

Making Financial Reporting Closer to the Investment Community

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Main points for discussion



- 1. Making financial reporting closer to the investment community: importance of the accounting standards**
- 2. Financial reporting and other forms of business reporting: can they be integrated and how?**
- 3. Preparers, auditors and audit committees: an important role in improving financial reporting**



» Usefulness

- Facilitates the allocation of global capital
- Attracting investments through transparency
- Reducing cost of capital
- Volume of quality of information
- Comparability across jurisdictions

» Efficiency

- One language: markets are interdependent in a globalized economy
- Facilitates the standardizing of information systems
- Eliminates wasteful reconciliations
- Audit efficiencies
- Education and training
- Comparability across jurisdictions



- » High quality standards – interests of various stakeholders considered
- » Financial information prepared using single set of high quality standards – only information that may be useful for economic decisions
- » Common approaches in financial sector supervision – rapprochement of prudential and general-purpose financial information
- » Information is comparable across the borders - single language
- » IFRS is geared toward users (economic decision usefulness), and **understandability** is a core qualitative attribute of financial reporting information



- » Framework-based thinking of IASB & framework-based understanding by users
 - Conceptual framework is used for judgments to set standards, teach standards, prepare financial information, audit financial information & take economic decisions
 - Information to be disclosed by entities should be useful for various users, including investors and creditors
- » Publishing IFRS F/S implies a willingness not just to comply with the letter of the standard but also the spirit
- » Focus on substance over form - the objective is to present fairly the assets, liabilities, revenues, expenses and cash flows
- » But.... The reality is complex (structured financing, financial instruments) - financial reporting information will never be so easy to understand - risk of expectation gap which we need to acknowledge

The IASB's *Conceptual Framework*



- » **Framework sets out agreed concepts that underlie IFRS financial reporting**
 - the objective of general purpose financial reporting
 - qualitative characteristics
 - elements of financial statements
 - recognition
 - measurement
 - presentation and disclosure

Other concepts all flow from the objective



» IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”

- Aims to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that appropriate disclosures enable users to understand their nature, timing and amount

» Business implications

- Provisions recognized, contingent liabilities not (only disclosed unless their occurrence is remote)
- Conditions to be met for recognition – no future expenses (present obligation should exist)
- Significant judgment about the amount, timing and risks of the cash flows required to settle the obligation
- Less risk of “earnings management”



» IFRS 1 “First-time adoption”

- Provides a starting point for financial reporting in accordance with IFRSs
- Aims to ensure that the information in an entity’s first IFRS financial statements and interim reports is transparent and comparable over all periods presented

» Business implications

- Plan for transition
- Accounting of some items need prior decision (hedges)
- Understand the impact on financial covenants (if exists) in borrowings



» IFRS 3 “Business combinations”

- Aims to improve the relevance, reliability and comparability of the information about business combinations and their effects

» Business implications

- Accounting is complex – frequently using/relying on valuers
- Recognition of identifiable assets (sometimes are not part of assets of acquired entity)
- Future losses and restructuring not recognized
- Transaction costs – expensed
- Assets at fair value – influence over subsequent accounting (e.g. higher amortization charges for the same assets)
- Always purchase method (no uniting of interests)



» IFRS 9 Financial Instruments

- Responsive to the needs of users - how an entity should classify and measure financial assets and financial liabilities
- IFRS 9 will ultimately replace IAS 39 (the project: Phase 1: Classification and measurement; Phase 2: Impairment methodology; and Phase 3: Hedge accounting) - Mandatory only after Jan 1, 2013
- IFRS 9 requires all financial assets to be classified on the basis of the entity’s **business model** for managing the financial assets and the contractual cash flow characteristics of the financial asset
- Use of less exceptions

» Business implications

- Use of business model – elimination of classification rules required by IAS 39
- Single impairment method – improved ability for users to assess cash flows and associated risk



» IFAC Business Reporting Project Group

- *Financial reporting in isolation – limited picture*
- *Context information is not always sufficient*
- *Good governance reporting*
- *Auditing*

All are elements of business reporting supply chain



- » Accounting for sustainability – sustainability reporting
- » Some stakeholders advocate for long-form audit report
- » Some countries require large entities to prepare social reports – employment, remuneration, etc.
- » Combination of various reports – and their independent assurance
- » One stop shop – very difficult to achieve – taxation, prudential (prudential filters model)



- » Preparers and auditors – need to ensure quality – capacity, managerial skills, understanding of why certain information is useful for investors – analytical skills
- » Audit committees – outside management, independent and competent – interests of investors
- » Audit standards – Clarified ISAs – risk based
- » EC green paper
- » Some discussions on whether auditors are “doing the right job” as opposed to “doing the job right”
- » Just issued IAASB consultation paper: Enhancing the Value of Auditor Reporting: Exploring Options for Change – usefulness of audit reporting, “information gap”, but also may generate discussion as to “whether to fill the information gap, auditors will need to do additional work”



Thank you for your attention.

Questions?

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