FINANCIAL REPORTING SUPPLY CHAIN

Current Perspectives and Directions

CORPORATE GOVERNANCE

FINANCIAL REPORTING PROCESS

AUDIT OF FINANCIAL REPORTS

USEFULNESS OF FINANCIAL REPORTS

About the Authors

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INTRODUCTION

In recent years, there have been significant efforts to change and improve financial reporting. What is the result of these efforts? Has the financial reporting process become better or worse? Have financial reports become more or less relevant, reliable and understandable? What should be done next?

These were the central questions in this independent global survey commissioned by the International Federation of Accountants (IFAC) among the participants in the financial reporting supply chain. (See box on the Financial Reporting Supply Chain.)

This report begins with a summary of key findings, followed by the survey methodology. All the key areas of the financial reporting supply chain are then discussed in detail: corporate governance, the financial reporting process, the audit of financial reports, and the usefulness of financial reporting information. Each section contains a brief discussion and analysis of the survey results and the recommended next steps for that area of the financial reporting supply chain. The results highlighted in this report generally represent the viewpoints of the majority of respondents. Quotes are used to illustrate the general opinion. Annexed to the report are the detailed findings, tables and graphs of the online survey, as well as the notes and references.

FINANCIAL REPORTING SUPPLY CHAIN

The financial reporting supply chain refers to the people and processes involved in the preparation, approval, audit, analysis and use of financial reports. All links in the chain need to be of high quality and closely connected to supply high quality financial reporting.

The cycle both starts and ends with the investors and other stakeholders, who want to make informed economic decisions about a company and, therefore, require financial information to do so. Subsequently, it is management that, under the general direction of the board of directors (supervisory board), prepares the financial information for eventual approval by the board and, in some countries, the general meeting of shareholders. The auditors interact with management and the board while auditing the financial information and provide independent opinions. The media and others distribute financial information, and analysts and credit-rating agencies evaluate it, to be used by the investors and other stakeholders.

Also within the chain there are the various standard setters in the areas of corporate governance, financial reporting and auditing; the regulators, who enforce those standards and professionals, such as investment bankers and lawyers, who provide advice to the other participants.

TABLE OF CONTENTS

SUMMARY OF KEY FINDINGS

In recent years, there have been significant efforts to change and improve financial reporting. What is the result of these changes? Has the financial reporting process become better or worse? Have the financial reports become more or less relevant, reliable and understandable? What should be done next? The International Federation of Accountants (IFAC) commissioned an independent global survey of the participants in the financial reporting supply chain to get feedback on these questions. In June and July 2007, the survey group conducted a global survey that yielded 341 responses from around the world and from all parts of the financial reporting supply chain, including users, preparers, auditors, standard setters and regulators. The survey group also conducted 25 telephone interviews from August to October 2007. This report is based on the findings of the global survey and interviews, as well as on additional research.

Participants in the survey and interviews were asked about their opinions on four areas of the financial reporting supply chain: corporate governance, the financial reporting process, the audit of financial reports and the usefulness of financial reports. Below is a brief overview of the findings that are discussed in more detail in the report.

Survey Results on Corporate Governance

Corporate governance has improved and the balance between costs and benefits has become better. (See page 11.)

POSITIVES

- Increased awareness that good governance counts
- New codes and standards
- Improved board structure
- Improved risk management and internal control
- Increased disclosure and transparency

AREAS OF CONCERN

- Governance in name but not in spirit
- Development of a checklist mentality
- Overregulation
- Personal risk and liability for directors and management
- Cost-benefit concerns

FURTHER IMPROVEMENTS

- Continue to focus on behavioral and cultural aspects of governance
- Review existing rules
- Further improve quality of directors
- Better relate remuneration to performance
- Expand view from compliance governance to business governance

Survey Results on the Financial Reporting Process

The financial reporting process has improved and the balance between costs and benefits is about the same. (See page 16.)

POSITIVES

- Convergence to a single set of global financial reporting standards
- Improvements to regulations and oversight
- Board of directors/management taking ownership of financial reporting
- Improved internal control over financial reporting systems
- Improved technology for preparing financial reports

AREAS OF CONCERN

- Transition to International Financial Reporting Standards (IFRS)
- Complying/reconciling accounts to different financial reporting standards
- Complexity of financial reporting standards
- Liability restricting process

FURTHER IMPROVEMENTS

- Continue convergence to one set of financial reporting standards
- Simplify and clarify financial reporting standards – more principles and fewer rules
- Ensure that boards of directors pay attention to the quality of financial reports
- Provide additional education and training for preparers

Survey Results on the Audit of Financial Reports

The audit of financial reports has improved and the balance between costs and benefits is about the same. (See page 22.)

POSITIVES

- Improved auditing standards and processes
- Increased awareness, commitment and competence of auditors and audit committees
- More risk-focused audits
- Greater auditor independence
- Improved quality review and auditor oversight

AREAS OF CONCERN

- Reduced scope for professional judgment
- Overregulation
- Liability fear leading to boilerplate audits and lack of innovation
- Limited auditor's communication with external stakeholders
- Limited choice of audit firms
- Increased audit cost relative to perceived benefits

FURTHER IMPROVEMENTS

- Continue to focus on independence, objectivity and integrity
- Converge to one set of global, principles-based auditing standards over time
- Ensure consistent use of audit standards and safeguarding of quality within audit firms
- Improve auditor's communication, both internally and externally
- Consider limited/proportionate liability for auditors
- Remove barriers that limit choice of auditor

Survey Results on Usefulness of Financial Reports

The relevance and reliability of financial reports have improved, but the understandability of financial reports has not improved. Respondents preferred annual reports to real time or monthly information, found analyst presentations useful, and would like to have more business-driven information. The survey also showed mixed results about the usefulness of XBRL. In addition, paper financial reports remain useful. (See page 28.)

POSITIVES

- Better financial information due to improved standards, regulation and oversight
- More disclosure and comparability in financial reports
- Improved reliability
- Increased emphasis on narrative reporting
- Easier access to financial information

AREAS OF CONCERN

- Reduced usefulness due to complexity
- Use of fair value
- Focus by companies on compliance instead of essence of the business
- Regulatory disclosure overload
- Difficult and often changing financial reporting standards
- Lack of forward looking information

FURTHER IMPROVEMENTS

- Improve communication within the financial reporting supply chain
- Include more business-driven information in financial reports
- Better align internal and external reporting
- Improve users' access to electronic data, for example, XBRL
- Encourage short-form reporting focusing on the material issues

Next Steps

The results of this survey are clear. Participants feel that the three key areas of the financial reporting supply chain – corporate governance, the process of preparing financial reports and the audit of financial reports – have clearly improved in the last five years. Unfortunately, however, they do not feel that the products of this supply chain, the financial reports, have become more useful to them. To resolve this situation, there needs to be continuing effort made by all participants to discuss and debate the purpose and objectives of financial reporting so that the information that is reported best suits the information needs of the wide range of users.

What Can IFAC and Its Member Bodies Do?

IFAC and its member bodies, working with the other financial reporting supply chain stakeholders, have an important role to play if financial reports are to become more useful and if the other findings from this survey are to be addressed. There needs to be a coordinated ongoing dialogue to address the concerns raised.

The first step is to determine what should be done to make financial reports more useful to the various user groups; what would a more useful business-reporting model look like? How would addressing the other concerns raised in the areas of corporate governance, the financial reporting process and the audit of financial reports impact on the usefulness of financial reports?

IFAC and its member bodies can take a lead in those projects where accountants and auditors have relevant expertise and can contribute to projects where other financial reporting supply chain stakeholders are leading the initiative. It is, therefore, recommended that IFAC, through its committee and board agendas and, where appropriate, via specific projects, should address the concerns raised in this survey.

SURVEY METHODOLOGY

A global survey was used to gather information from all participants in the financial reporting supply chain, and in-depth interviews were conducted with a range of experts from all parts of the chain around the world.

The global survey and interviews identified the following:

- Whether participants in the supply chain consider that there have been improvements in the areas of governance, accounting, auditing and using financial reports
- The good and the less desirable things that have happened over the last five years
- Suggestions to further improve the quality of the financial reporting supply chain and financial reports

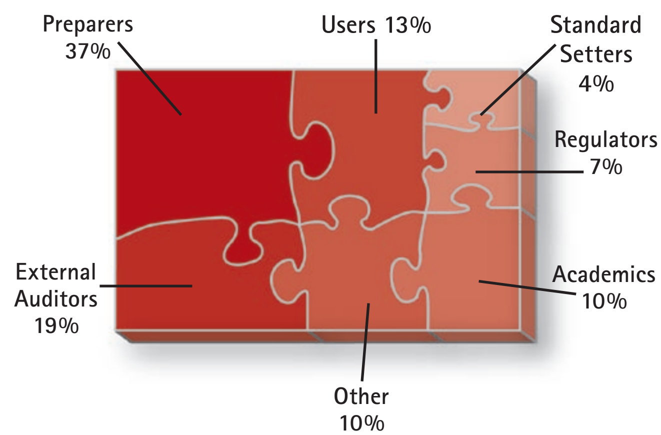
Recommendations made in past IFAC-commissioned reports on financial reporting have also been evaluated. (See section on previous IFAC reports.) Relevant work already undertaken by IFAC member bodies and others at a national and international level is also highlighted in this report.

International Survey

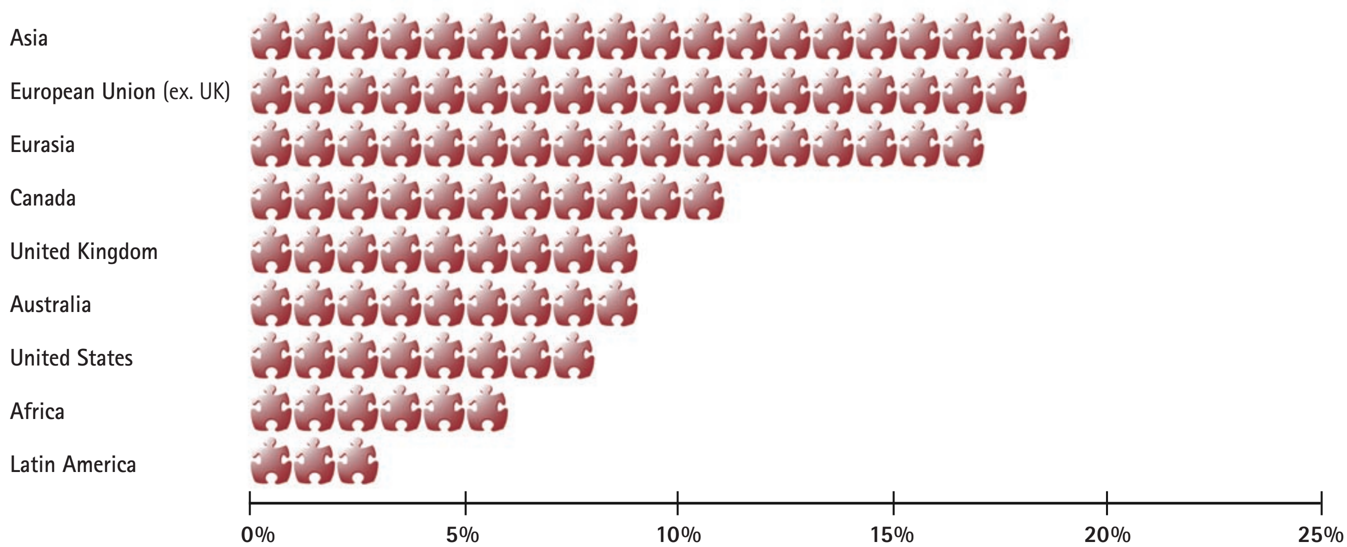
The international survey research was carried out from June to July 2007. One key objective of the survey was to obtain responses from participants across the financial reporting supply chain, including preparers, external auditors, users, regulators, standard setters and academics. Extensive efforts were made to publicize the survey and to encourage as wide a range of people to respond as possible.

341 people completed the survey. These respondents came from around the world and all parts of the financial reporting supply chain. They represent the views of different types of respondents from different regions in the world. (See boxes below.) The results of the online survey are presented in Appendix A.

SURVEY RESPONDENTS BY PERSPECTIVE



RESPONDENTS BY REGION



Telephone Interviews

Telephone interviews were conducted with 25 people from August to October 2007. The objective of the interviews was to gain a more in-depth perspective of the issues covered in the survey. During the interviews, respondents were taken in depth through the survey to elicit their views on the various topics and issues. Those interviewed included experts from all parts of the financial reporting supply chain, such as company directors, chief financial officers, regulators, standard setters, financial analysts and institutional and retail investors, as well as professional accountants and auditors. (See Appendix B: Persons Interviewed for this Survey.)

Previous IFAC Reports

In recent years, IFAC has issued a number of significant reports focused on enhancing the quality of the various links in the financial reporting supply chain. These include *Rebuilding Public Confidence in Financial Reporting: An International Perspective* (2003), *Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs* (2004), and *Enterprise Governance: Getting the Balance Right* (2004). This current survey evaluated the recommendations from these reports.

Rebuilding Public Confidence in Financial Reporting: An International Perspective

The report, *Rebuilding Public Confidence in Financial Reporting: An International Perspective* (Credibility Report), was published by IFAC in August 2003. It was developed by the Task Force on Rebuilding Public Confidence in Financial Reporting, an independent group commissioned by IFAC to address, from an international perspective, the loss of credibility in financial reporting and approaches to resolving the problem.

The report identified and analyzed the causes of the loss of credibility in financial reporting, considered alternative courses of action that might restore credibility, and considered recommendations to the participants in the financial reporting supply chain as to best practice in the areas of financial and business reporting, corporate governance and auditor performance.

The Credibility Report focused on rebuilding public confidence in financial reporting.

The main recommendations of the Task Force on Rebuilding Public Confidence in Financial Reporting were as follows:

- Effective corporate ethics codes need to be in place and actively monitored
- Corporate management must place greater emphasis on the effectiveness of financial management and controls
- Incentives to misstate financial information need to be reduced; companies should refrain from providing profit forecasts, determine executive remuneration more independently and be more transparent about executive remuneration
- Boards of directors need to improve their oversight of management
- The threats to auditor independence need to receive greater attention in corporate governance processes and by auditors themselves
- Audit effectiveness needs to be raised primarily through greater attention to audit quality control processes
- Codes of conduct need to be put in place for other participants in the financial reporting process, and their compliance should be monitored
- Audit standards and regulation need to be strengthened
- Accounting and reporting practices need to be strengthened
- The standard of regulation of issuers needs to be raised

Since the report was published, measures have been taken in many parts of the world to align business practices and regulations with these recommendations. According to the findings in this survey, the results of these efforts have clearly been successful in most areas.

The main recommendations of the Task Force on Rebuilding Public Confidence in Financial Reporting, a brief overview of what has happened since, and the findings in this survey on the results and progress in these areas, as well as the recommended next steps, are discussed in this report. (See Appendix D: Credibility Report: Recommendations and Results.)

Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs

In 2004, IFAC commissioned Peter Wong, a former IFAC Board member, to carry out this study on the challenges and successes in adopting and implementing International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISAs).

The key premise of this report was that global capital markets require high quality, globally consistent, and uniform regulatory and standards regimes. It considered that the benefits of a global financial reporting framework are numerous and include:

- Greater comparability of financial information for investors
- Greater willingness on the part of investors to invest across borders
- Lower cost of capital
- More efficient allocation of resources
- Higher economic growth

Before these benefits can be fully realized, however, there must be greater convergence to one set of globally accepted, high quality accounting and auditing standards.

The report found that action is necessary at all points along the information supply chain that deliver financial reporting. Governments, regulators, international and national standard setters, reporting entities, and auditors, as well as other participants in the financial reporting process, have important roles to play in international convergence. Boards of directors and management, who have the primary responsibility for financial reporting, as well as auditors, standard setters, regulators and other participants in the financial reporting process, such as lawyers, investment bankers, analysts, credit rating agencies and educators, all have important roles to play in achieving international convergence.

Enterprise Governance: Getting the Balance Right

The report, *Enterprise Governance: Getting the Balance Right*, published by IFAC/CIMA in 2004, complements the Credibility Report. It specifically focused on what goes right and wrong in listed companies, and emphasises that it is important to balance good corporate governance with the creation of sustainable value.

Enterprise Governance Recommendations	***What happened since?***	***Results so far and recommended next steps***
Application of enterprise governance means that companies get the right balance between performance and conformance.	Corporate governance has received a lot of attention from all participants around the financial reporting supply chain.	Respondents in this survey felt that corporate governance clearly has become better, but with too much focus on compliance. They recommend a move from compliance governance to business governance.
According to the report, there were four key corporate governance issues that underpinned both success and failure. These were: • Culture and tone at the top • The chief executive • The board of directors • Internal controls	Many codes and standards on governance and ethics that have been developed or renewed refer to these four corporate governance issues.	Respondents in this survey recognized these issues as key elements of corporate governance and recommended continuous focus on the behavioral and cultural aspects of governance. (See the next section on corporate governance for more information.)

