requiring more detailed disclosures. The current challenges in implementing them, are seen as significant improvements over previous standards.

Detail of Current Accounting Standards for Leases Under US GAAP – ASC842

As noted above, ASC 842 is the accounting standard issued by the FASB that outlines how lessees and lessors should account for leases in their financial statements. The standard was issued in February 2016 and started to become effective in fiscal years beginning after December 15, 2018.

ASC 842 replaced ASC 840 Leases, which had different accounting requirements for finance leases and operating leases. As referred to above, one of the biggest changes under ASC 842 is that lessees are required to recognize a lease liability and a right-of-use asset for all leases, including operating leases, with a term of more than 12 months. This means that lessees must bring operating leases on to the balance sheet, which will increase the assets and liabilities reported. To be clear on the change this represents, these kinds of operating leases had previously been treated as operating expense items in most company's financial statements.

Under ASC 842, the reported lease liability on the balance sheet should represent the lessee's obligation to make lease payments, while the right-of-use asset represents the lessee's right to use the leased asset during the lease term.

The right-of-use asset is measured at the lease liability, plus any upfront lease payments, and is then amortized over the lease term in a manner similar to how assets that are "owned" have been traditionally depreciated.

Under ASC 842, lessees are required to recognize the lease liability at the present value of the lease payments, discounted at the lessee's incremental borrowing rate. Lessees are also required to apply the requirements of ASC 842 retrospectively, meaning that lessees are required to restate their lease accounting for all years presented in the financial statements as if ASC 842 had always been in effect.

As for lessors, they are required to classify their leases as either sales-type leases, direct financing leases or operating leases. Sales-type leases and direct financing leases are accounted for in a similar manner to that under ASC 840, and the lessor recognizes an asset (the lease receivable) and a liability (the unearned finance income) from these leases.

Operating leases are not recognized as assets or liabilities on the balance sheet. Instead, the lessor recognizes lease income over the lease term, typically on a straight-line basis. As with lessee accounting, under ASC 842, lessors are required to apply the new standard

retrospectively, which means that they will be required to restate their lease accounting for all years presented in the financial statements as if ASC 842 had always been in effect.

In summary, ASC 842 requires lessees to recognize right-of-use assets and lease liabilities on their balance sheets for all leases with a term of more than 12 months. This will generally result in increased assets and liabilities reported on the balance sheet, and provide a more accurate picture of a lessee's lease obligations and assets.

Current Accounting Standards for Leases under International Financial Reporting Standards – IFRS16

IFRS 16 is the international accounting standard for leases that was issued by the International Accounting Standards Board in 2016 following the consultation described above. IFRS 16 is mandatory for all companies that report under International Financial Reporting Standards (IFRS) and is effective for annual periods beginning on or after January 1, 2019.

The requirements under IFRS 16 are broadly the same as for those under ASC 842 in that lessees are required to recognize a lease liability and a right-of-use asset for all leases, including operating leases, with a term of more than 12 months. This means that lessees must bring operating leases on to the balance sheet, which will increase the assets and liabilities reported on the balance sheet.

The lease liability represents the lessee's obligation to make lease payments, while the right-of-use asset represents the lessee's right to use the leased asset during the lease term. The right-of-use asset is measured at the lease liability, plus any upfront lease payments, and is then depreciated over the lease term.

As with ASC 842, IFRS 16 requires lessees to recognize the lease liability at the present value of the lease payments, discounted at the interest rate implicit in the lease or, if that rate cannot be determined, at the lessee's incremental borrowing rate. Lessees are also required to apply the requirements of IFRS 16 retrospectively, meaning that lessees will be required to restate their lease accounting for all years presented in the financial statements as if IFRS 16 had always been in effect.

Some example calculations

By way of example, let's say that a company, XYZ Inc., enters into a lease agreement to rent a warehouse for a term of five years. The lease requires XYZ Inc. to pay \$1,000 per month in rent, with the first payment due at the start of the lease. The lease also requires XYZ Inc. to pay for all operating expenses, such as property taxes and insurance, associated with the warehouse.

Under the new rules, XYZ Inc. would be required to recognize a lease liability and a right-of-use asset on its balance sheet. The lease liability would be the present value of the lease payments over the five-year lease term, discounted at the interest rate implicit in the lease or, if that rate cannot be determined, at XYZ Inc.'s incremental borrowing rate.

