International
Federation of
Accountants

Project on Business Reporting
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A Global Language for Business Reporting

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For the fourth part in its series (see also "IFAC project on business reporting"), IFAC interviewed five specialists to get their recommendations on how to improve the language of business reporting, including management commentary, the global convergence and simplification of standards, and the need to exercise professional judgment when applying these standards.

The interviewees for this article expressed their views on, and recommendations for, a global language for business reporting, of which financial accounting—together with management commentary (see below)—plays an important part. The five specialists discussed their views on complexity of accounting standards; principles, rules, and professional judgment; as well as the roles of the various stakeholders in the development of a global language for business reporting. The views and quotes in this article were taken from interviews with the following business leaders:

- Jan McCahey, lead partner of financial reporting standards for PricewaterhouseCoopers (PwC) Australia;
- Richard Deutsch, national assurance leader for PwC Australia;
- Dr. Ernest Kan, senior partner, chief of operations, and head of the Global IFRS & Offerings Services of Deloitte Singapore;
- James Kroeker, chief accountant of the US Securities and Exchange Commission (SEC);[1] and
- Sir David Tweedie, chairman of the International Accounting Standards Board (IASB).

IFAC project on business reporting

In response to the report, *Financial Reporting Supply Chain: Current Perspectives and Directions* (March 2008), IFAC established a project group* to study progress in the areas of governance, financial reporting, and auditing. *Developments in the Financial Reporting Supply Chain—Results from a Global Study among IFAC Member Bodies* was issued in February 2009. This study indicated that, although progress had been made, several unresolved issues remain. In the final phase of this project, the project group has interviewed 25 key leaders from around the globe on what should be done to improve these areas.

Over the next months, the interviews, including overviews of the recommendations, will be available on the IFAC website, grouped in the following themes:

- Good governance and sustainability fundamental for improved business reporting (issued in June 2010)
- Business reporting beyond the crisis: how to make sure that we don't tumble into another black hole (issued in July 2010)
- Business reporting through the lens of the investor (issued in August 2010)
- A global language for business reporting
- Towards a broader view of business reporting

Subsequently, the project group will develop an action plan, based on the recommendations of the interviewees and taking into account the reader response.

* *The IFAC Business Reporting Project Group consists of Charles Tilley (Chief Executive of CIMA), Graham Ward (retired Senior Partner at PricewaterhouseCoopers and past IFAC President), Norman Lyle (retired Group Finance Director of Jardine Matheson Holdings Limited and Chair of the former IFAC Financial Reporting Supply Chain Project Group), and Al Anderson (Managing Principal—Accounting and*

[1] As a matter of policy, the Securities and Exchange Commission disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. The interview expresses Mr. Kroeker's views and does not necessarily reflect those of the Commission, the Commissioners, or other members of the SEC Staff.

Assurance Services of Larson Allen and Chair— Assurance Services Executive Committee of the American Institute of Certified Public Accountants (AICPA)). The project group was assisted by Stathis Gould and Vincent Tophoff (both of IFAC), and Amy Pawlicki (of the AICPA). IFAC Board member Joycelyn Morton kindly supported the project group by participating in a number of interviews.

International convergence of accounting standards

The interviewees were unanimous in their support for global convergence of accounting standards. Ernest Kan explains the value of achieving global convergence: "Having to comply with more than one accounting standard increases costs on the part of the preparer. An obvious solution is further harmonization of accounting standards so that a single global yardstick is used. If we commit resources to a single set of standards now, there will be long-term savings." Richard Deutsch agrees, "I absolutely endorse a global set of international financial reporting standards, and the sooner the community can get to that position, the greater our [accountants'] potential to have more credibility in the marketplace."

Currently, all eyes are on the US, which is still considering its options: straightforward adoption of IFRS, or further convergence between US GAAP and IFRS. James Kroeker explains the stance of the SEC: "We received a lot of comments from a broad range of stakeholders on the proposed SEC Roadmap on potential incorporation of IFRS, and many of them thought there was a benefit from global consistency in standards. However, there are certainly different viewpoints on how to best accomplish that. For most respondents, however, there was the recommendation that there should be further continuation of the FASB[2] and IASB convergence effort before a final decision is made." On the adoption of IFRS in the US, David Tweedie predicts: "The SEC has committed itself to decide on US adoption of IFRSs during 2011, and I'm pretty confident that they will come on board."

Principles, guidance, *and* professional judgment

One of the main obstacles impeding adoption of a global language for financial accounting—whether IFRS or some converged global standard—is overcoming cultural differences, according to Richard Deutsch: "The cultural difference among countries is a major issue to address. The proper application of IFRS requires a more principles-based approach—but how do you ask countries such as Japan and the US to move to a principles-based approach when they are steeped in rules-based approaches? It is almost a cultural behavioral journey that needs to be considered to assist some of these countries in their move to IFRS."

Interviewees agreed that achieving a balance between principles and rules/guidance, while avoiding bulk and complexity, is necessary but not easy. According to Ernest Kan, "If you look at this whole convergence project, the future IFRS will become much, much heavier. So, yes, I believe in one global set of international standards, but the FASB/IASB convergence project does not make it very easy." The way forward, according to James Kroeker, is a combination of principles and guidance: "Standards should have a clearly articulated principle or objective, but you also need to have sufficient guidance so that you don't get broad ranges of diversity in practice."

[2] US Financial Accounting Standards Board

Mr. Kroeker encouraged accountants to consult with the SEC on reporting requirement issues and emphasized the need for professional judgment in applying standards, “I would point out that what people are asking from us [the SEC] is exactly what we are asking from them: to exercise professional judgment.”