CORPORATE GOVERNANCE

POSITIVES

- Increased awareness that good governance counts
- New codes and standards
- Improvements in board structure
- Improved risk management and internal control
- More disclosure and transparency in business and financial reporting

AREAS OF CONCERN

- Governance in name but not in spirit
- Overregulation
- The development of a checklist mentality
- Personal risk and liability for company directors and senior management
- Cost-benefit concerns

FURTHER IMPROVEMENTS

- Continue to focus on the behavioral and cultural aspects of governance
- Review existing rules as many have been introduced as a response to crises
- Further improve the quality of directors
- Better relate remuneration to performance
- Expand view from compliance governance to business governance

Corporate Governance Has Improved

Respondents felt that corporate governance clearly has become better over the last five years. This view was held across all types of respondents and regardless of the respondent's country of origin. Respondents gave a number of reasons for this improvement. For example, boards of directors have become more aware of their responsibilities to provide meaningful reports and to act in a responsible way to all stakeholders. A respondent commented, "Directors of listed companies and statutory bodies have become more knowledgeable about financial reporting, take their responsibilities more seriously and appear to be more independent in carrying out their fiduciary duties."

Many respondents commented that changes to law and regulation have improved corporate governance. Other respondents pointed to increased communication as a reason for improvement. In one respondent's words, "Governance has dramatically improved. There has been an improvement of dialogue between directors and investors."

Respondents felt that overall the balance between the costs and benefits of corporate governance had become better over the last five years. While this result was consistent regardless of the type of respondent, regulators were the most positive, while users were among the least positive and felt that the balance had remained about the same.

Looking across regions, there was also little difference between respondents. According to an Asian respondent, "The benefits of corporate governance outweigh negatives. The challenge is to not lose sight of business realities." A European respondent commented that the cost-benefit balance has stayed about the same, and that in places where costs rose at the expense of benefit, this increase in costs has now ended.

The Positive Aspects of Corporate Governance

In describing the good things that have happened over the last five years in corporate governance, the issues mentioned most often were:

- Increased awareness that good governance counts
- New codes and standards
- Improvements in board structure
- Improved risk management and internal control
- More disclosure and transparency in business and financial reporting

Increased Awareness that Good Governance Counts

Virtually all respondents felt that past scandals and failures in corporate governance have sparked the increased focus on improving corporate governance. Good governance counts because it makes directors and management more aware of their responsibilities to act in a responsible way to all stakeholders and to provide useful reports and also contributes to corporate effectiveness.

Respondents observed that, although most boards want to do what is right, corporate governance also has become better due to more external pressure coming from regulators, stock exchanges and, especially, investors. One respondent noted, "In addition to the government and financial market regulators, professional bodies have also put considerable efforts into promoting corporate governance." Greater public scrutiny has helped too. For example, a respondent observed, "The 'name and shame' environment in the UK has increased awareness of issues; companies don't want to be in the newspaper."

New Codes and Standards

Changes to the codes, standards and rules governing companies and boards of directors in the past five years were widely felt by respondents to have led to improvements in governance. A respondent from the US commented, "Corporate governance has significantly improved due to the SOX[1] Act as boards are now much more involved and there is more clarity around their responsibilities." Respondents also considered that making management explicitly responsible for the information used by third parties was a positive development that had improved corporate governance.

Many respondents preferred the principles-based codes and standards to the more rules-based approach of the US. "Luckily, the UK did not fall in the SOX trap," a respondent noted. Having a 'comply or explain' provision was seen as one of the key strengths of principles-based codes. This approach has lead to companies applying a sensible approach to corporate governance and has resulted in useful additional disclosures. Respondents also felt that increased oversight and enforcement were contributing to better corporate governance.

Improvements in Board Structure

Many respondents mentioned improvements in board structure as an important reason for improved corporate governance. The key improvement in board structure mentioned by respondents was recognition of the importance of independent, non-executive directors. "The independent non-executive director provides a useful check and balance," one respondent commented. Non-executive directors, a respondent commented, "have a greater awareness of the expectations that shareholders and others have for them." Various respondents also had the following to say: "Directors that did not do their homework got increasingly concerned about liability and stopped serving as directors";

[1] US Sarbanes-Oxley Act 2002

"New directors have a good understanding of the company and the industry in which it operates and are more knowledgeable about financial reporting"; "Boards are much more aware of board responsibilities"; and "They are conscious of the need to add value for shareholders."

In addition, respondents felt the wider adoption, the increased competence and the improved operation of audit committees have created a key mechanism to bring internal and external audit and management together to the benefit of good corporate governance. Other committees of the board, such as the nomination and remuneration committees, were also considered to add value.

Improved Risk Management and Internal Control

Respondents generally felt that increased emphasis on risk management and internal control by executive management and boards had led to improved business operations and better reporting. "The level of engagement is higher and working procedures are improved," one respondent replied.

However, many respondents objected to the way some elements had been applied. For example, the documentation and the testing of controls were often felt to be too detailed and laborious. In the words of one respondent, "The bottom-up approach to the documentation of internal controls over financial reporting (and the resulting identification and testing obligation of many detailed controls) proved to be grossly inefficient and ineffective, which ultimately provided little value to shareholders." Also, the auditor sign-off on top of the management sign-off on internal control was seen as redundant by some respondents.

More Disclosure and Transparency in Business and Financial Reporting

Respondents appreciated increased disclosures, for example, on company risks, opportunities and strategic decisions, executive pay, and on related parties. They also mentioned more informative annual reports, more informative corporate websites, more standardized financial reports, and more transparent general shareholders meetings.

Respondents felt this enabled users to get more information about the company and also improved accountability.

Areas of Concern in Corporate Governance

In describing the less desirable things with respect to corporate governance, respondents were concerned about the following:

- Governance in name but not in spirit
- Overregulation
- The development of a checklist mentality
- Personal risk and liability for company directors and senior management
- Cost-benefit concerns

Governance in Name but Not in Spirit

Many respondents felt that many changes that have been made were made in "letter," not in "spirit." They shared the view that quite a few companies are pushed to improve their governance more by the regulatory bodies than by their own/inner self-discipline mechanism. In their opinion, numerous companies and boards of directors consider governance as yet another certification, and still think that forming committees and hiring consultants to write polices solves the problem. Companies quickly adopt the easy-to-comply-with governance, but seem slower to adopt the more painful measures. It is "lip service to corporate governance rather than real corporate governance," as one respondent put it.

Respondents noted that there are (still) some individuals who think they are above best practice, for example, "Directors who still believe that they are the company and do not always act in the interests of shareholders."

Respondents felt that fostering a culture for corporate governance is far more than a compliance exercise and warned that compliance in form rather than substance provides a false sense of security.

Overregulation

Respondents recognized that the financial reporting scandals of some years ago really let investors down. Many were skeptical, however, about the response. "Additional regulation tends to be a knee-jerk reaction to a corporate failure," said one respondent, and "governance principles are currently drowned in a whole pile of rules," according to another. Some feel the result is that "regulation now feels more over bearing and is constantly being raised."

Respondents especially disliked what one respondent called "the increased prescriptiveness of regulatory frameworks that encourages legalistic compliance rather than principles-oriented 'better' practice." And many felt that the US has gone overboard with its SOX and compliance disclosure. "This has led to a greater disclosure burden, higher costs, and many companies view it as an exercise in compliance rather than embracing the spirit of good governance," another respondent noted.

The Development of a Checklist Mentality

It was felt that overregulation had created a situation where people focus now too much on compliance and are not talking about matters such as strategy and building a business. There is also too much focus on rules instead of integrity. This might create a culture of simply following rules instead of thinking about how to deal with governance aspects in general. "Increasing the amount of box ticking is unhelpful as it doesn't make people think," a respondent commented.

Respondents signaled a preoccupation with governance rather than making the company achieve and prosper. As a result, the potential exists that compliance activities are taking too much time and attention and real risk areas could be overlooked. Many believe that companies have become too risk averse and are avoiding risk rather than managing it.

An external auditor commented, "Directors [are] spending more and more time in compliance issues and losing sight of operational issues." Another respondent recommended that boards take responsibility and "review their agendas and see how much time they spend on the various topics like compliance versus strategy and find a balance."

Personal Risk and Liability for Company Directors and Senior Management

The personal risk and liability faced by company directors was an issue raised by some respondents as it had caused some directors to reevaluate their board positions. Respondents also commented that it is more difficult to recruit new board members and senior management level people due to increased legal liability exposures. "It is not worth taking the risk anymore to assume a board or CEO/CFO position," one respondent said.

Some respondents observed a level of paranoia which has caused some directors to be overly skeptical and distrustful of the action of management, which has led to inefficient business decisions. They point out the need to allow directors some protection, because now they are too risk adverse. As one respondent put it, "They should only get charged when their wrongdoing is willful."

Cost-Benefit Concerns

The majority of respondents felt that the balance between the costs and benefits of corporate governance had become better. However, many respondents expressed concerns that the costs of certain regulations, especially section 404 of the US Sarbanes-Oxley Act, have vastly outweighed the benefits.

Many respondents felt there was a need for continuous vigilance against having a governance-at-all-costs mentality.

What Needs to be Done Next in Corporate Governance?

Respondents were asked to think about how to further improve corporate governance in their respective countries and to prioritize a number of different measures that might achieve this goal. The measures respondents considered to be of high priority were:

- Continue to focus on the behavioral and cultural aspects of governance
- Review existing rules as many have been introduced as a response to crises
- Further improve the quality of directors
- Better relate remuneration to performance
- Expand view from compliance governance to business governance

Continue to Focus on the Behavioral and Cultural Aspects of Governance

Across the different types of respondents, continuous attention to the behavioral and cultural aspects of governance was considered to be the most important priority. One respondent expressed his "lingering concern that the importance of corporate governance will fade from radar screens, leaving the door open for future governance failures." Another respondent added, "There is some fatigue about corporate governance."

Ethics is not only important within companies. One respondent advised, "The ethical dimension – social, cultural and personal behavior – is fundamentally important throughout the whole financial reporting supply chain." Another commented, "It is good to improve accounting and auditing, but banks, financial advisers and analysts, credit raters and lawyers should also adhere to a code of ethics." Still another said, "More attention should be given to governance arrangements of institutional investors themselves, like pension funds and equity/fund management groups" because there are "…lots of conflicts of interests that are inadequately disclosed." Finally, a respondent commented, "Companies are mirrors of the societies in which they operate and they influence each other. Therefore, improved corporate governance has a positive impact on societal governance and vice versa."

Review Existing Rules as Many Have Been Introduced as a Response to Crises

Several respondents proposed a review of the regulation that has been introduced as a response to the crises, based on the experiences so far. Others observed that this is already happening in some countries. Comments included: "The Combined Code in the UK has recently been reviewed and found satisfactory; the principles are becoming much better understood," and "The Australian Stock Exchange recently refreshed its principles of corporate governance." Respondents also commented that the approach of some countries was to let the US go first through the process and then adopt what worked and reject what went wrong.

Respondents thought that in developing countries, there should be a focus on the basic principles that underlie good financial reporting, including the existence of a market economy, respect for the rule of law and legal protection for minority shareholders. Many respondents shared the opinion that emphasis needs to be given to improving skills as in some developing countries there is a lack of competent accounting and auditing professionals. Removing impediments to capital flows to allow foreign ownership of domestic companies might also improve corporate governance, according to some respondents, as foreign owners would bring with them skills, experience and expectations with respect to good financial reporting.

Further Improve the Quality of Directors

Respondents considered that generally the best people to oversee management are non-executive directors. Therefore, independence of directors is seen as fundamental to good governance. In the words of one respondent, "More independent directors would generally be healthier for governance and making sure that management is 'doing the good thing.'" Many respondents considered that separation of the roles of chairman and CEO is logical and effective. "One runs the company and one runs the board," said one respondent. "They are different roles and it is hard to do both," and "Otherwise there is a risk of a less well-controlled CEO," were other comments made.

For many respondents, the crucial point is the quality of who you get on the board, focusing on substance rather than on form. A better selection processes and annual reviews might help to improve the quality of non-executive directors. Another suggestion was to increase the ability of shareholders to remove directors.

Respondents also recognized the need for (at least) some directors to have significant experience, as one respondent stated, "Directors who have been on boards a long time have accumulated wisdom and skills that are of benefit to the company."

Better Relate Remuneration to Performance

According to the survey results, executive remuneration is still an issue, especially as it is difficult to relate remuneration to performance. Respondents held strong views: "Remuneration is the biggest area of trouble [because there is] very little correlation between remuneration and performance," and "A Pandora's Box is opened with all these performance incentives." Another respondent commented, "A lot of compensation is now totally at random" and this was detrimental to the quality of corporate governance as "all or most accounting scandals involve compensation."

Respondents felt that there needed to be a better alignment of compensation with longer term company performance. Alternatives to current remuneration structures included a larger amount of pay in the form of "plain old fashioned salary," and equity only for exceptional performance. As well, respondents considered that there should be more transparency in executive compensation.

Expand View from Compliance Governance to Business Governance

According to many respondents, there is a need to consolidate the current position and to move on to other areas, as one of them pointedly said, "Compliance is done. Now we need to go back to business." There is too much compliance governance instead of business governance – not only to satisfy regulators, but also because many institutional investors put too much emphasis on compliance with governance rules. Respondents also felt that the overemphasis on internal control over financial reporting should be reconsidered.

Governance should not be a separate pillar mainly concerned with compliance, but "a more integrated way of running your business effectively and efficiently," a respondent commented. Furthermore, control processes should be more embedded in the business processes, and should be designed by people who have experience with the area of organization, people and processes.

And what could institutional investors do to help companies making this transition? Responses included: "They should have a more constructive relationship with management of companies in which they invest," and "Make sure that the dialogue is about long term issues, strategy, overall risk, whether they got the right people in place etcetera."

FINANCIAL REPORTING PROCESS

POSITIVES

- Convergence to a single set of global financial reporting standards
- Improvements to regulations governing financial reporting, including increased oversight of financial reporting
- Board of directors/management taking ownership of the financial reporting process
- Improved internal control over financial reporting systems supported by improved technology for preparing financial reports

AREAS OF CONCERN

- The costs of transition to IFRS
- The need to comply or to reconcile accounts with more than one set of financial reporting standards
- The complexity of financial reporting standards
- Liability restricting process

FURTHER IMPROVEMENTS

- Continue convergence to one global set of financial reporting standards
- Simplify and clarify financial reporting standards focusing more on principles and less on rules
- Ensure that boards of directors pay attention to the quality of financial reports
- Provide additional education and training for preparers

The Process of Financial Reporting Has Become Better

Respondents felt that the process of financial reporting, including the preparation and internal approval of financial reports, had become better in their respective countries over the last five years. While the results did not differ significantly between the different types of respondents, standard setters were the most positive and auditors were among the least positive.

"The financial reporting culture has improved," commented one respondent. "There is now improved attention for financial reporting and as such for the financial reporting process," said another. Yet another noted the existence of "increased attention of boards and audit committees on importance of financial reporting."

Overall respondents felt that the balance between the benefits and the cost of the financial reporting process was about the same compared to five years ago. Regulators and standard setters felt that the balance was better, while external auditors, preparers and users felt that the balance was about the same compared to five years ago. However, respondents felt that attention needed to be paid to cost-benefit issues. "It should be recognized that there are costs associated with information and that users (especially owners) need to set some priorities as to the information needed, while recognizing that information is not a free commodity," a respondent pointed out.

Respondents from different regions had different views about the balance between the benefits and costs of the financial reporting process. Respondents from Eurasia, Africa, Asia and Latin America were generally much more positive that the benefits outweighed the costs than respondents from the European Union, United States, Canada, the United Kingdom and Australia.

The Positive Aspects of the Financial Reporting Process

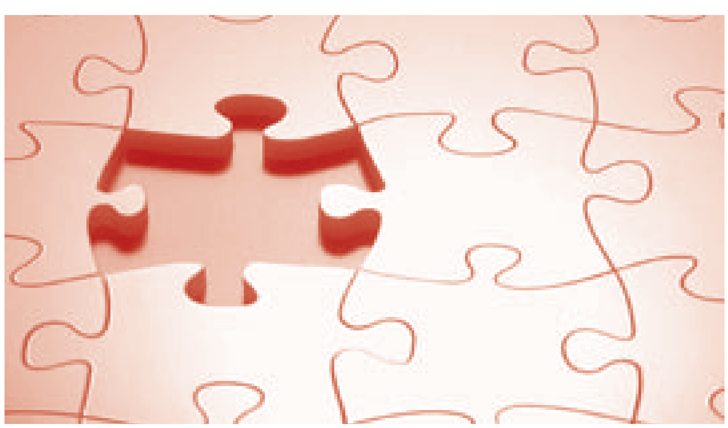
In considering the good things that have happened over the last five years with respect to the financial reporting process in their countries, the issues listed most often by respondents were:

- Convergence to a single set of global financial reporting standards
- Improvements to regulations governing financial reporting, including increased oversight of financial reporting
- Board of directors/management taking ownership of the financial reporting process
- Improved internal control over financial reporting systems supported by improved technology for preparing financial reports

Convergence Is Positive

Convergence to IFRS was seen as a positive development. As one respondent explained it, "IFRS, by creating a global level playing field, must be a good thing." Another said, "There has been an increase in transparency due to having a global language." IFRS was also seen as an improvement on local generally accepted accounting principles (GAAP). "Certain business transactions and accounting practices, not covered in great detail under [some local] GAAP[s], are subjected to more detailed analysis in IFRS, increasing the level of comfort provided to preparers, auditors and users," as one respondent said.