Let's assume that the lease has an implicit interest rate of 6%. The present value of the lease payments over five years would be calculated as follows:

Month	Payment	Discounted value
1	1,000	1,000

2	1,000	995
..		
60	1,000	745
TOTAL	60,000	51,967

So, the lease liability would be recorded as \$51,967. The right-of-use asset would be recorded as \$51,967 + any additional upfront lease payments (if any).

Throughout the five-year lease term, XYZ Inc. would be required to recognize a lease expense on its income statement, which would be calculated as the difference between the lease payments and the interest on the lease liability. XYZ Inc. would also be required to depreciate the right-of-use asset over the lease term, reducing the asset value over time. Let's see what those journal entries would look like:

At the start of the term

When the lease is set up, assuming no additional up-front payments, the required journals would be:

Dr Right of Use Asset 51,967
 Cr Lease liability* 51,967

* Note this would usually be split between current and non-current liabilities

At the end of month one, the asset would be depreciated by a monthly amount of depreciation ($51,967 * 20\% * 31/365 = \883) and the first month's payment would be recognized in the journals as follows:

Dr Depreciation expense 883
 Cr Accumulated Depreciation 883
 Dr Lease liability 1,000
 Cr Lease payment 1,000

In following months, the lease payment is split across the reduction in lease liability and the amount of interest for the relevant month, e.g., in month 2, the second part of the journal would be:

Dr Lease liability 995
 Dr Interest expense 5
 Cr Lease payment 1,000

At the end of the lease term, the right-of-use asset would be fully depreciated and the lease liability would be fully settled.

At AssetAccountant™, we automate all of these calculations for our users who enter their lease data and the system calculates the required entries over the life of the lease and outputs the journals.

Acquired **1 Jan 2023** First Used **1 Jan 2023** Cost **\$51,967.10** Accumulated Depreciation **(\$5,154.00)** Written Down Value **\$46,813.10**
at 30 June 2023 at 30 June 2023

Date	Type	Asset <			Lease <		
		Cost	Depreciation	Book Value	Principal	Interest	Lease Liability
1 Jan 2023	Lease Entered	\$51,967.10	-	\$51,967.10	\$51,967.10	\$0.00	\$51,967.10
1 Jan 2023	First Use	-	-	-	-	-	-
1 Jan 2023	Lease Payment	-	-	-	(\$1,000.00)	-	\$50,967.10
31 Jan 2023	Interest Accrual	-	-	-	-	\$4.92	\$50,972.02
31 Jan 2023	Depreciation	-	(\$882.73)	\$51,084.37	-	-	-
1 Feb 2023	Interest Accrual	-	-	-	-	\$0.16	\$50,972.18
1 Feb 2023	Lease Payment	-	-	-	(\$994.92)	(\$5.08)	\$49,972.19
28 Feb 2023	Interest Accrual	-	-	-	-	\$9.31	\$49,981.49

Acquired **1 Jan 2023** First Used **1 Jan 2023** Cost **\$51,967.10** Accumulated Depreciation **(\$5,154.00)** Written Down Value **\$46,813.10**
at 30 June 2023 at 30 June 2023

Date	Type	Asset >		Lease <		
		Book Value	Principal	Interest	Lease Liability	
1 Jan 2023	Lease Entered	\$51,967.10	\$51,967.10	\$0.00	\$51,967.10	
1 Jan 2023	First Use	-	-	-	-	
1 Jan 2023	Lease Payment	-	(\$1,000.00)	-	\$50,967.10	
31 Jan 2023	Interest Accrual	-	-	\$4.92	\$50,972.02	
31 Jan 2023	Depreciation	\$51,084.37	-	-	-	
1 Feb 2023	Interest Accrual	-	-	\$0.16	\$50,972.18	
1 Feb 2023	Lease Payment	-	(\$994.92)	(\$5.08)	\$49,972.19	

Generate Payment Schedule

Amount Financed Interest Rate (if known) % Starting Interest From

Date * Lease Payment * Other Payment Frequency *

Calculated Interest Rate

6.183131%

Date	Principal	Interest
1 Jan 2023	\$1,000.00	\$0.00
1 Feb 2023	\$994.92	\$5.08
1 Mar 2023	\$990.35	\$9.65
1 Apr 2023	\$985.32	\$14.68
1 May 2023	\$980.47	\$19.53
1 June 2023	\$975.49	\$24.51
1 July 2023	\$970.69	\$29.31
1 Aug 2023	\$965.75	\$34.25
1 Sept 2023	\$960.85	\$39.15
1 Oct 2023	\$956.12	\$43.88
1 Nov 2023	\$951.26	\$48.74
1 Dec 2023	\$946.58	\$53.42
1 Jan 2024	\$941.77	\$58.23