David Tweedie agrees that professional judgment is crucial for a global accounting language, but at the same time, recognizes that it is not always easy to instill: “Now one of the big issues is what the former chairman of the FASB, Bob Herz, said: ‘We are going to have to educate the American accounting profession. This isn’t the way they have been taught.’ They were taught the rules at the university. So we are right back to the educational implications of this.” Richard Deutsch adds: “My strong recommendation would be that professional accounting bodies, in conjunction with IFAC, think about how they can assist and educate their members to help them along this journey, [moving from a rules-based to a principles-based approach in accounting standards].”

Management commentary

Another issue with current financial reporting is that it does not provide the information that investors and other stakeholders are looking for, according to Jan McCahey: “We are still suffering to a large degree from the gap between what the information in the financial report is purporting to do and what it is that people wish that it did.”

Like many others in IFAC’s previous studies on business reporting, the current interviewees pointed out that management commentary, also called management discussion and analysis (MD&A) or an operating and business review, is increasingly more important to bridge that gap. David Tweedie expressed support for management commentary: “Accounting doesn’t do things too well sometimes and that is why the narrative statement is going to be so important in addition to the raw facts. . . . My view is that financial accounting should show things in the raw, warts and all, and narrative reporting should say: ‘Now, let me explain this to you.’” This is a view shared by James Kroeker: “The financial information provided by US GAAP is an extremely important starting point, but in business reports today, this is not the end of it. Therefore, we have MD&A and other information about the business, so investors can understand the broader picture.”

The next step is to provide management commentary that is meaningful, as Mr. Tweedie says: “Getting people to do that properly, without just boilerplate, will be tough. It is going to be one of the big challenges for the accounting profession.” The recent financial crisis might be beneficial in this respect, as Jan McCahey explains: “Australian companies have provided more balanced narrative reports over the last couple of years. In this turbulent financial environment, companies needed … to put additional explanatory information into their accounts. One of the good things that might come out of this crisis is that companies and their boards would retain that kind of open, balanced approach.”

Accounting standards should be simplified

Like many of the interviewees in this series, the specialists interviewed for this article generally agree that financial reporting has become too complex, as Ernest Kan says: “Annual reports are getting so complicated that preparers of financial reports now have to explain to investors and other readers what the financial numbers tell about the organization. Many people tell me today that they can no longer understand annual reports.”

Financial reporting standard setters are frequently blamed for making financial reports too complex and theoretical. IASB chairman David Tweedie sees it differently: “As I often say: ‘we get the standards that we deserve.’ . . . People are asking for rules, and exceptions from rules, and guidance for rules.” James Kroeker agrees with this view: “Let’s take a step back and ask ourselves what generated such volume and complexity in those standards. In many cases, it can be attributed to requests by a host of people—whether preparers, auditors, or others—for exceptions to the general rule and to the development of practices that push up against the very standard itself.”

Regardless of the source of complexity in financial standards, most interviewees agreed that complexity can and should be reduced. Jan McCahey says: “One of the things that we at PwC are trying to do, as a global accounting firm, is to avoid doing exactly what Sir David Tweedie is critical of. When we are preparing comment letters on IASB proposals, we are extremely careful not to ask for more guidance.” Fewer requests for interpretations seems like a general trend that may contribute to less guidance and complexity. Mr. Tweedie notes: “It was interesting that when Europe switched to IFRS, we thought we would have an avalanche of requests for interpretations, but we didn’t. The technical partners of the firms did their jobs and kept them back, and the firms settled any interpretation questions with their clients.”

Importance of Strong Corporate Governance

According to interviewees, reliable accounting practices and reporting depend upon strong corporate governance. David Tweedie says, “Investors should feel confident that the directors are in control. We need the non-executive directors to stand up against what I would consider to be unacceptable accounting. Good corporate governance is therefore critical.” According to Jan McCahey, “In Australia, we have embedded a very clear distinction between the role of executive and non-executive director in the make-up of company boards. For example, it’s common to have a chairperson of the board who is not an executive of the company. This brings a greater degree of independence to boards; the chairperson can objecively review management’s performance, ask tough questions to satisfy him- or herself that financial information is accurate, and help determine appropriate levels of remuneration for senior executives.”

Next steps

Simplification and convergence of accounting standards still have a ways to go, according to those interviewed. When asked how business reporting should further evolve over the next 5 to 10 years, Richard Deutsch noted the importance of simplification of financial reports, and that to increase its relevance, “business reporting needs to be more prospective rather than backward looking.”

David Tweedie indicated that after global convergence, simplification should be the next priority. “Financial accounting isn’t rocket science and we have had a tendency in the past to do things that are terribly complicated and that don’t need to be. The whole idea for the future is to make this as simple as possible. . . . Our job in the first few years was to patch up the standards in time for the first wave of jurisdictions to use the standards, then to improve them jointly with the FASB and to bring about their convergence. The objective for our successors’ Board will be to reduce the complexity…”

The participants interviewed for this article agreed that simplifying, condensing, and improving the overall quality of financial reports is the responsibility of all participants: preparers of financial accounts, board members, accountants and auditors, as well as financial reporting standard setters.

To read the complete interview transcripts, including summaries of interviewees' recommendations, see the IFAC website at www.ifac.org/frsc. Readers are encouraged to respond to the recommendations of the interviewees by completing a brief survey found at the conclusion of each interview transcript. For more information about IFAC's business reporting project, please contact Vincent Tophoff at VincentTophoff@IFAC.org.