The change to IFRS has also changed the behavior of some company directors. According to one respondent, "Directors have struggled with IFRS and have therefore devoted more time to financial reporting." Within companies, another noted, "The move to IFRS has encouraged organizations to review more closely the appropriateness of their accounting policies." At a practical level, "Due to mandatory compliance of the Code of Corporate Governance, almost all publicly listed companies are issuing financial reports within the time limit, as well as with improved presentation," another respondent observed.



Regulation and Oversight Have Improved

Respondents saw improved regulation and oversight as positive developments. One commented that there is now an "up-to-date Companies Act passed, which makes compliance with IFRS in the preparation and presentation of financial statements mandatory." Another noted, "In the EU, the introduction of EC Regulation requiring listed companies throughout Europe to adopt IFRS in their consolidated accounts by 2005 is a major achievement in terms of comparability and transparency of the financial information across Europe."

The increase in oversight of financial reporting by regulators was viewed positively by respondents. In particular, respondents commented that regulators have increased their scrutiny of company financial reports. One respondent noted, "Financial reports are now scrutinized and inspected more objectively by the [regulator] resulting in more responsible, true, fair and objective reporting." Another respondent made a similar comment, "Companies are aware of the financial reporting process, especially listed companies." Still another felt that financial reports had improved because companies, especially listed companies, were now subject to more scrutiny by the regulator, and the regulator was checking to ensure that financial reports were prepared in accordance with GAAP.

Boards of Directors and Management Have Taken Ownership

Boards of directors and management have increasingly taken ownership of the financial reporting process. Respondents observed a regular review and sign-off by all levels of management and oversight by directors, and an improved scrutiny by boards of directors of the quality, accuracy and reasonability of financial information released to the public.

Another respondent considered that despite its costs, the SOX legislation in the US had made a positive contribution. CEOs were now more involved in financial reporting and the requirement that CEOs and CFOs sign-off on the financial reports has increased the importance within companies of financial reporting and internal controls.

Improved Internal Control and Better Technology

Improved internal control over financial reporting was another positive development. One respondent commented, "Companies have increased the emphasis on financial reporting and internal control with an emphasis on the quality and accuracy of financial reporting and the role of audit, the audit committee and regulators." However, in another respondent's opinion, "There is still not a good understanding of what we mean by a sufficient level of internal control." "An undue focus on too deep controls [might give a] false impression of increased security," replied another.

Respondents also recognized the trade-off between quality and time. "We need an ongoing integrated reporting process to be able to issue reports within two weeks of closing," a respondent stated. The use of technology has improved the preparation of financial reports, prompting a respondent to comment, "Process is more automated and [takes] less cost and time," while another pointed out that technological improvements were leading to more accurate and timely reporting.

Technology was also improving workflow. In the opinion of a respondent, "Tools for automated workflow have become more available. Participants in the reporting work stream place much more importance on accuracy and timeliness." These changes are improving the quality of financial reports, leading a respondent to comment, "The use of computers and standard procedures in the process of bookkeeping and financial reporting makes less artificial errors and incompliance." "The emergence of data analysis techniques [applied to financial statements] has greatly helped detect errors and outright fraud," another added.

Areas of Concern in the Financial Reporting Process

Respondents considered the less desirable changes over the last five years in regard to the financial reporting process to be:

- The costs of transition to IFRS
- The need to comply or to reconcile accounts with more than one set of financial reporting standards
- The complexity of financial reporting standards
- Liability restricting process

The Transition to IFRS Has Had a Significant Impact

Many respondents viewed the move to IFRS as costly. One respondent commented, "The move to IFRS has had a significant impact on the large companies because it forced them to look at all their systems to gather the required information." Another commented, "In IFRS, the income statement has become a real problem." One respondent saw the issue this way, "IFRS has been implemented in due haste. It would have been better if the implications had been thoroughly discussed by all participants (not only accountants) before it was implemented. Now it is something that is of no help to management and no help to investors either."

Another respondent commented that with the move to international standards, "The large [audit] firms now all have a London desk and if there are IFRS interpretation issues, these now get referred to London rather than being resolved domestically and this takes time. The desire for consistency has slowed down the financial reporting process."

Some respondents considered that given the changes in recent years, there was a need for stability in financial reporting requirements and standards, as the time spent understanding and implementing new rules and regulations was taking time away from managing the business. As a respondent explained, "Fifty years of change has taken place in ten years, which is creating indigestion and distorting reporting resources as a consequence."

Reconciliation Is a Concern

The need to comply with more than one set of financial reporting standards was of concern to some respondents. As one respondent explained it, "Due to international standards, companies have to report in two different ways. Quite often the numbers substantially differ." One respondent, describing the situation in Canada, stated, "Now we are reporting in Canadian GAAP and US GAAP and are moving to IFRS. Who can follow that?"

According to a respondent from the US, the 2007 proposal from the Securities and Exchange Commission (SEC) to eliminate the reconciliation requirement will help the convergence process. However, "Moving from US GAAP to IFRS is a big undertaking for US companies. The devil is in the details. There are huge infrastructures in place to report that need to be changed," this respondent commented.

Financial Reporting Standards Are Adding to Complexity

Respondents recognized that companies have become more complicated over time, but they felt that financial reporting standards should not add to this complexity. Many respondents indicated there was a need to simplify financial reporting standards, as one put it, "We need to simplify the accounting rules so they are more easily applied and understood by preparers and users." Standards

THE DEBATE: PRINCIPLES OR RULES?

Many respondents commented on the current debate regarding how financial reporting standards should be written and whether they should be principles based or rules based. The views expressed were mixed; they recognized that the situation was complex and the difference between principles and rules was not always clear-cut and that a combination of both approaches might be necessary and appropriate.

Principles Are Preferred to Rules

Most respondents preferred principles to rules, as one respondent said, "Principles provide benefits (over rules) in that it requires preparers and auditors to exercise judgment. With rules people stop thinking. Furthermore the legal profession finds ways around rules."

Another respondent commented, "Everybody would rather live in a principles-based environment. In the US, however, there are rules. How much they might like to move back to principles, they need the protection of rules to cover their backs against litigation…the legal framework prohibits the move back."

It was also noted, "Previously, the US had a principles-based accounting system but gradually migrated towards a rules-based system…largely driven by litigation and by the general feeling that an increase in rules would also increase the protection for preparers and auditors because they applied rules." But a rules-only system is not the solution. "Enron happened in a rules-based environment," as a respondent pointed out.

But Both Are Needed

A number of respondents shared the belief that the debate about principles and rules was misleading as it suggests that standards should be either all principles or all rules. These respondents felt that this overly simplified the issues involved. One respondent stated, "The idea is to have principles and rules that are both simple and effective, but this is difficult to achieve. It is not realistic to have no rules, but at the same time, standards need to be based on a framework."

There was also a feeling that characterizing jurisdictions as principles based or as rules based does not result in an accurate description of the current situation. One respondent said, "Principles versus rules is misleadingly characterized. UK, in fact, is not principles, but a hell of a lot of rules…it is a hybrid, principles but also rules."

Respondents also considered that both principles and rules should be used. One respondent said, "First [you need] principles, then high level application guidance and examples." There should be, the respondent said, "More discussion first on what is the right principle: you should first have an exposure draft on the principle before getting into the details." Another respondent made a similar point, "First you need strong concepts, then objectives and then reasonably consistent application, guidance/rules." Finally, there was a respondent who reminded us that "Neither principles nor rules will stop a person who wants to do something extreme."

and disclosures are seen as far too long and complex. "We are scaring new entrants from joining the accounting profession and are confusing readers," another acknowledged.

Some respondents felt that IFRS was at least partly responsible for this situation, for example, the person who wrote, "Many parts of IFRS are unnecessarily complex. So much so that there are a limited number of preparers who could claim they are confident with their knowledge of all standards and their ability to interpret those standards. There needs to be a focus on simplifying the standards, not just for the small and medium entity area, but for the main body of standards." Another respondent commented, "The introduction of IFRS has increased complexity with the outcome that fewer people are equipped to interpret financial reports, but more people are engaged in (the) process of production."

In particular, the use of fair value within IFRS was seen as giving rise to complexity and confusion within the financial reports. Respondents shared the view that preparers were struggling with fair value and that fair value was not a sensible valuation method in all cases. Fair value is not necessarily fair. It is, in one respondent's words, "more fair for liquid assets. Otherwise the numbers are modeled and are less reliable, especially if the marketplace does not actually exist." For assets where there is no active market, the right assumptions need to be built in and disclosed or fair value results in "garbage in, garbage out."

The Legal Environment

Respondents felt that the legal environment has become worse. "Five-page-long footnotes are a disclosure overload. The lawyers of the preparers write the disclosures; therefore, they are no longer understandable. It is not plain business language." One respondent expressed it this way, "If you are a public company, then you have to tell the public what is going on. But everybody is afraid of liability. Therefore, a lot of management reports are meant NOT to be understood." Another respondent said, "Boards feel that they should communicate more clearly and directly to their stakeholders. But even a simple press release takes hours of lawyers. Why? A lot of businesses are afraid of liability."

Respondents say that financial reporting could be improved by having less rigid requirements and less risk of litigation so that the report actually could be written by the board itself and in a freer style. One respondent expressed his thoughts this way, "Reporting needs to transform from an exercise of compliance into an exercise of communication – meaningful, cohesive, and sufficient for making well-informed decisions."

Respondents suggested limiting the risk of litigation by having safe harbors for boards and senior management for financial reporting and narrative reporting, unless there is deliberately lying or reckless behavior. "Liability for fraudulent reporting: yes. Liability for the rest: no," replied one respondent. Another sug-

PRINCIPLES NOT RULES CAMPAIGN

In 2005, the IFAC member body, Institute of Chartered Accountants of Scotland (ICAS), established a working group to help find a resolution to the principles versus rules debate within international accounting standard setting. This resulted in the publication *Principles Not Rules: A Question of Judgement*.

ICAS found almost unanimous agreement for principles-based accounting, but how to implement the report's recommendations remained an issue. ICAS is committed to advancing the debate and facing the challenges of moving to a principles-based accounting framework. In its view, none of these challenges are insurmountable, but they do require concerted action by all the stakeholders in financial reporting, and the development of trust by and among all parties.

A conference was held in London in October 2006 to explore the challenges of moving to a principles-based accounting framework. The key points from this conference, "Too Late for Principles?" have been published by ICAS in its report *Principles into Practice*. On April 2007 ICAS held a conference in cooperation with the American Institute of Certified Public Accountants to consider principles-based accounting and the challenges of implementation. The key points from this conference have been published by ICAS in its report, *Principles into Practice – key points from the New York conference*. A further event – a roundtable discussion – was held in Brussels in September 2007; a report will be available on the ICAS website, **www.icas.org.uk**.

For more information on the ICAS Principles Not Rules campaign, visit its website.

gested that maybe institutional investors could also give a clearer signal here. "It is a bit brave for boards to really assume control over narrative reporting but they are pushing on an open door," the respondent said.

What Needs to be Done Next in the Financial Reporting Process?

In thinking about how to further improve the financial reporting process in their countries, respondents thought that the following measures were a high priority:

- Continue convergence to one global set of financial reporting standards
- Simplify and clarify financial reporting standards focusing more on principles and less on rules
- Ensure that boards of directors pay attention to the quality of financial reports
- Provide additional education and training for preparers

Convergence

While respondents often had concerns about the content of IFRS, they did express support for convergence and a single set of global accounting standards. A preparer put it this way, "There is a big problem in that standards vary around the world." Another respondent felt, "Convergence of IFRS worldwide allows consistent accounting treatment of transactions for global operations." Another respondent warned, however, "There will never be a global interpretation of IFRS. We have to accept local interpretations which will lead to differences in results."

Respondents also felt that a single set of accounting standards would not, on its own, improve the financial reporting process. The financial reporting standards themselves need to be simplified and clarified.

Financial Reporting Standards Need Improvement

Financial reporting standards should place an emphasis on the directors telling their story in the annual report, not on the annual report being something to meet the disclosure requirements set by others. More emphasis is needed on true and fair as the ultimate principle governing reporting. One user expressed it this way, "More focus on simplicity and understandability would be good for both companies and shareholders…if the company wants to disclose something and we are happy to receive it, they should not be dissuaded from doing so by the regulator if it is non-GAAP. All this does is make the reporting process less relevant."

Financial reporting standards also need to be more principles based. "Consistent principles with good explanations are better than rules. Rules are restrictive and the same for everything, but everything is not the same; principles can be adapted to what is appropriate for a particular circumstance," was one respondent's view. Financial reporting standards need to be based on "strong concepts, then objectives and then reasonably consistent application through guidance or rules," said another. An issue that arises with principles-based standards is that different interpretations might be made of the same information; however, a regulator commented, "If there is more than one interpretation possible, a company should disclose in their accounts what they have done and also disclose how it could have been done otherwise."

Respondents commented as well that the way financial reporting standards are written would also help preparers, as one of them expressed, "IFRS should be in plain English and in plain translations. Native English speakers already struggle with the language." It was also noted that translation of IFRS is a major task.

Attention by Board of Directors to Quality

Respondents considered that the board of directors needs to pay continual attention to the quality of financial reports. In particular, they felt that the role of audit committees needed continued attention. "We are far from having a culture where the involvement of audit committees is key in the process for issuing financial information," stated one respondent. This view was also held by a user who considered that there should be "increased focus on the quality of the audit committee." Another respondent commented, "The whole board needs to own the financial reporting process more and not let IFRS force them into particular roads. They have a duty to produce accounts with a true and fair view."

More Education and Training for Preparers

The need for additional education and training for preparers was seen as important by many respondents. For some respondents, this need was driven by the adoption of IFRS. "Education and training on IFRS is needed as IFRS can be different to national GAAP and people are used to their GAAP," commented one respondent. As noted by another respondent, "IFRS is difficult to understand and apply. Therefore, first do your homework and get your education system up to speed first." This need for education with regard to IFRS is also important at the most senior levels, as one respondent pointed out, "Companies just hire a Big 4 auditing firm to do it for them and then the directors have no idea about it."

THE AUDIT OF FINANCIAL REPORTS

POSITIVES

- Improved auditing standards and processes
- Increased awareness, commitment and competence of auditors and audit committees
- More risk focused audits
- Greater auditor independence
- Improved quality review and auditor oversight

AREAS OF CONCERN

- The reduced scope for professional judgment
- Overregulation
- Liability fear leading to boilerplate audits and a lack of innovation
- Limited auditor's communication with external stakeholders
- Limited choice of audit firms
- Increased audit cost relative to perceived benefits

FURTHER IMPROVEMENTS

- Continue to focus on independence, objectivity and integrity
- Converge to one set of global, principles-based auditing standards over time
- Ensure consistent use of audit standards and safeguarding of quality within audit firms
- Improve auditor's communication, both internally and externally
- Consider limited/proportionate liability for auditors
- Remove barriers that limit choice of auditor

The Audit of Financial Reports Has Become Better

Overall, respondents to the survey felt that the audit of financial reports has become better over the last five years; preparers and users were slightly less positive than other respondents.

Across all respondents, the balance between the benefits and costs of the audit of financial reports has stayed the same, as compared to five years ago. By region, the regions with the bigger capital markets, UK, EU, and the US, were a bit more pessimistic about the cost-benefit balance compared to respondents in Africa, Eurasia, Asia and Latin America.

The Positive Aspects of the Audit of Financial Reports

In describing the positive aspects in auditing over the last five years, the issues mentioned most often by respondents were:

- Improved auditing standards and processes
- Increased awareness, commitment and competence of auditors and audit committees
- More risk-focused audits
- Greater auditor independence
- Improved quality review and auditor oversight

Better Auditing Standards and Processes

The improvement of financial auditing standards and the resulting improvement in financial auditing processes were the most common reasons for the perceived improvement of financial auditing quality. The respondents noted there has been a very significant effort for the profession to improve quality, which has been translated in a joint effort on regulatory, ethics and technical matters, and that IFAC's *Code of Ethics for Professional Accountants*, *International Standards on Auditing* (ISAs) and other IFAC standards are now widely implemented.

One respondent considered that while international auditing standards are important, adherence to those standards is even more important! Respondents also saw improvements in the auditing process, for example, a more systematic approach and analytical reviews with emphasis on the risks and controls. They also said that more demanding standards require auditors to gain a better knowledge of the audited company and a deeper level of understanding of the audited company's financial reporting process, and thus make the audit process more relevant and efficient for the audited company.

In developing countries, the presence of international accounting firms brought high quality services and promoted an increase in the level of professional education. "Since the auditing firms are trying to apply international auditing standards, the quality of the audits is increasing day by day," according to a respondent.

Increased Awareness, Commitment and Competence of Auditors and Audit Committees

There has been a significant increase in audit quality. As one respondent explained, "External auditors are now more careful, preparers have become more diligent and audit committees are more aware of importance of their role." Auditors are held more accountable which, according to many respondents, has led to increased awareness, commitment and competence within the audit profession "Auditing has come back to where it used to be: quality, rigor and greater focus on controls," commented one. Another sensed "a renewed professional passion after 'the impossible thing'[2] proved to be possible!"