Current Lease Liability	Current Lease Liability	\$1,000.00	\$0.00	AA - Leases
Show Details				
Lease Payment Clearing	Lease Payment Clearing	\$0.00	\$1,000.00	AA - Leases
Show Details				
Cost	Cost	\$51,967.10	\$0.00	AA - Leases
Show Details				
Current Lease Liability	Current Lease Liability	\$0.00	\$12,000.00	AA - Leases
Show Details				
Non Current Lease Liabilit	Non Current Lease Liability	\$0.00	\$48,000.00	AA - Leases
Show Details				
Current Unexpired Interest	Current Unexpired Interest	\$322.22	\$0.00	AA - Leases
Show Details				
Non Current Unexpired Ir	Non Current Unexpired Interest	\$7,710.68	\$0.00	AA - Leases
Show Details				
ases		\$61,000.00	\$61,000.00	
		\$61,000.00	\$61,000.00	

	A	B	C	D	E	F	G
1	Journal Date	Group	Account Type	GL Account	Debit	Credit	Description
2	01/01/2023	Leases	Current Lease Liability	Current Lease Liability	1,000.	-	AA - Leases: Lease Payment from 1 July 2022 to 1 January 2023
3	01/01/2023	Leases	Lease Payment Clearing	Lease Payment Clearing	-	1,000.	AA - Leases: Lease Payment from 1 July 2022 to 1 January 2023
4	01/01/2023	Leases	Cost	Cost	51,967.	-	AA - Leases: New Leases from 1 July 2022 to 1 January 2023
5	01/01/2023	Leases	Current Lease Liability	Current Lease Liability	-	12,000.	AA - Leases: New Leases from 1 July 2022 to 1 January 2023
6	01/01/2023	Leases	Non Current Lease Liability	Non Current Lease Liability	-	48,000.	AA - Leases: New Leases from 1 July 2022 to 1 January 2023
7	01/01/2023	Leases	Current Unexpired Interest	Current Unexpired Interest	322.	-	AA - Leases: New Leases Unexpired Interest from 1 July 2022 to 1 January 2023
8	01/01/2023	Leases	Non Current Unexpired Interest	Non Current Unexpired Interest	7,711.	-	AA - Leases: New Leases Unexpired Interest from 1 July 2022 to 1 January 2023

Conclusion

As has been outlined, lease accounting has had a long and complex history mirroring the nature of the transactions it seeks to report. The latest iterations of the relevant accounting standards, compliance burden aside, are generally viewed as an improvement on previous disclosures. However, one thing that seems certain is that the area will continue to evolve in future years as IFRS16 and ASC 842 become broadly adopted and further enhancements are identified.



For Profit: A History of Corporations

By Gerald Trites, FCPA, FCA, CISA

Editor in Chief

In this insightful and informative book, written by William Magnuson and published by Basic Books, New York, November 2022, Magnuson traces the history of corporations and the role that profit has played in them over more than two thousand years.

He begins with the Roman Republic, prior to the advent of the Roman Empire. He feels that was when the idea of the corporation began, pointing out that “the term *corporation* derives from the Latin Word ‘corpus’ or body.” Modern corporations can act as a single body under the law and offer some protection to their owners through the concept of limited liability. They also issue shares to shareholders and through this means can raise capital from the public. Corporations in Roman times didn’t share all these attributes, but they did consist of groups of people acting as a body for business purposes.

The corporations in the Roman Republic, says Magnuson, were used to execute government contracts for activities such as road building and tax collecting. They also provided resources for the Roman army and indeed played a major role in building the most powerful army in the world at that time. Their objective was to provision the army, and raising capital and making profits was a means to that end.