Many respondents considered that audit committees are a key mechanism to bring internal and external audit and directors together and are of the opinion that they have become much more effective and that the relationship between audit committee and auditor has much improved. "Now there is much more financial literacy in the board and audit committees," said one respondent. Another explained, "There are much more open discussions between auditor, board and audit committee on all assumptions and accounting choices." The view of another was, "They are working together for common results, i.e., checking falsehoods don't creep through, that the company is not stretching the boundaries of risk, making sure the whole board understands risks and helping them to supervise management."

More Risk-Focused Audits

To many respondents the understanding of the entity and the improvements in the risk-based approach to audits are an important improvement. They applaud that auditors now are more focused on the overall risk profile of the audited company rather than on a micro review of transactions. "Most corporate failures come from governance failures, management issues, tone at the top, etcetera. It is good that auditors focus more on that!" noted one respondent. Others respondents felt that audits had improved because auditors had returned to the actual testing of controls, instead of only getting the big picture view.

Greater Auditor Independence

To many respondents, strengthening of the independence rules for auditors has been a positive move that has yielded good results. "Now auditors do realize that they are responsible to shareholders," said one, while another added, "They are a partner to oversee management." As a priority to further improving auditing, external auditor independence was rated highest by respondents.

[2] The collapse of the accounting firm Arthur Andersen

Improved Quality Review and Auditor Oversight

The improved internal quality review and enhanced external auditor oversight were seen as contributing to a better financial audit. Respondents felt that both within the accountancy profession and in the accounting firms themselves, there are infrastructures in place to facilitate and enhance quality. As a result, international accounting and auditing methodologies and guidance are applied fairly consistently.

According to the respondents, auditing has improved due to [more] external oversight. "Auditors know that they are audited themselves," a respondent offered. This has contributed to the change in attitude of auditors. In the eyes of one respondent, "More independent from clients, more inclined to look at the public interest rather than the client's interest." As a result, respondents had more confidence in the audit than five years ago.

However, respondents felt that ensuring that the reliability of financial reports increased was not solely the auditor's responsibility, but was also dependent on other participants in the financial reporting supply chain. For example, one respondent noted that as long as management is heavily incentivized by equity, the incentive to "cook the books" to get the share price up is overwhelming, and the auditor has a tough job fighting against this capital market incentive structure.

Areas of Concern in the Audit of Financial Reports

Respondents also raised a number of concerns in the auditing area, in particular:

- The reduced scope for professional judgment
- Overregulation
- Liability fear leading to boilerplate audits and a lack of innovation
- Limited auditor's communication with external stakeholders
- Limited choice of audit firms
- Increased audit cost relative to perceived benefits

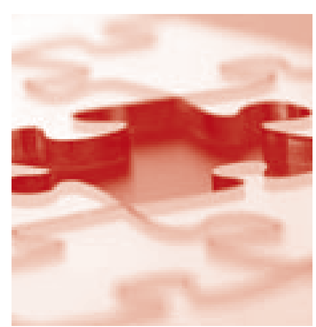
Reduced Scope for Professional Judgment

Many respondents considered that too many auditors are defensive, the audit has changed from materiality audits to formal audits, leaving little room for professional judgment. "As long as all forms have been completed, it is fine," was the opinion of one respondent. Overregulation and liability fear are seen as the main causes for this pressure on professionalism.

THOUGHT LEADERSHIP

Thought Leadership is an initiative of the Institute of Chartered Accountants in England and Wales (ICAEW), an IFAC member body, to address major questions relevant to its members' areas of professional expertise. The ICAEW's thought leadership initiative currently consists of eight programs, including:

- **The Audit Quality Forum.** The initial focus of the Forum was to improve audit transparency and support shareholder involvement in the audit process. It has gone on to explore a broader agenda which examines the relationships between shareholders, boards, auditors, regulators and other stakeholders in the audit. The Forum brings together these groups, promoting an open and constructive dialogue in order to contribute to the work of government and regulators and generating practical ideas for further enhancing confidence in the independent audit.
- **Information for Better Markets.** Since the corporate scandals of 2001 and 2002, there has been increased interest by business, regulators and the government in initiatives which reinforce integrity and enhance trust in reporting. Business reporting relies on a complex web of interactions, discussions and communications between individuals, including many who do not work for the reporting entity. The ICAEW's *Information for Better Markets* publication, *Reporting with Integrity*, brings together ideas from a variety of disciplines, in order to obtain a more comprehensive understanding of what is meant by integrity, both as a concept and in practice. Moreover, because this publication sees reporting with integrity as a joint endeavor of individuals, organizations and professions, including the accounting profession, the concept of integrity is considered in all these contexts.



For more information on all the ICAEW's thought leadership programs and publications, visit: **www.icaew.com/thoughtleadership**.

Improved standards are seen as one of the main reasons for the perceived improvement of financial auditing quality. But respondents are concerned that the use of professional judgment gained from experience is being removed through more prescriptive and standard treatments that defy common logic. "Principles-based systems are being corrupted by rules," was one related comment.

Many respondents also noted the accounting and auditing standards overload, which has led to very lengthy and difficult audit procedures. Now specialists are needed to understand the rules. "The audit partner is always checking treatments with the technical people, so we are moving away from the idea of an audit staff that can use judgment," observed a respondent.

Liability Fear Leading to Boilerplate Audits and a Lack of Innovation

Respondents felt turning accounting and auditing standards into rules, as well as excessive oversight and litigation, has made external auditors afraid to exercise any professional judgment and created a compliance-focused audit mentality leading to suboptimal audits. Comments on this topic included: "Auditors micro audit. They are too concentrated in small details and are not overseeing the big picture"; "Auditors now spend disproportionate time on checking technical compliance and on evidencing their own work to reduce risk of criticism and hence liability"; and "In an effort to protect themselves, auditors are advising the board or audit committee of boiler plate items that add no value."

For some respondents, the auditing industry needs to change substantially, away from the current checklist mentality to much more innovation like continuous auditing, using XBRL[3], looking at the underlying business and auditing fair value.

Limited Auditor's Communication with External Stakeholders

Respondents considered the fear of litigation was also affecting the auditor's communication, particularly to external stakeholders, and this part of the audit process generated a number of negative comments. Among those: "The audit report is more a disclaimer than an opinion"; "The auditors are so risk averse that their report hardly means something [anything]"; and "No one reads the audit report because it is restrictive and legalistic."

At best, to many respondents, the external audit report is only a checkpoint. "Good is good, but you don't know how good. And bad is a sort of disaster," was one of the comments received. The audit report provides too little insight into the quality of the financial reports. As another respondent put it, "The same opinion for a company that scrapes over the line versus a high flying company that jumps 10 feet over the bar, that can't be right."

The auditor's report to the audit committee that comments on specific areas of the company, its financial reporting and the audit is considered to be more useful. But respondents realize that if it was made public, "then no one wants to stick their neck on the line," as one respondent put it.

Limited Choice of Audit Firms

Many respondents considered that the limited choice of audit firms was a real problem, but one that was difficult to solve. In one respondent's words, "For listed companies, the choice may be made only between the Big 4 firms and, if one is the outgoing auditor and another is providing consultancy services, this means the company is choosing between two firms." In specific sectors, the problem can even be worse. One respondent noted that limited choice of audit firms is also an issue when it comes to non-audit work, especially with mergers and acquisitions, where it can be difficult to get one who is not conflicted.

Audit market concentration is a concern to many but not all respondents. They are of the opinion that the remaining (Big 4) firms are very strong and they know their business. However, there would be a real problem if another big firm collapsed.

Increased Audit Cost Relative to Perceived Benefits

On average, respondents felt that the cost-benefit ratio of the audit of financial reports is about the same as five years ago. However, this average hides the wide range of responses. To many respondents, while the value of the audit has risen, the costs have risen more and the cost-benefit balance has deteriorated. Users, preparers and standard setters were more negative than regulators, academics and external auditors. Respondents from Africa, Eurasia, Asia and Latin America were clearly more positive about the cost-benefit balance than respondents from the United Kingdom, European Union, US, Canada and Australia.

Respondents recognized that audit firms have had to invest to improve quality. One respondent, who felt the cost-benefit balance had worsened, considered that compliance rules are forcing auditors into excessive documentation that slows the process and increases fees. "Auditors are doing a lot of steps just to put documents in the file," the respondent pointed out. Another suggested explanation for the increase in audit cost is the lack of competition and choice in the audit market.

[3] XBRL: eXtensible Business Reporting Language

What Needs to be Done Next in the Audit of Financial Reports?

What course of action should be taken by the auditing profession to further strengthen the external audit and to preserve the public confidence that has started to return? The priorities to further improve the financial audit were:

- Continue to focus on independence, objectivity and integrity
- Converge to one set of global, principles-based auditing standards over time
- Ensure consistent use of audit standards and safeguarding of quality within audit firms
- Improve auditor's communication, both internally and externally
- Consider limited/proportionate liability for auditors
- Remove barriers that limit choice of auditor

Continuous Focus on Independence, Objectivity and Integrity

According to virtually all respondents, the overriding principle for auditors should be their fiduciary role to users. While the survey and interview outcomes indicate a positive trend, not all respondents are confident that auditors are independent enough from the companies they audit, or that their objectivity, integrity and professional competence is guaranteed. At least a continuous focus on these issues is required.

Regulations, professional standards and guidelines provide some safeguards, but respondents recognized that it would be difficult or impossible to completely regulate human behavior.

Also audit rotation in some form is seen as a good measure to maintain sufficient independence, objectivity and integrity. Although there are concerns about loss of valuable knowledge and experience, long lead times to get up-to-speed and more expensive audits, many respond that getting fresh eyes on the audit outweighs cost.

Convergence to One Set of Global, Principles-Based Auditing Standards over Time

In general, respondents were positive about convergence to one set of global, auditing standards, and in particular, the alignment of the standards of the [US] Public Company Accounting Oversight Board (PCAOB) and IFAC. However, they noted that these standards should be both within a principles-based framework and adopted without limitations. "Otherwise they become just national audit standards and the whole concept of international recognition is lost," a respondent observed.

Respondents also commented that too much change in ethical, accounting and auditing standards at the same time has diverted attention from core skills and basic auditing. There is a need for a period of relative calm to ensure that all of the changes are properly embedded.

Consistent Use of Audit Standards and Safeguarding of Quality within Audit Firms

To many respondents, audit firms operating under the same brand should be more one entity, especially internationally. The current structure of local or country firms can result in varying standards. One respondent commented that standardization across firms could enhance the quality and consistency of audit procedures.

There is a general opinion that auditors need to have high skill levels, more knowledge of finance and economics and better understanding of business models and business risks, not just accounting. Auditors can have a narrow view due to their training, and according to some respondents, they should spend more time within a company finance department and experience financial reporting from the inside.

It was commented by some respondents that to stimulate genuine quality, regulators need to step away from second guessing, because that drives the auditors to a very bureaucratic approach. Regulators need to focus less on the audit paperwork. One respondent explains it this way, "They should strive much more to a qualitative assessment of the audit firm overall. How it gets qualified people to the front line. To make audit firms aware that it is more about quality than paperwork." Respondents also noted that currently audit firms oversight is on a country-by-country basis even though many audit firms operate internationally. It was suggested that for these transnational audit firms, a lead regulator might be appropriate.

Improvement of Auditor's Communication, Both Internally and (Especially) Externally

According to many respondents, auditors could certainly improve their communication to remain relevant, especially with the external stakeholders. The audit report could be much more useful if it would move away from a standardized text to be more responsive to the increasingly complex circumstances of the businesses, their financial reporting and the corresponding audit.

The challenge, however, is to create an audit report that does not just replace boiler plate with boiler plate. Rather than a prescribed text, respondents suggest there should be guidelines on how to draw up such a report. As one noted, the objective should be, "Here is what I found."

Numerous suggestions for improvements have been made, for example, expanded information about nature of and impacts of estimates. Possibly the auditor's opinion could also provide more insight in the process and communication that has taken place in the audit committee and between the audit committee and the internal and external auditors. The audit report should also better reflect the work of the auditor. For example, there should be increased focus on explanation of decisions made during the audit process. As one auditor commented, “Not just [issue] an opinion as today, but try to explain your risk analysis and priorities and how you have applied it. Not only with the audit committee, but also externally.” Also various levels of assurance are proposed, including high level for financial statement, but lower level or no assurance on management commentary and internal control.

There were also several more out-of-the-box ideas, such as reporting on the quality of financial reporting process in the company and the quality of the provided information. One recommendation was to include a statement, such as “Your figures are in accordance with the applicable accounting standards, but you could have been more transparent.” Others would much rather have something more like a credit rating. “Why not rank a company on the basis of an audit report on a scale of 1 to 5?” suggested another.

The need for more informative audit reports is clear, but this will mean that stakeholders would need to become less litigious, especially in the period of trying to find new and better ways to communicate. The same goes for providing assurance on other than historic financial information, for example, extended business reporting.

Limited/Proportionate Liability for Auditors

Together with the discussion on what the auditor should be doing and communicating, there should be a discussion within the financial reporting supply chain about the corresponding level of liability.

Most respondents agree that a strong auditor with a clear opinion is a real strength in the checks and balances within a company. Many think that the provision of safe harbors would make the auditor stronger and his opinion clearer.

To many respondents, liability capping is a top priority. Reasons given differed, but included not only for the continuity of the audit profession but also to increase competition between audit firms, because proportionate responsibility could increase the supply of audit services.

A Greater Choice of Auditor Is Desirable

The general view is that the Big 4 audit firms’ hold on the audit market is very strong, and the gap with the “second tier” firms is also very big, creating an oligopoly environment. The respondents see many challenges for second tier firms to fill this gap, including raising the necessary capital, attracting and retaining talent, building reputation, gaining international experience, and bridging the initial economies of scale disadvantages given the costs associated with licensing, training, professional indemnities etcetera. Nor are respondents sure that the smaller audit firms actually want to grow, for example, because of the risks involved.

Some also pointed to the demand-side problem: the barriers for companies to move from a Big 4 firm to a smaller audit firm, leading to many companies taking the path of least resistance. Arguments are that big companies draw comfort from the name of a Big 4, that mergers and acquisitions (M&A) and private equity deals often include standard provisions on hiring a Big 4 auditor, and that it is much easier to have a single firm to do the lot. However, some institutional investors are willing to buck the trend by writing to the companies they invested in, and saying that they would be willing to deal with a smaller audit firm. “The door is open,” one respondent commented. One of the arguments is that the auditor choice should not primarily be based on the size of the audit firm but rather on the quality of the individual engagement partners and staff.

Some respondents expressed difficulty in finding suitable audit firms for non-audit work, such as due diligence, because of existing relationships with the Big 4 audit firms. They suggested that this may provide an opportunity for smaller transnational audit firms. One respondent suggested that the smaller transnational audit firms could expand into non-audit areas by flying in people from overseas with the required skills, rather than only relying on staff and partners within a particular country. This would allow the smaller audit firm to expand its client base and reputation, which could lead to the firm gaining larger audit clients over time.

THE USEFULNESS OF FINANCIAL REPORTS

POSITIVES

- Better financial information due to improved standards, regulation and oversight
- More disclosure and comparability in financial reports
- Improved reliability
- Increased emphasis on narrative reporting
- Easier access to financial information

AREAS OF CONCERN

- Reduced usefulness due to complexity
- Use of fair value
- Focus by companies on compliance instead of reporting on the essence of the business
- Regulatory disclosure overload
- Difficult and often changing financial reporting standards
- Lack of forward looking information

FURTHER IMPROVEMENTS

- Improve communication within the FRSC to determine what information should be reported
- Make financial reports more informative by including more business-driven information
- Better align internal and external reporting
- Promote the use of technology that gives users access to electronic data so that they can compile their own information
- Encourage short-form financial reporting focusing on the material issues facing a company

Introduction

The ultimate purpose of financial reporting information is to assist users in making decisions about an entity. But financial reporting information is not the only source of information available; users have access to a range of financial and non-financial information.

All Sources of Information about a Company Are Useful

Respondents felt that all information sources about a company were useful. The most useful source was the company's annual financial statements, followed by interim financial statements, while media reports were the least useful source of information.

The frequency of financial reporting information is also important to users in making economic decisions about a company. Respondents were asked how useful it was for companies to publish their financial reporting information – choices included annually, semi-annually, quarterly, monthly or in real time. Across all respondents, annual information was considered to be the most useful, but not for everyone. One respondent noted, for example, "While the annual report as such is not important anymore; it is an annual checkpoint. It shouldn't have any surprises and shouldn't move the market. Quarterly reports and investor meetings and other ongoing communications are much more important and it is these communications that move the market." Another respondent stated, "Profit warnings have an impact. Annual reports are hardly noticed."

Monthly information was not rated highly by respondents to the survey. Users and auditors were among the most negative. One respondent commented, "Greater frequency is a real backward step. It would encourage short-term earnings management; it would encourage poor quality analysis of a company's strategy and value creation potential. It would put too much emphasis on reporting and not leave enough time to actually do anything."

The least useful frequency of reporting to respondents was real time information; users were the most negative and regulators were the most positive about the usefulness of real time information.

One respondent said, "The ongoing business and the long-term results are essential. Thus, over-emphasis on short-term reporting deteriorates long-term results and shifts management focus."

Mixed Results about XBRL

Companies can use XBRL to "tag" company financial information so that users can rearrange and analyze the information to suit themselves. The survey asked respondents to state how useful it was for companies to publish their financial information in XBRL format. Overall, respondents felt that XBRL could be a useful tool to help them find and interpret financial reporting information, although there was a low level of understanding about how XBRL exactly works. Regulators were the most positive respondents about the use of XBRL, while auditors and users also considered that having information presented using XBRL would be useful. According to one respondent, "An issue will be how to distinguish between audited and unaudited information within the XBRL system."