He further discusses the Italian Renaissance and the powerful Medici family. The Medicis built their fortune and remarkable status on their bank, which provided much funding for the armies of the state and the Pope. The Medici Bank generated new ideas about corporate structure. Rather than organizing itself as a single entity, located, managed and owned in Florence, it set up an early multi-structured form of holding company; “the Medici Bank in Florence was the principal entity, but other separate entities were formed across the continent. These separate branches had their own names, administrators and accounting books — and had to report regularly to the bank holding company in Florence.” (Pg. 67)

With this structure, the Medicis were able to encourage the local managers, who were part owners of their own branches, to operate independently, within certain parameters, in the interests of the business. It also helped protect the corporation by spreading the risks across the entire corporate structure. Having offsite owners, with managers running the company, was to become a major feature of corporations after the Renaissance and, of course, into the present day.

New Elements to Corporate Organization

The large trading companies of the sixteenth and seventeenth centuries in Britain added some new elements to corporate organization. One of these was the East India Company, formed in the year 1600, which led the way by being formed as a joint stock company. “Joint stock companies, a new concept in English law, proved particularly well suited to the grand voyages

of the Age of Discovery. In short, they allowed businesses to sell stock in their companies to investors, who would pay in cash up front in return for a slice of future profits down the line.” (Pg. 70)

This approach worked well for those particular trading companies because they had high up-front costs preparing and manning their vessels and would return profits, if any, only several months or even years later. It took a long time to sail halfway around the world and back again in those days. While the stockholders were very much venture capitalists, the government of the day still played a very large role in their activities.

In those years, corporations could only be created by petitioning the crown. The East India Company was officially formed on New Year’s Eve of 1600, “when Queen Elizabeth I granted a charter to the “Company of Merchants of London Trading into the East Indies” (Pg. 77). There were 218 merchants involved and together they became “one Body Corporate and Politick, in Deed and in Name,” with a monopoly over all trade between England and the East Indies (which covered anything east of the Cape of Good Hope).

The charter was clear that the purpose of the company was to contribute to the greatness of England in addition to the advancement of trade of merchandise and increased navigation. Profits would be necessary to sustain this trade.

While the company was spread around the Globe, it was actually run by a small group of men in a building in London. They soon learned lessons that had been learned by the companies in Rome and Florence – that they required a system of management and controls to ensure that the managers in faraway places worked to the advantage of the overall business. This required a record-keeping system, which was based on double entry bookkeeping, something started in the fifteenth century in Florence for keeping track of finances and profits. Their systems were “required to maintain detailed ledgers of the contents of warehouses and the terms of contracts. This was a remarkable level of efficiency for a business operating in the seventeenth century.” (Pg. 83)

Issuing Stock to Investors

The East India Company was one of the first companies to issue stock to their investors. The investors had limited liability, could trade their stocks, and were not involved in managing the company. Therefore, their prime interest was in the profitability of the company, which in turn led to a major change in the focus of management, in that they now had to keep the investors happy, or else they might impair their ability to raise capital. Although the author states that this reliable source of capital enabled the company to take a longer-term view of the company’s prospects, this is questionable, since we know that the need to satisfy investors can cause a company to take a short-term view, sometimes even leading to the falsifying of profits at the expense of future profits. He does acknowledge that the change led the companies to focus on profits more than on the long-term benefits to the nation and society.

The East India Company also maintained a military (shades of the Roman and Florentine versions) and, by 1742, had a force of some 1,200 soldiers at its base in Madras, India. “While the East India Company would nominally continue its business for another seventy years (until the Indian Mutiny in 1857 led the British government to fully nationalize the company), its era as a private corporation was for the most part at an end. It had become an arm of the British government.” (Pg. 99)

The company went on to have a significant role in world affairs, when its trade in tea through Boston triggered the Boston Tea Party, which in turn helped to foster the American Revolution!

The “East India Company had ... shown the power that corporations could wield in the world. The joint stock company and its progeny would come to dominate capitalism and commerce for the next several centuries. It would foster the colonization of the New World. It would usher in the Industrial Revolution. And it would fuel the spread and growth of the American economy.” (Pg. 100). The need for companies to satisfy the investors’ desire for higher stock prices led the companies to place an even greater emphasis on profits.

Railroads Into the Future

Fast forward to the nineteenth century and the formation of companies like the Union Pacific Railroad Company during the great westward migration. The Union Pacific was specifically formed to build a railroad from Iowa to California and meet up with another railroad started in California to be built by the Central Pacific Railroad Company. President Lincoln had decided that the railroad would be built by corporations. The companies were set up complete with capital stock and a board of directors. There was limited oversight by the government.