The results were more mixed when looking across the different regions. Respondents from Asia were the most positive, while respondents from Canada and Australia were more negative.

XBRL: A SIMPLE EXPLANATION

The idea behind XBRL, eXtensible Business Reporting Language, is simple. Instead of treating financial information as a block of text - as in a standard Internet page or a printed document - XBRL provides an identifying tag for each individual item of data. This is computer readable. For example, company net profit has its own unique tag.

The introduction of XBRL tags enables automated processing of business information by computer software, cutting out laborious and costly processes of manual re-entry and comparison. Computers can treat XBRL data intelligently. They can recognize the information in a XBRL document, select it, analyze it, store it, exchange it with other computers and present it automatically in a variety of ways for users. XBRL greatly increases the speed of handling of financial data, reduces the chance of error and permits automatic checking of information.

Companies can use XBRL to save costs and streamline their processes for collecting and reporting financial information. Consumers of financial data, including investors, analysts, financial institutions and regulators, can receive, find, compare and analyze data much more rapidly and efficiently if it is in XBRL format.

XBRL can handle data in different languages and accounting standards. It can flexibly be adapted to meet different requirements and uses. Data can be transformed into XBRL by suitable mapping tools or it can be generated in XBRL by appropriate software.

Source: **www.xbrl.org/WhatIsXBRL**.

Paper Financial Reports Remain Useful

Over recent years, more and more financial reports have been available over the Internet. Given this development, respondents to the survey were asked whether they still found paper versions of financial reports useful. The survey results indicate that all those in the financial reporting supply chain find paper reports useful, with only few respondents saying these reports were no longer useful.

The responses from the different regions were slightly more diverse. Among respondents from Africa, Latin America and the UK, for example, no respondents said paper version financial reports were no longer useful. However, respondents from Canada and the US were less in favor of paper reports.

The Relevance, Understandability and Reliability of Financial Reports

The Relevance of Financial Reports Has Improved

The majority of the respondents felt that financial reports in their respective countries had become more relevant over the last five years. The opinions across the various respondents were similar, although regulators and standard setters were slightly more positive and academics and auditors slightly less. The developing regions were more positive about the increased relevance than the more developed regions.

The Understandability of Financial Reports Did Not Improve

Respondents were less positive in answering the question on whether financial reports in their respective countries had become more understandable over the last five years. Across all respondents, there was a shared feeling that the understandability of financial reports did not improve compared to five years ago. Regulators, preparers and academics were generally more positive than users, standard setters and external auditors. Across the regions, there were also mixed responses, with the developing regions clearly positive and the more developed regions all clearly negative.

But the Reliability of Financial Reports Has Improved

A majority of respondents indicated that financial reports in their respective countries had become more reliable over the last five years, with very few considering that it had become worse. Standard setters, preparers and regulators were slightly more positive about the improved reliability, and the external auditors, academics and users slightly less positive, but positive nevertheless. Also here the developing regions were more positive than the more developed regions, but the differences between the regions were small.

THE USE OF FAIR VALUE

The increased use of fair value in accounting standards caused many comments, both positive and negative. Some respondents liked the use of fair value ("what something is worth today") because it is more helpful to investors, "Historical cost gives you only an idea how much something cost 20 years ago." Another respondent noted, "Fair value plays a significant role in decision making. For example, assets valued at historical cost might show a huge return, but that could evaporate when using fair value." But other respondents were less positive and felt that fair value information is one of the biggest challenges for accounting, as one of them said, "Historically, 90% of the business' assets were on the balance sheet and now only 30%. How can a company not say anything about the other 70%?"

Some respondents considered the term "fair value" to be unclear. One respondent stated, "If it is a modeled value, call it a modeled value. If it is a market value, than call it a market value. Many people would rather have a hard historic number than a modeled value." Another one argued that fair value could be useful, if people would understand the basis on which fair value estimates are made, and suggested disclosing a margin of error or a range of possible outcomes, providing a reconciliation with historic cost and including more explanation about the measurement bases used by companies and a sensitivity analysis.

Respondents were not sure whether fair value accounting is improving the fundamental understanding of the business and the accomplishments of management. One person noted for example, "Some fair value measurements reflect what has happened in the outside world and is beyond the control of management. Other measurements, however, indicate how well management responded to external opportunities or threats."

One of the main concerns about fair value is that it increases the volatility of results and can produce counter-intuitive outcomes. As one respondent said, "In IFRS, the income statement has become a real problem. A partial shift to fair value is producing peculiar, confusing results and also leading to a lot more volatility." Another respondent added, "It looks like investors don't want to go the direction the accounting standard setters want to go: an income statement that jumbles up everything."

Positives Aspects about the Usefulness of Financial Reports

The good things that have happened over the last five years with regard to the usefulness of financial reports in their respective countries that the respondents mentioned most were:

- Better financial information due to improved standards, regulation and oversight
- More disclosure and comparability in financial reports
- Improved reliability
- Increased emphasis on narrative reporting
- Easier access to financial information

Better Financial Information Due to Improved Standards, Regulation and Oversight

As discussed in the previous section of this report, many respondents were positive about the efforts put into the establishment of one set of global financial reporting standards. In particular, respondents appreciated the joint work of the international and American accounting standards setters, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB), towards one set of high-quality financial reporting standards.

In many countries, the government and/or the regulator have been paying more attention to the quality of accounting information in recent years. A number of respondents considered that this improved external oversight has helped to limit financial reporting abuses and has raised public confidence in the quality of financial reporting.

More Disclosure and Comparability in Financial Reports

Respondents felt that more disclosure about topics such as executive remuneration, pension obligations and expensing stock options strategy, as well as more business reporting has lead to both more transparent financial reporting and a better understanding by users of the operating activities of companies. They also felt that the trend to more uniformity of reporting, for example the adoption of IFRS, has led to more consistency and better comparability in financial reports internationally. Respondents acknowledged, however, that there will always be differences because there are so many unique solutions.

Improved Reliability

To many respondents, the improved standards, regulation, auditing process and oversight has also improved the reliability of the financial reports. Additionally some respondents identified a

REPORT LEADERSHIP

Report Leadership is a multi-stakeholder group that aims to challenge established thinking on corporate reporting. The contributors to this initiative are IFAC's member body, the Chartered Institute of Management Accountants, PricewaterhouseCoopers LLP, Radley Yeldar and Tomkins plc.

The group believes that corporate reporting should be more relevant, informative and accessible. It should provide investors with what they want without inundating them with unnecessary detail. As part of the initiative, Report Leadership seeks to align external reporting more closely with management reporting, recognize the complexity of business today and provide reporting that will adapt readily to other media. It focuses on three areas of topical interest:

- **Effective communication** through clear messaging and navigation
- **Modeling the future** through the provision of contextual information that allows investors to assess the quality and sustainability of future cash flows
- **Rethinking the financials** to provide greater detail on revenue, costs, segmental information, pensions and debt

To bring its ideas alive, the group has demonstrated how these can be applied in extracts from the annual report of a fictitious company, Generico.

The group has also undertaken work on two key areas:

- **Executive Remuneration** will provide practical ideas for communicating one of the most sought after areas of corporate reporting.
- **Online Reporting** will look at what investors want from online reporting with the launch of the online version of the Generico annual report.

For more information on the Report Leadership project, visit: **www.reportleadership.com**.

trend away from companies providing quarterly reporting guidance, which they considered a positive development, because the fear of not making the numbers can lead to strange behavior. “If you fall short, you try to make up with your own accounting,” one respondent offered.

However, respondents saw a new danger on the horizon. “Now [that] it is more difficult to mess around with accounting, companies are messing around with their business flow to get favorable accounting results. This is even worse for investors.”

Increased Emphasis on Narrative Reporting

Many respondents were pleased with the increased emphasis on narrative reporting, for example, by having an expanded management commentary in the annual report which included topics such as business strategy, risk management, business performance and more future oriented information. “Business reports better express what is creating value, where value is coming from, and what might threaten the value creation,” as one respondent put it. They also liked narrative reporting because it is something that people can easily read. Some respondents suggested that IFAC should play a role in further promoting narrative reporting.

Easier Access to Financial Information

Respondents were generally happy that electronic disclosure of financial reporting has been introduced, for example, via the Internet, as it has facilitated easier and timely access to the company’s financial information. However, respondents felt that PDF files were not an ideal medium as they are not easy to read on screen. In contrast, new technology, such as XBRL, was expected to be a more useful medium by enabling users to access a summary financial report and to have the ability to get more detailed information as well if the user wants it. As one respondent put it, “The ease of access to financial and other business information through the Internet and electronic analysis tools enables a user to quickly analyze and compare a company’s performance.”

Areas of Concern about the Usefulness of Financial Reports

While the survey results ranged from neutral to positive, respondents raised concerns in the following areas:

- Reduced usefulness due to complexity
- Focus by companies on compliance instead of reporting on the essence of the business
- Regulatory disclosure overload
- Difficult and often changing financial reporting standards

Reduced Usefulness Due to Complexity

According to many respondents, financial reports have become less useful because they have become too complex[4] for the average reader to understand. They consider the drivers behind this complexity to be regulatory disclosure overload; difficult and often changing accounting standards, especially the greater use of fair value; and the increased fear of liability by company directors and senior management. However, many respondents also recognize that the underlying business reality has become

ENHANCED BUSINESS REPORTING CONSORTIUM

The Enhanced Business Reporting Consortium (EBRC) was founded in 2005 by the American Institute of Certified Public Accountants, an IFAC member body, Grant Thornton LLP, Microsoft Corporation, and PricewaterhouseCoopers. The EBRC is an independent, market-driven, non-profit collaboration focused on improving the quality, integrity and transparency of information used for decision-making in a cost effective, time efficient manner. Its objectives are to:

- **Give the capital markets relevant information.** By providing information about value drivers–the elements of a company’s business that are the sources of its value.
- **Eliminate stale and redundant disclosures.** Because these redundancies create confusion and waste both company and investor resources.
- **Make information easier to use.** To create useful classifications like taxonomies for value drivers, nonfinancial performance measures and qualitative information, and to promote the use of XBRL.
- **Collaborate with users and suppliers of capital.** To provide an opportunity for the users and providers of capital, working together, to improve the quality of the information provided to the capital markets.
- **Enhance the integrity of the capital markets.** To foster (1) a culture that embraces transparency, accountability and integrity; with (2) effective controls over business systems and processes; (3) a more efficient and effective way to accumulate, disseminate, and use information; (4) a voluntary framework for providing relevant information; and (5) timely assurance that a broad range of information is relevant and reliable.

For more information on the EBRC project, visit: **www.ebr360.org**.

[4] Complexity is one of the most mentioned words in the survey responses.

much more complex, and this is creating a challenge for businesses to provide information that is, at the same time, relevant and reliable but also understandable.

Preparers Are Focusing on Compliance

Respondents felt that preparers were too focused on compliance with financial reporting standards rather than on reporting the underlying economics of the business. This was making it more difficult for users to understand the financial reports. One respondent said, "The accounts are not giving users a feel for how the company is doing, but are only helping specialists at the expense of clarity." Another respondent made this point, "There is an underlying reality of the company somewhere and financial reporting is building a wall around that. Users want to see the reality, taking the wall down again and seeing the underlying situation. We are in quite an uncomfortable place at this moment. Companies are more complex. But users want to understand what the company does, the difference between the costs and the revenues, how many products it sold and how sustainable this flow of value creation is. Modern financial reporting is obscuring this reality."

Regulatory Disclosure Overload

In many jurisdictions, regulatory disclosure requirements have led to much more information being provided, but that does not mean it is more useful. As one respondent put it, "An annual report of 400 pages can't be right."

Greater disclosure requirements should enhance the reader's understanding, but many respondents doubt that is currently the case. To them there is such a regulatory disclosure overload that the really important information is hidden from users. One respondent put it colorfully, "It is difficult to pick the needle of the significant issues in the middle of the haystack of information."

At the same time, even with so much information being provided, respondents considered that there is still insufficient transparency in financial reports with regard to the most complex accounting, such as derivatives or securitization.

What has gone wrong? According to one respondent, "Too many cooks are trying to add requirements to the annual report. Politicians and regulators keep adding more requirements so as to be able to have said that they have done something, regardless of real value added." What could be done? Respondents suggest that financial reporting supply chain participants should work together to determine what information is valuable and what is not. Although one respondent adds that participants should not ask for more information unless they can also demonstrate why they need specific additional information and what it is worth to them, i.e., a cost-benefit test needs to be applied to disclosure requirements.

Respondents also point to new technologies which might allow presentation of financial information in different layers, so that users could more easily navigate the key financial headlines and then get more detailed information on their particular areas of interest.

Difficult and often Changing Accounting Standards

Many respondents felt that accounting standards are increasingly more difficult and detailed and this is a significant reason for the increased complexity of financial reports, especially the use of fair value in financial reporting. They believe that current accounting standards are expert driven and the resulting complexity does not benefit the users.

The constant changes and revisions in accounting standards were also seen as adding to complexity. Respondents wondered how a non-accounting expert still can use financial statements with so many changes. This may be related to the transition from national GAAP to IFRS and may be resolved over time.

The requirement for some companies to report in more than one GAAP also adds more confusion to interpreting financial reports. "Due to international standards, companies have to report in two different ways. Quite often the numbers substantially differ," concluded one respondent.

What Needs to be Done Next about the Usefulness of Financial Reports?

Respondents acknowledged that all those in the financial reporting supply chain need to take up the challenge to provide more useful information. In particular, respondents suggested the following:

- Improve communication within the financial reporting supply chain to determine what information should be reported
- Make financial reports more informative by including more business-driven information
- Better align internal and external reporting
- Promote the use of technology that gives users access to electronic data so that they can compile their own information
- Encourage short-form financial reporting focusing on the material issues facing a company

Communication within the Financial Reporting Supply Chain Needs to Improve

Many respondents believed the first question when considering how to improve the usefulness of financial reports should be: Useful for whom? Different users have different needs. As one respondent explained, "An investor looks forward to performance, while a banker looks forward to security. The tax authorities look backward over results attained to raise taxes, the employees look back over results attained to check performance/targets."

The financial reporting model should provide users with the information they need. Respondents considered that user needs and interests – not accounting theory – should drive financial reporting. To achieve this, users need to be more effectively involved in the standard and regulatory setting process so that their real needs are properly understood. Respondents felt the current approach does not go far enough, as one of them said pointedly, "You don't reach users by issuing exposure drafts and ask[ing] 'what do you think of it?'." You have to get the users involved in a much earlier stage in the process and to engage them face to face." Another suggestion for determining users' needs was to conduct more surveys and research on how users actually use financial reporting information.

Respondents also emphasized the need to balance the costs and benefits of financial reporting, because, "Investors always want more disclosure since more is free to them," as one of them said. This was consistent with the survey findings as almost all respondents wanted more reporting in all of the areas that were listed. Another respondent warned, "It is important that the total costs associated with the financial reporting process, including the costs of analysts, are known to the real investors, because, at the end of the day, the costs are taken from their pockets."

It is clearly an issue that users are fragmented and busy and therefore not easy to reach. Some respondents held a rather pessimistic view of users, as one of them wrote, "Many investors complain, but very few are involved. You have to be involved; otherwise you get the standards you deserve." Others were more positive, for example this one, "Shareholders have shown more interest in how the company is performing rather than being content with dividends paid by them. Now they are articulating more clearly what information they want." But respondents also felt that users are in the best position to decide what is good for them. "Regulators should assist and not replace the users in doing so. Regulators are facilitators for the end users. If it is all for the users, then let the users decide on what is good for them," and "Let the markets decide," as respondents put it.

The bottom line is clear. In the opinion of one respondent, "There needs to be a broader, more relevant financial reporting framework developed collaboratively by all financial reporting supply chain participants." It was also recognized that users are in many different groups and getting a common view would not be easy.

Towards More Informative Business-Driven Reporting

"Neither historic cost nor fair value fully captures what make companies competitive," one respondent pointed out. Respondents felt that sometimes words and pictures are better than just numbers to explain what has happened and probably the combination of the two will work out best. According to many respondents, contextual narrative information is becoming more important now that financial reports are getting much more difficult and volatile. According to one respondent, "This is especially true where the value of the enterprise is substantially more than the value on the balance sheet."

Although a number of respondents noted some recent improvements resulting in a more narrative style of business reporting, many believe there is still a long way to go. Respondents felt

that narrative reporting needs to be clearer so that users of financial reports are more able to understand whether there is value in a company or not. "What matters is the company's view on market opportunities and risks, its strategy and its analysis of why that will be value creating," a respondent said. This could be complemented by metrics and key performance indicators that provide feedback on how a company has executed on its strategies.

To many respondents, additional management information is a good idea as it is something people can easily read. Respondents suggested that these reports should be written and presented in a manner that tells a story, preferably, as one pointed out, "in the honest and open style used by Warren Buffet from Berkshire Hathaway. 'These are the numbers and this is how I look at the business.'"

Respondents were also supportive of including more non-financial information. In particular, respondents felt that companies needed to improve their reporting on corporate social responsibility issues and environmental issues. It was commented that, "We have done the financials to death but left the other important aspects of reporting untouched."

Alignment of External and Internal Reporting

A number of respondents considered that more alignment of external and internal reporting would benefit both companies and users. One of them proposed, "Let's improve financial communication by reporting to users the internal information you actually use to run your own business. This is not a wasted effort because external pressure makes you run your company better."

One of the objections on publishing more management information is the risk of giving away trade secrets. One preparer noted that they would be happy to provide more management information to the public, but "we must recognize the need to avoid giving away competitive info on customers and sectors."

More Use of Technology

Respondents considered that more use could be made of technology for preparing, communicating and analyzing information. Respondents liked being able to access information over the Internet. "Due to the advantages of the Internet, financial information of listed companies can be easily obtained," one said. Another respondent commented that the Internet also helped to compare companies, adding, "Ease of access through the Internet and electronic analysis tools enables a person to quickly analyze and compare a corporation's performance."

Respondents felt that users of financial reports should be given access to electronic data (XBRL) so that they can compile their own information. New techniques such as XBRL could help the financial reporting supply chain as a whole in terms of providing information that is reliable and able to be manipulated by users to meet their own needs. Respondents considered that XBRL will facilitate higher volumes of business information, supplied at higher precision and lower costs, and that it would also facilitate the analysis of financial reports.

While many respondents indicated XBRL or similar technology would be useful, other respondents noted that not all users of financial information would know how to use it to assess results. One respondent said, "XBRL sounds useful, but not all users, myself included, would know how to use it to assess results." Another noted, "There is need to engage in the understanding and adoption of XBRL both as a format and a collaborative process for the development and enhancement of a more relevant and cost-effective reporting framework."

Respondents suggested broadcasting analyst and strategy presentations made by the company via a web stream on the Internet, as one of them put it, "These meetings are very useful and should be made public to all the (potential) investors." This is already happening in some countries, such as the US, the UK and in parts of Asia, but there is clearly demand for the use of this technology to increase.

Less Is Sometimes Better, Short-Form Reporting Focusing on the Material Issues

"Given the pace of life, I want a shortened report containing key information with greater use of charts and pictures – that also should be audited – and less detailed commentary." This quote illustrates the opinion of many respondents that a bulky financial report with many detail disclosures is too much, especially for the small investor.

Respondents shared the opinion that the bulk of investors only read the short-form report or rely on the press release and base their investment decisions on that. Therefore, "A decent company should put hard work into the short form to get the stuff that matters over to investors," as one respondent put it. But they also warned that boiling down information into headline earnings, ratios, or other highly aggregated matrices, can give a false sense of simplicity, and be insufficient for properly assessing the performance, financial condition, and/or future prospects of an entity. Furthermore, they indicated that there should also be some regulation around short-form reporting, for example, standardized ratio definitions and external audit requirements.

CONCLUSION

Survey Results and Next Steps

The results of this survey are clear. Participants feel that the three key areas of the financial reporting supply chain – corporate governance, the process of preparing financial reports and the audit of financial reports – have clearly improved in the last five years. Unfortunately, however, they do not feel that the products of this supply chain –the financial reports– have become more useful to them. To resolve this situation, there needs to be continuing effort made by all participants to discuss and debate the purpose and objectives of financial reporting so that the information that is reported best suits the information needs of the wide range of users.

What Can IFAC and Its Member Bodies Do?

IFAC and its member bodies, working with the other financial reporting supply chain stakeholders, have an important role to play if financial reports are to become more useful and if other findings from this survey are to be addressed. There needs to be a coordinated ongoing dialogue to address the concerns raised.

The first step is to determine what should be done to make financial reports more useful to the various user groups; what would a more useful business-reporting model look like? How would addressing the other concerns raised in the areas of corporate governance, the financial reporting process and the audit of financial reports impact the usefulness of financial reports?

IFAC and its member bodies can take a lead in those projects where accountants and auditors have relevant expertise and contribute to projects where other financial reporting supply chain stakeholders are leading the initiative. It is, therefore, recommended that IFAC, through its committee and board agendas and, where appropriate, via specific projects, should address the concerns raised in this survey.

APPENDIX A:

ONLINE SURVEY RESULTS

Financial Reporting Supply Chain Survey

Thank you for taking part in our survey.

The International Federation of Accountants, IFAC, is the global organization for the accountancy profession, representing 155 professional accountancy bodies in 118 countries.

IFAC is conducting a survey on the financial reporting supply chain for publicly listed companies. This is the chain of people and processes involved in the preparation, approval, audit, analysis and use of financial reports. Both the people and the processes need to be of high quality if financial reporting is to be of high quality.

This survey asks for your views on three key areas of the financial reporting supply chain for publicly listed companies: corporate governance, the process of preparing financial reports and financial auditing. It also asks some questions about financial reports and how useful these are to you.

Your views on these issues will help IFAC to develop recommendations on how to further improve the quality of financial reporting.

We estimate that this survey will take you no more than 20 minutes to complete.

Part 1: Classification

1.1 From which perspective are you completing this questionnaire?

	ABSOLUTE	PERCENTAGE
Preparer of financial reports	125	36.7%
Independent auditor	66	19.4%
User of financial reports	45	13.2%
Standard setter	13	3.8%
Government agency/regulator	23	6.7%
Academic/educator	35	10.3%
Other	34	10.0%
Total	**341**	**100.0%**

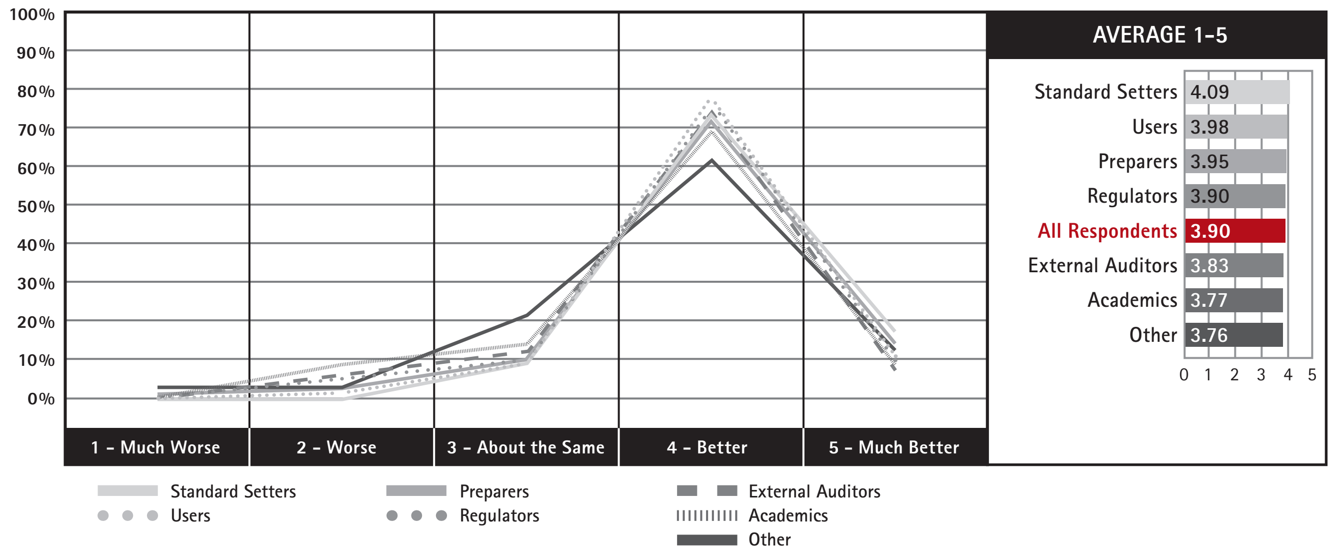
1.2 In which country are you based?

	ABSOLUTE	PERCENTAGE
Eurasia (78% Turkey)	56	16.4%
Asia	66	19.4%
Canada	37	10.9%
Australia	31	9.1%
European Union (excluding UK)	63	18.5%
United Kingdom	31	9.1%
United States	28	8.2%
Africa	21	6.2%
Latin America	8	2.3%
Totals	**341**	**100.0%**

Part 2: Corporate Governance

2.1 In general do you feel that corporate governance in your country has become better or worse over the last 5 years?

RESPONDENT TYPE



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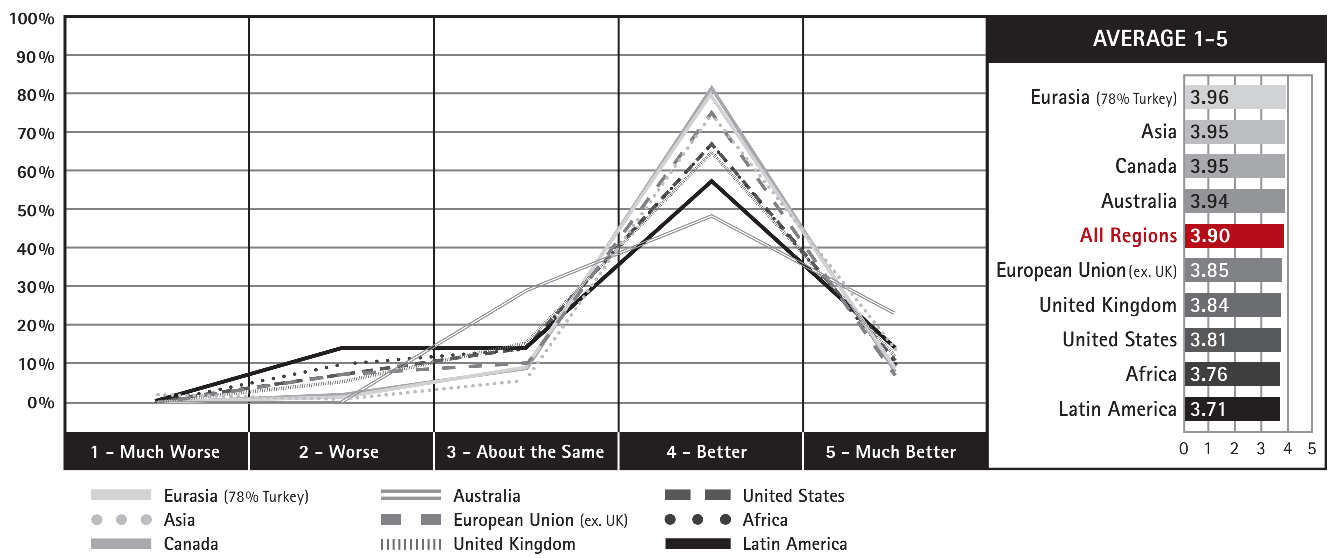
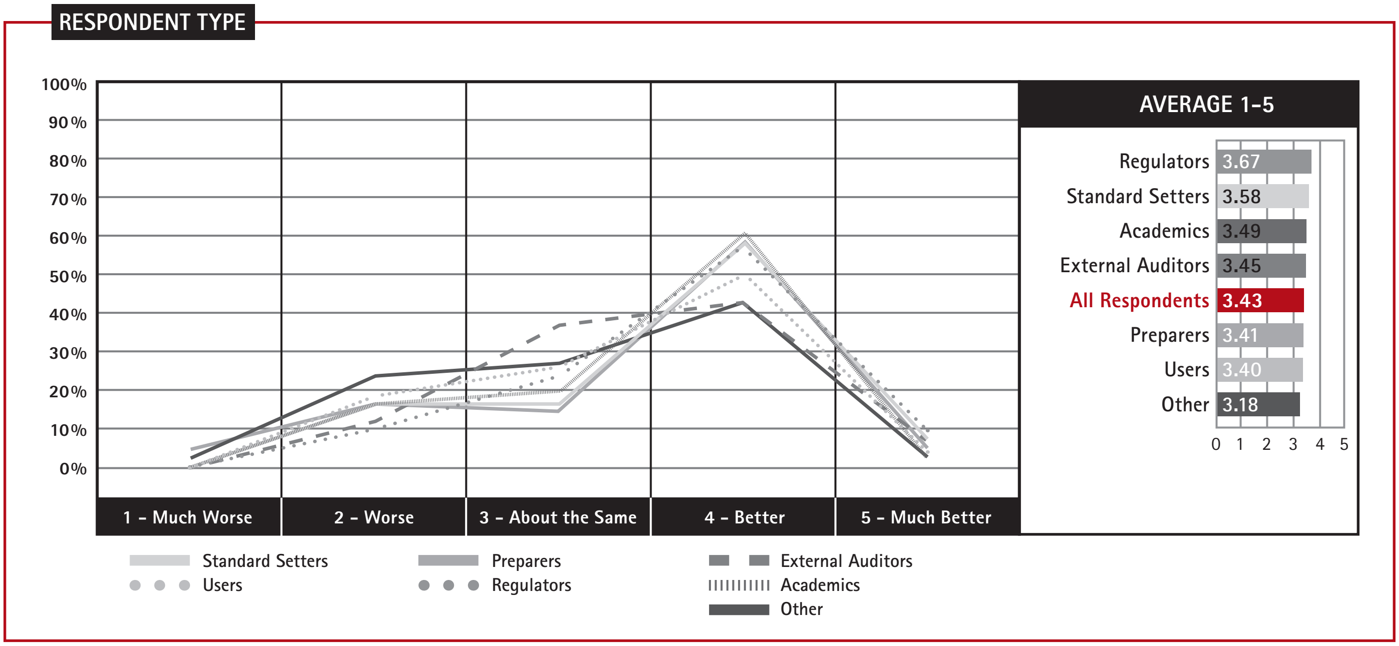


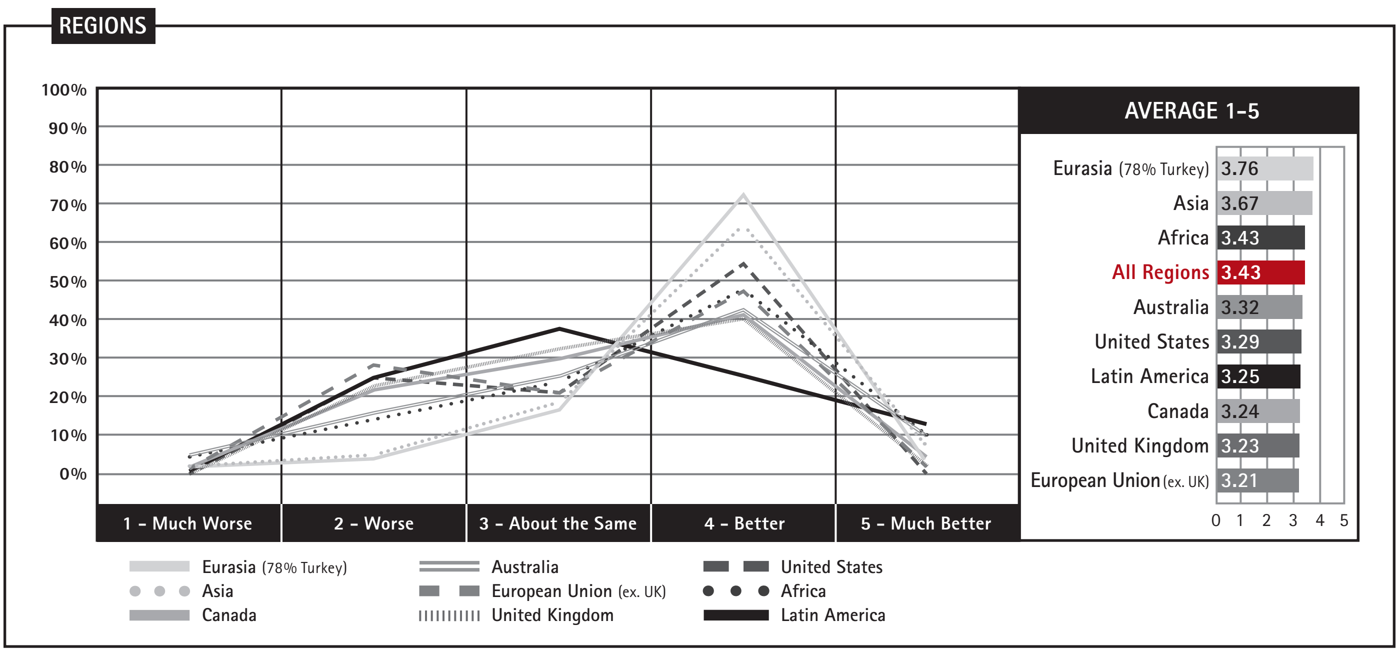
2.2 In your opinion, what have been the good things and what have been the not so good things that have happened over the last 5 years in regard to corporate governance in your country?

Good things: ______________________________

Not so good things: ______________________________

2.3 Overall, compared to 5 years ago, do you feel that the balance between the benefits and costs of corporate governance has become better or worse?