The result of this organization was that the stockholders stood to make lots of money on railroads, and they did. The incentive, opportunity and limited oversight drove many of them to unethical practices. These owners became known as the robber barons. They drove any competition out by various means including violence and kept costs down by importing cheap Chinese labour and exploiting its workers. Many fortunes were made in the railroads during this period. The country got its railroad, which provided the infrastructure to support the rapidly growing trade in beef, grain and other products across the country.

And, Then, Cars

The important transportation business took a major turn in the early twentieth century when Henry Ford used the form of a corporation to make cars. They were not the first cars, but they were the first to be mass produced and sold. The core of this mass production was the assembly line.

“The Ford Motor Company transformed itself into the most efficient system of production the world had ever seen. In 1913, the year before the introduction of the assembly line, Ford produced 68,733 Model Ts. In 1914, the number soared to 170,211. Production accelerated as the company refined its methods through constant experimentation. In 1915, Ford produced two hundred thousand Model Ts, then three hundred thousand, then five hundred thousand.

By 1918, it was producing over seven hundred thousand cars a year. Ford Motor Company was now producing half of all US automobiles.” (Pg. 162)

But there was a tawdry side to Henry Ford’s glittering reign over the automobile industry. Because it needed to sell all these cars at a price people could afford, the company created dehumanizing working conditions. “Outside the corporation, it created new appetites for consumption as an end in itself and, perhaps worse, incentives for corporations to generate those appetites on a societal scale. Mass production, it turned out, was a dangerous recipe for materialism, waste, and environmental destruction.” (Pg. 178)

The resultant controversy ultimately led to the famous decision of the Michigan Supreme Court: “A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.” (Pg. 167) Much of the corporate activity in the remaining years of the twentieth century was consistent with this directive.

Around the same time, the famous economist, Milton Friedman, concluded that “there is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game.” (Pg. 7)

Here Come the Multinationals

The latter part of the twentieth century saw the advent of Multinational Corporations. These companies no longer did business primarily in a single country and with a single domestic market. Instead, they operated wherever and whenever it made sense — regardless of jurisdictions or borders, currencies or languages. Today, they are found everywhere in companies like Walmart, Amazon, Apple, Exxon, and Facebook.

Multinationals really began with the big oil companies, when the world’s use of oil grew dramatically in mid-century and local sources were not available. The companies began to explore and develop the resource wherever in the world it could be found. Eventually, they settled largely on the Middle East. OPEC was formed to enable the oil producing countries to help control their resource, but it eventually led to their establishing an embargo on the export of oil. After negotiations with OPEC failed, the big oil companies (the Seven Sisters) began to coordinate their shipments. It was organized by Exxon, which was able to manage this arrangement because it had a long history of navigating the global economy and therefore had developed a multinational reach. It was another indication of the power of the multinationals.

The multinational corporation represented an important shift in the nature of capitalism because the companies were freed from the clutches of their local governments. Since they operated so freely around the world, multinationals also drove the development of globalization.

In the after-war years, national economies became increasingly interdependent as supply chains went global and people and ideas crossed borders as never before. International corporations encouraged these developments, not just by taking advantage of the economic prospects of cross-border trade, but also by attracting the world's best and brightest and training them to succeed in the new world. A new kind of cosmopolitan capitalism began to take shape.

In retrospect, Magnusson points out that "It should come as no surprise that the rise of the multinational in the post – World War II world coincided with the rise of the world's most pressing multinational problem: climate change." (Pg. 214) Their efforts to seek out the most profitable jurisdictions in which to do business often meant finding countries that imposed lower taxes, or fewer restrictions on employment conditions, or lax environmental rules.

According to Magnusson, "capitalism had lost its way. The modern corporation was no longer an exemplar of industry and efficiency; it was a symbol of greed and excess." (Pg. 218) Popular culture picked up this view of corporations, at least those of corporate raiders, in the form of Gordon Gekko, the prime hero/villain of the movie "Wall Street." His "greed is good" speech ranks as one of the more powerful contemporary commentaries on modern capitalism.

One of the most prominent practitioners of corporate takeovers in this period was Kohlberg and Kravis and Roberts, generally known as KKR. They fostered the concept of the leveraged Buyout (LBO) which meant they could buy a company with other investors' money and very little of their own. Then they could sell it and make a huge profit on their own investment.

Another investor, Stephen Schwarzman, saw the tremendous potential of LBOs and formed the company Blackstone, now one of the world's largest investment companies, making Schwarzman a multi-billionaire.