2.4 **Thinking about how to further improve corporate governance in your country, how would you prioritize each of the following measures?**

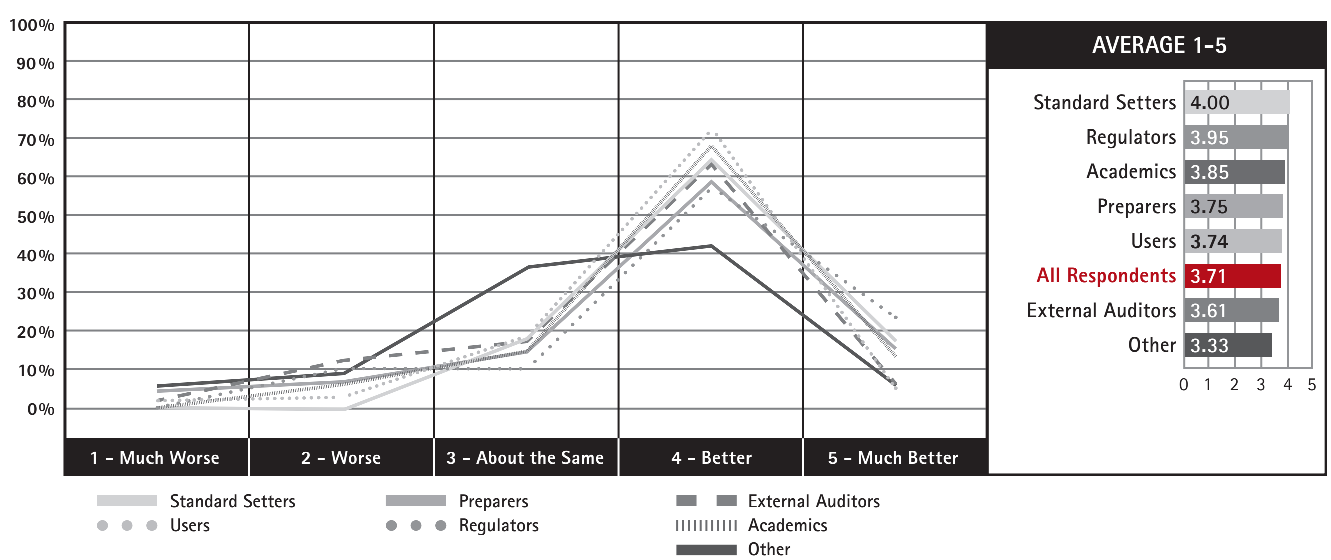
	NO (ADDITIONAL) ACTION NEEDED	LOW PRIORITY	MEDIUM PRIORITY	HIGH PRIORITY	AVERAGE 1–5
Attention to ethical leadership ("tone at the top")	1.8%	9.6%	30.1%	58.4%	4.43
Alignment of remuneration with longer term company performance	1.5%	15.1%	37.0%	46.4%	4.27
Emphasis on education and training for governance issues	3.3%	10.2%	39.3%	47.1%	4.27
Attention by the company leadership to risk and control issues	5.2%	9.4%	34.5%	50.9%	4.26
Independence of non-executive directors / Supervisory board from executive management	7.5%	10.5%	31.9%	50.0%	4.17
Compliance with corporate governance codes	10.0%	6.9%	32.0%	51.1%	4.14
Regular evaluation of board performance	4.5%	12.3%	44.7%	38.4%	4.12
Movement away from the pursuit of short term earnings guidance	4.2%	14.7%	44.1%	36.9%	4.09
Mechanisms in place to report alleged irregularities within companies (whistleblower policies and procedures)	6.0%	16.9%	40.8%	36.3%	4.01
Legal liability of the company leadership for governance failures	8.1%	22.9%	29.5%	39.5	3.92

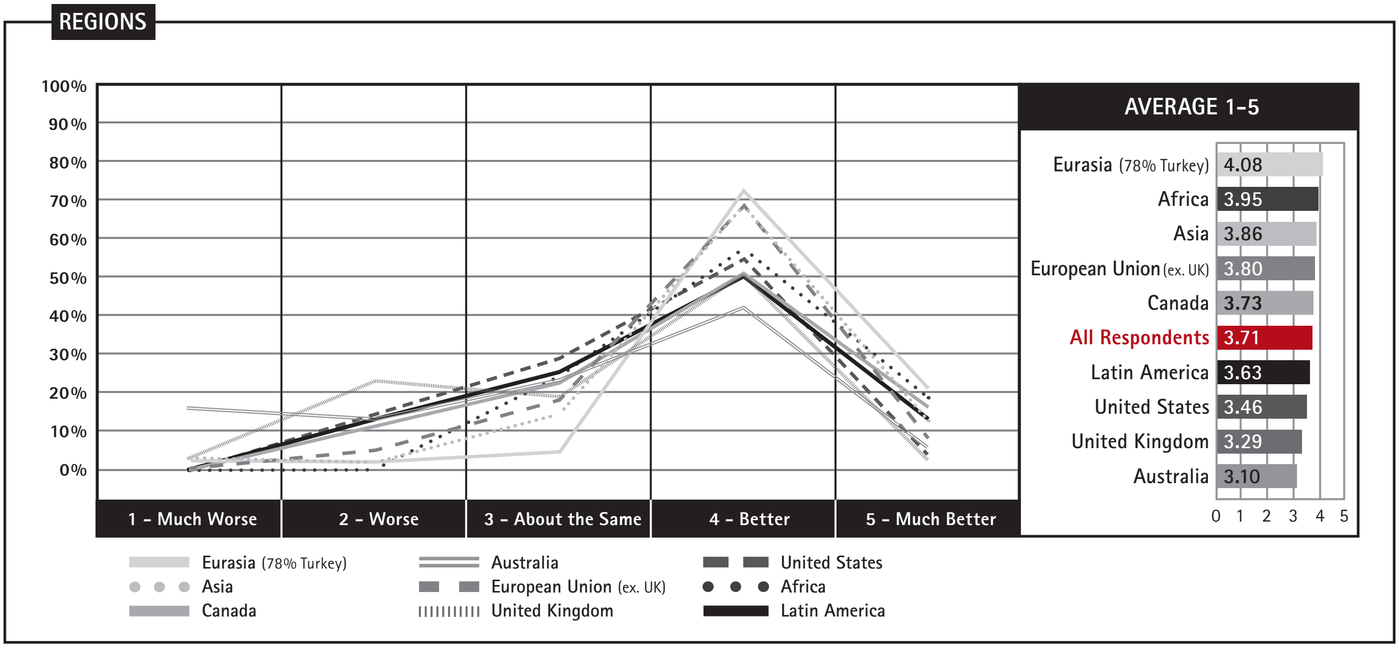
Are any other measures needed to further improve corporate governance?
(Please specify): ____________________

Part 3: The Financial Reporting Process

3.1 **In general do you feel that the financial reporting process (including preparation and internal approval) in your country has become better or worse over the last 5 years?**

RESPONDENT TYPE



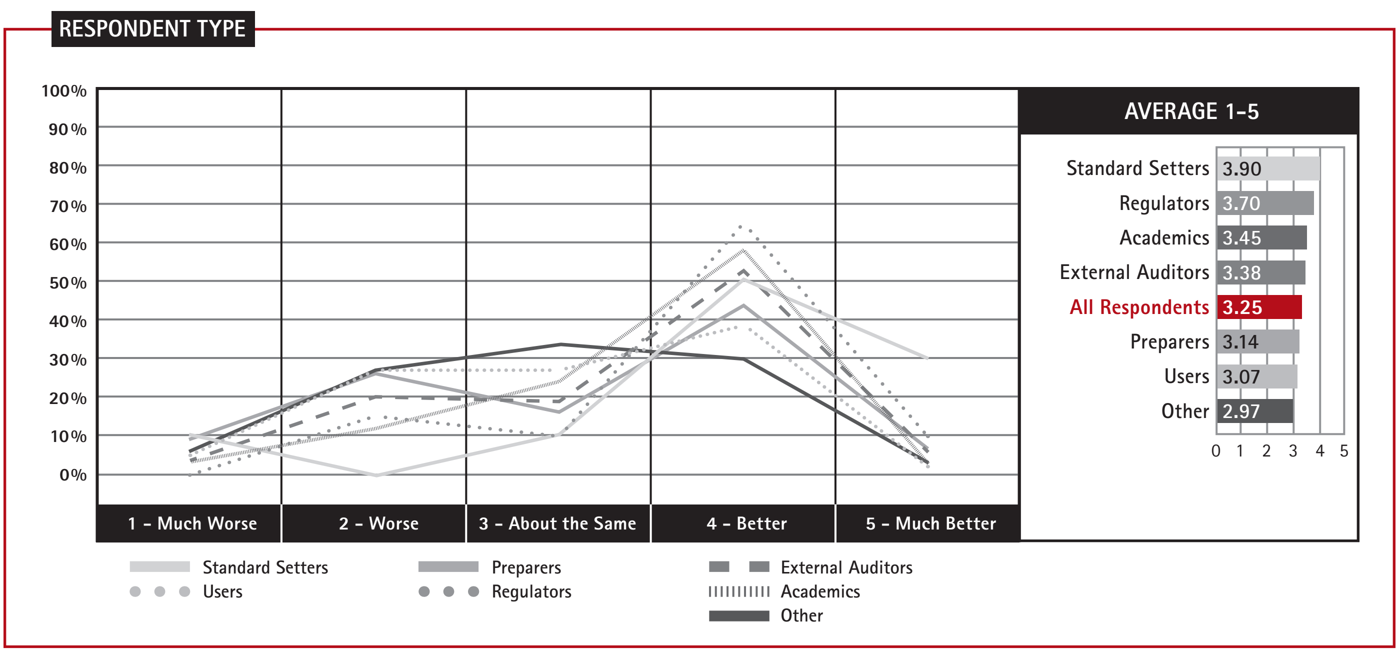


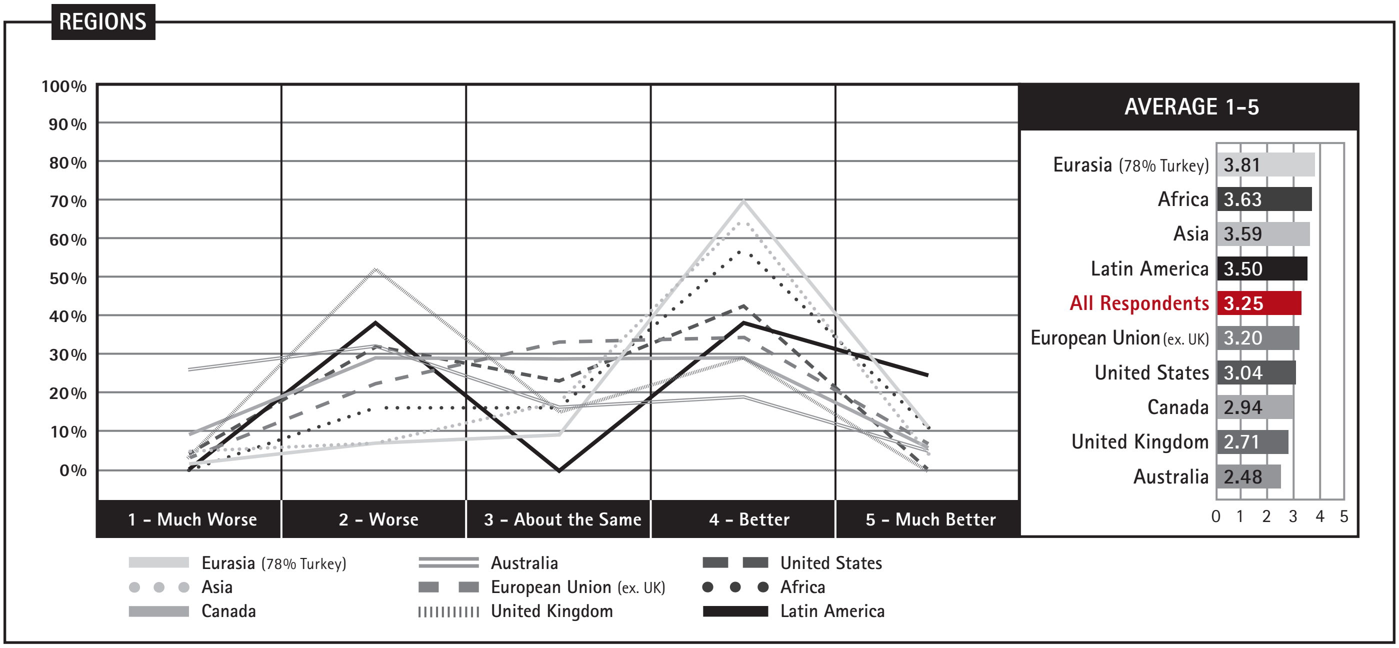
3.2 In your opinion, what have been the good things and what have been the not so good things that have happened over the last 5 years in regard to the financial reporting process (including preparation and internal approval) in your country?

Good things: ____________________

Not so good things: ____________________

3.3 Overall, compared to 5 years ago, do you feel that the balance between the benefits and costs of the financial reporting process as a whole has become better or worse?





3.4 Thinking about how to further improve the financial reporting process in your country, how would you prioritize each of the following measures?

	NO (ADDITIONAL) ACTION NEEDED	LOW PRIORITY	MEDIUM PRIORITY	HIGH PRIORITY	AVERAGE 1–5
Attention paid by the board of directors to the quality of financial reports	3.6%	9.3%	32.2%	54.8%	4.34
Emphasis on financial reporting education and training for preparers	3.0%	10.5%	33.4%	53.0%	4.33
Financial reporting standards based more on principles and less on rules	5.4%	11.4%	31.5%	51.7%	4.24
Emphasis within companies on internal controls over the financial reporting process	6.9%	9.0%	40.1%	44.0%	4.14
Developments in information technology systems for the financial reporting process	6.6%	16.5%	41.0%	35.9%	4.00
Code of conduct for all those involved in preparing financial reports	9.7%	18.7%	29.6%	42.0%	3.94
Oversight and enforcement of financial reporting by external regulators	11.4%	15.0%	35.0%	38.6%	3.89
Legal liability of company leadership for financial report-ing irregularities	12.4%	16.4%	30.3%	40.9%	3.87
Adoption of International Financial Reporting Standards	17.7%	11.4%	25.5%	45.3%	3.80

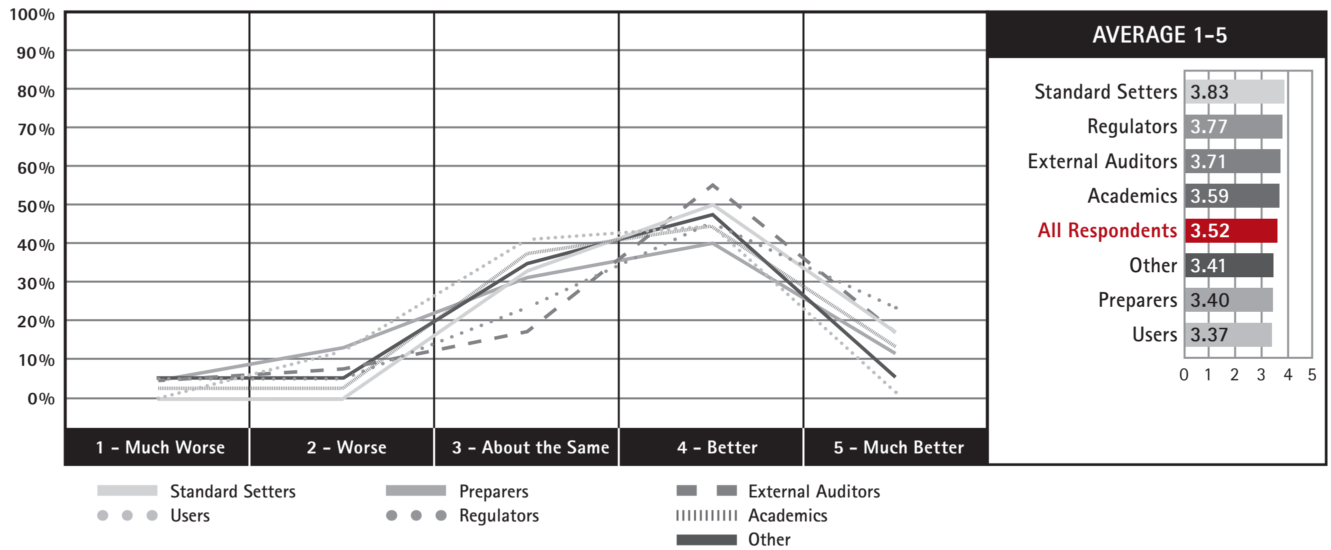
Are any other measures needed to further improve the financial reporting process?

(Please specify): ____________________

Part 4: The Audit of Financial Reports

4.1 In general do you feel that the audit of financial reports in your country has become better or worse over the last 5 years?