Technology Changes the World

Finally, in his historical work, Magnusson focuses on the advent of the technology start-ups – perhaps the most striking example of the evolution of capitalism in the twentieth and twenty-first centuries. Examples include Facebook, Airbnb, Instagram, Snapchat, Twitter, Uber. There are several others, all sharing a similar business model.

To quote Magnusson, "No corporation in the history of the world has ever come anywhere close to the sheer size and scope of Facebook (or Meta, as it has now rebranded itself). Not Standard Oil. Not the East India Company. Not the Medici Bank. Simply put, Facebook is unprecedented. In the evolution of the idea of the corporation, Facebook represents the apex predator." (Pg. 253) He adds that "Mark Zuckerberg himself is worth an estimated \$76 billion. The golden age of start-up culture dawned with Facebook." (Pg. 255)

The US election of 2016 witnessed a turnaround: a good deal of concern about "fake news" and mis-information carried by Facebook and other social media. In an appearance before Congress after the election, Zuckerberg apologized for what his company had wrought. "It's clear now

that we didn't do enough to prevent these tools from being used for harm as well. That goes for fake news, foreign interference in elections, and hate speech, as well as developers and data privacy. We didn't take a broad enough view of our responsibility, and that was a big mistake. It was my mistake, and I'm sorry. I started Facebook, I run it, and I'm responsible for what happens here...." (Pg. 293)

Magnuson observed that, by most measures, Facebook was supremely successful, but that, much like the ancient Roman corporations had done during the first century BC, Facebook had ignored, dismissed, or simply not known how its behavior affected the common good." (Pg. 283)

For the Good of Society?

For Profit – A history of Corporations presents a coherent view of corporations over the past millennia. It shows how the quest for profit has interacted with other business objectives and with the good of society. And it makes clear how those interactions have varied and fluctuated.

Magnuson's account leaves us with challenging questions. What does the story tell us about the pressures for change facing modern corporations? And does it provide any hints about the possible future direction of the corporations?

A few observations can be made. At present, there is strong pressure from several segments of society to take stronger action with regard to corporate impact on the environment. History shows us that corporations have always had to respond eventually to the demands of society. The Medici bank was closed down when it no longer met those needs. Similarly, The East India company was disbanded by the British government. In current times, we see Twitter and Facebook trying to deal with their role in dispensing misleading and erroneous information.

And the future? Today, companies are faced with massive change, in the form of shifting attitudes toward work, economic disparity, moves towards mobile and hybrid work, the growth of the gig economy and others. There is little doubt that they will change, perhaps drastically, to meet these pressures.

A person is shown from the chest up, sitting at a desk and working on a laptop. The person's face is blurred. The background is a dark, blurred office setting. The text is overlaid on this image.

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Twenty-First Century Corporate Reporting: Effective Use of Technology and the Internet

How and why do corporations use the internet for reporting to their stakeholders? How and why has corporate reporting extended beyond financial reporting to include environmental, social, and governance (ESG) reporting and even integrated reporting. The major drivers of modern reporting have changed, to include data driven decision making, big data, and advanced analytics, as well as the use of electronic representations of data with tools such as XBRL.

Here we explore the various vehicles for using the internet, including social media and blogs as well as corporate websites and the websites of regulators. And we delve into the impact of portable devices, like smartphones and tablets.

Corporate reporting on the internet is changing fast because of changes in technology and stakeholder expectations. Companies are having a hard time keeping up. This book offers a roadmap to follow—a roadmap to start on now. Most importantly, the book lays out a strong case for integrated reporting and shows how reporting on the internet is ideally suited to the creation of integrated reports.

This book is of interest to executives in charge of the reporting function for their companies, students of accounting and management, and to serious investors and others with a strong interest in corporate reporting and the direction in which it is headed.



Gerald Trites is a CPA with a history of writing and publishing and a unique background. He was a partner in KPMG for seventeen years, and a tenured professor of accounting and information systems for ten. He also served for twelve years as director of XBRL Canada. He has published twelve books and numerous articles and papers. He worked as a research associate for the Canadian Institute of Chartered Accountants and served as chair of the Auditing Standards Board. He currently serves as editor-in-chief of ThinkTWENTY20 magazine, a publication he started in 2019 with the objective of publishing well-researched articles of substance.

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