RESPONDENT TYPE



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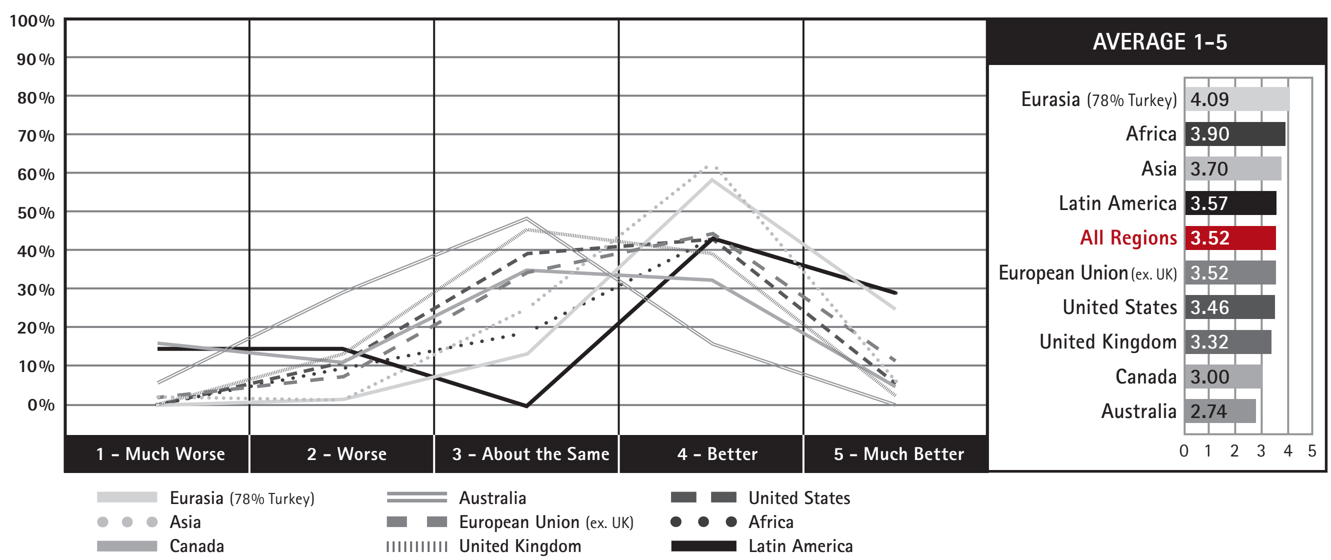


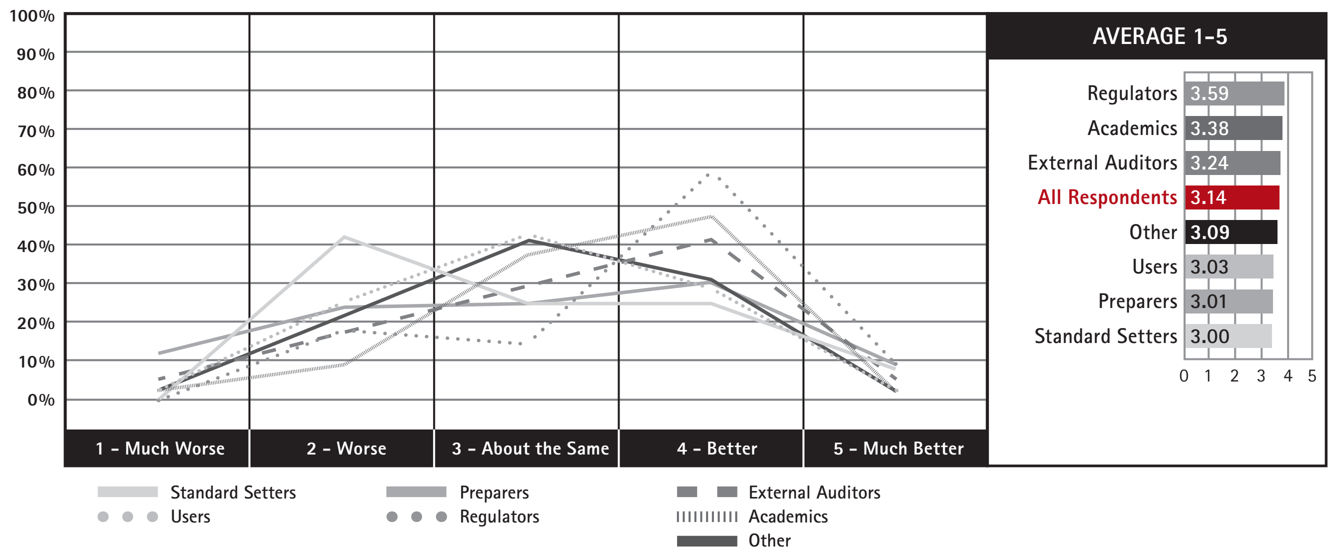
4.2 In your opinion, what have been the good things and what have been the not so good things that have happened over the last 5 years in regard to the audit of financial reports in your country?

Good things: __________

Not so good things: __________

4.3 **Overall, compared to 5 years ago, do you feel that the balance between the benefits and costs of the audit of financial reports has become better or worse?**

RESPONDENT TYPE



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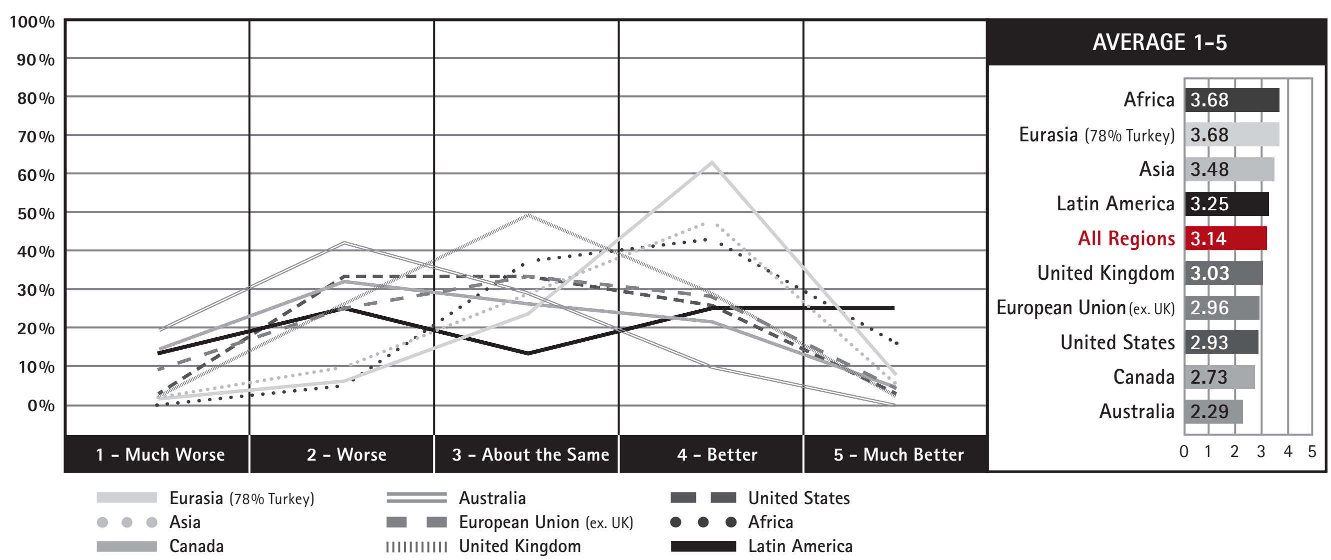

4.4 Thinking about how to further improve the audit of financial reports in your country, how would you prioritize each of the following measures?

	NO (ADDITIONAL) ACTION NEEDED	LOW PRIORITY	MEDIUM PRIORITY	HIGH PRIORITY	AVERAGE 1–5
Financial auditing standards based more on principles and less on rules	6.3%	11.4%	28.3%	53.9%	4.23
Emphasis on additional education and training for auditors	6.3%	14.2%	31.1%	48.3%	4.15
Stronger emphasis on the audit committee by the board of directors	8.8%	13.0%	33.0%	45.2%	4.06
Auditor's communication to stakeholders on the results of the audit	10.1%	16.5%	29.6%	43.9%	3.98
Auditor's communication to management on the results of the audit	9.1%	14.0%	38.1%	38.7%	3.97
Contact between the board of directors and the internal and external auditors	9.7%	13.3%	38.2%	38.8%	3.96
Independence of external auditors from the companies they audit	17.5%	8.4%	19.0%	55.1%	3.94
External quality assurance reviews of auditors' work	11.8%	13.3%	36.4%	38.5%	3.90
Developments in information technology systems for auditing	7.6%	22.0%	36.4%	33.9%	3.89
Legal liability of the independent auditor	13.3%	15.2%	30.6%	40.9%	3.86
Adoption of international standards of auditing	17.8%	10.2%	27.1%	44.9%	3.81
Code of ethics for auditors	18.2%	11.8%	24.2%	45.8%	3.79

Are any other measures needed to further improve the audit of financial reports?
(Please specify): ______________________________

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Part 5: The Usefulness of Financial Reporting Information

5.1 How useful are each of the following sources of information when you make economic decisions about a company?

	NOT USEFUL	SOMEWHAT USEFUL	USEFUL	VERY USEFUL	AVERAGE 1-5
The company's annual financial statements	1.5%	15.7%	30.5%	52.3%	4.32
Analysts reports and credit ratings	3.0%	17.6%	45.9%	33.4%	4.06
Interim financial statements	3.0%	22.1%	47.1%	27.8%	3.97
Disclosures required under stock exchange rules	4.0%	24.9%	38.9%	32.2%	3.95
Disclosures required under securities regulations	5.2%	23.9%	37.3%	33.6%	3.94
Non financial information published by the company in the annual report	3.3%	27.1%	40.1%	29.5%	3.93
Company press releases, including preliminary results	3.6%	29.3%	36.9%	30.2%	3.90
Annual strategy presentations to analysts by the company	6.1%	25.8%	38.6%	29.5%	3.85
Prospectuses	5.8%	28.0%	42.9%	23.4%	3.78
The independent auditor's report	10.0%	26.1%	30.4%	33.4%	3.77
Information on the company's website other than the above	7.9%	37.7%	36.5%	17.9%	3.57
Media reports	9.1%	40.5%	35.1%	15.2%	3.47

Are there any other sources of information you use when making economic decisions about a company?
(Please specify): ______________________________

____

5.2 In making economic decisions about a company, how useful is it to you if companies publish their financial reporting information?

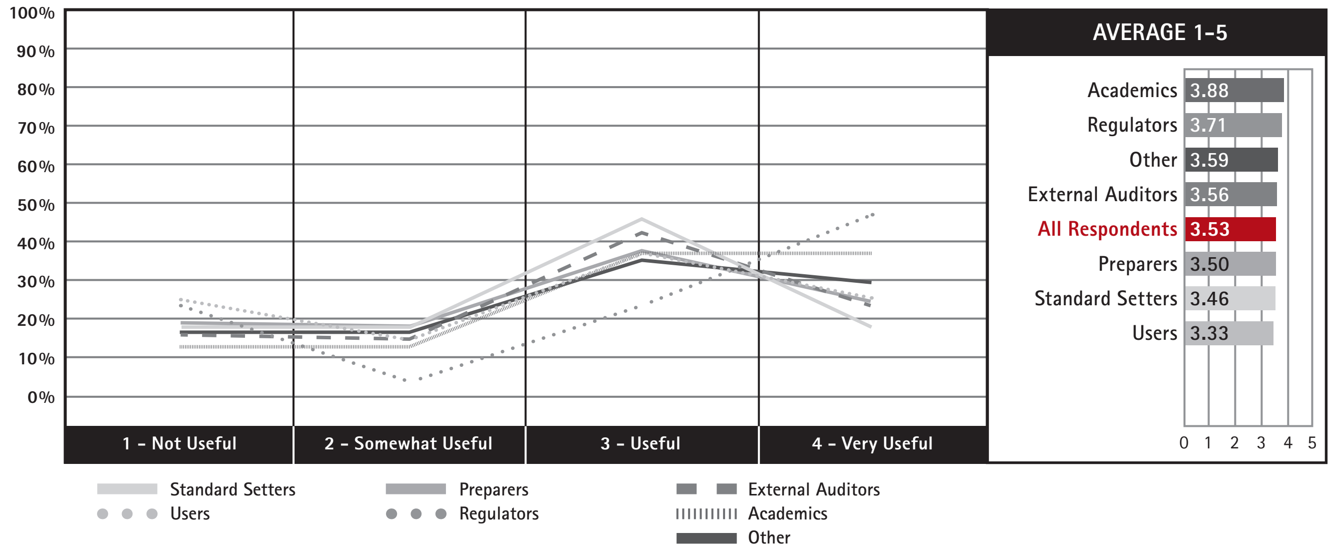
	NOT USEFUL	SOMEWHAT USEFUL	USEFUL	VERY USEFUL	AVERAGE 1-5
Annually	3.7%	13.4%	23.0%	59.9%	4.35
Semi-Annually	4.7%	19.2%	40.1%	36.0%	4.03
Quarterly	6.8%	22.5%	34.2%	36.6%	3.94
Monthly	29.1%	31.0%	22.4%	17.6%	3.00
Real Time	38.5%	22.0%	15.2%	24.3%	2.87

Do you have additional comments on the frequency of financial reporting information?
(Please specify): ______________________________

____

5.3 **Extensible Business Reporting Language, XBRL, is a standards-based way to electronically communicate business and financial performance data. In making economic decisions about a company, how useful is it to you if companies publish financial information in XBRL format?**

RESPONDENT TYPE



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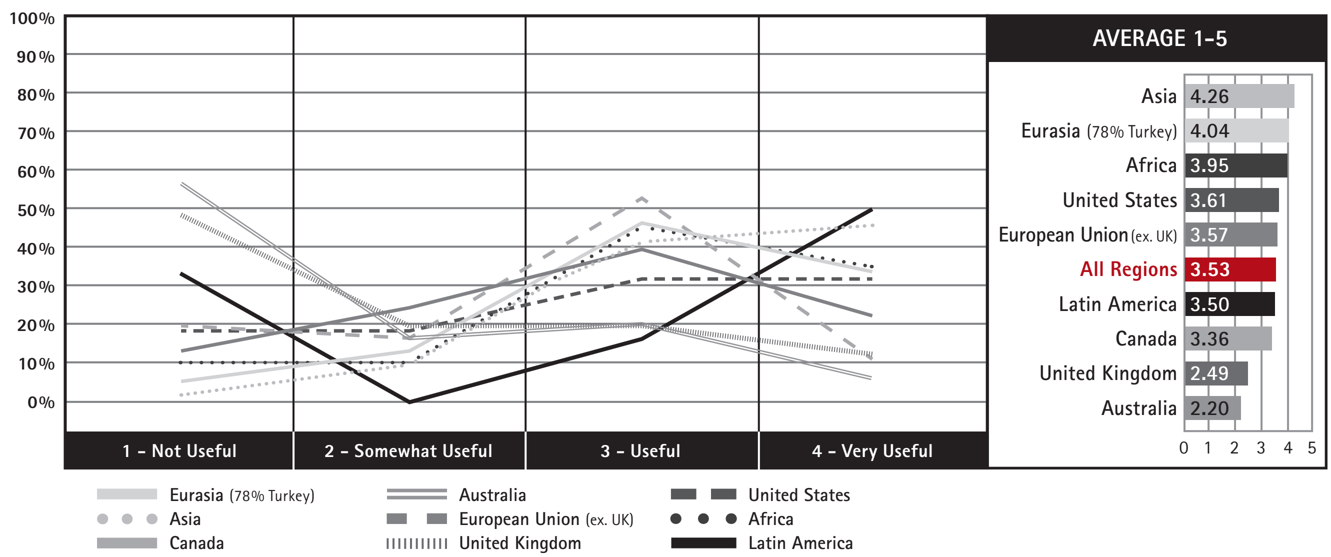
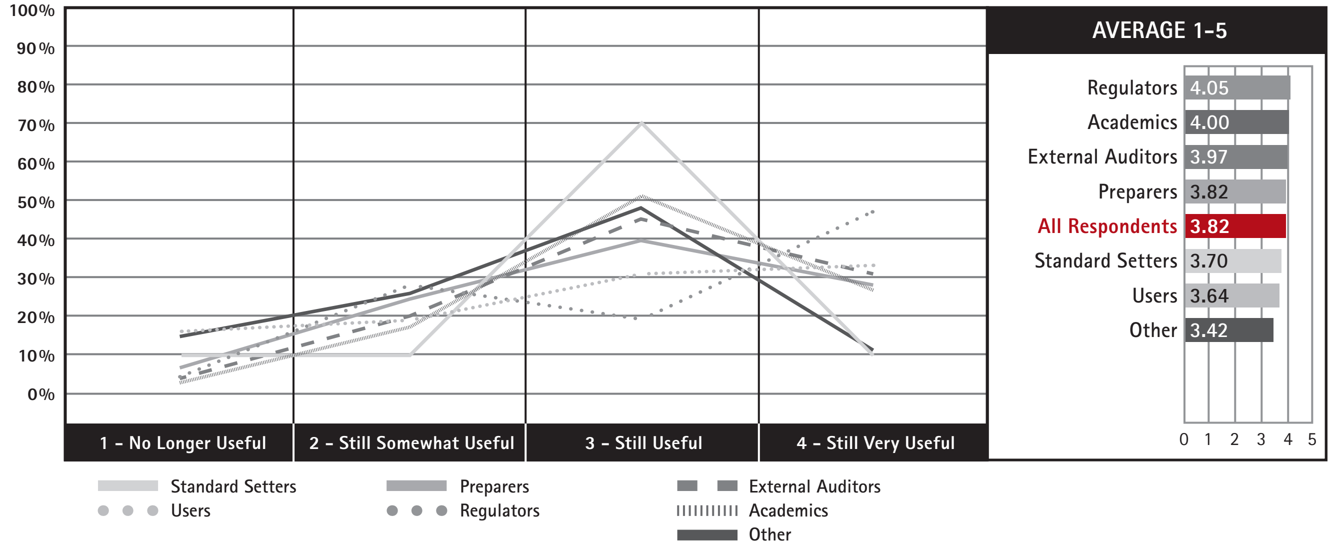


5.4 Do you feel that paper version financial reports are still useful in your country?

RESPONDENT TYPE



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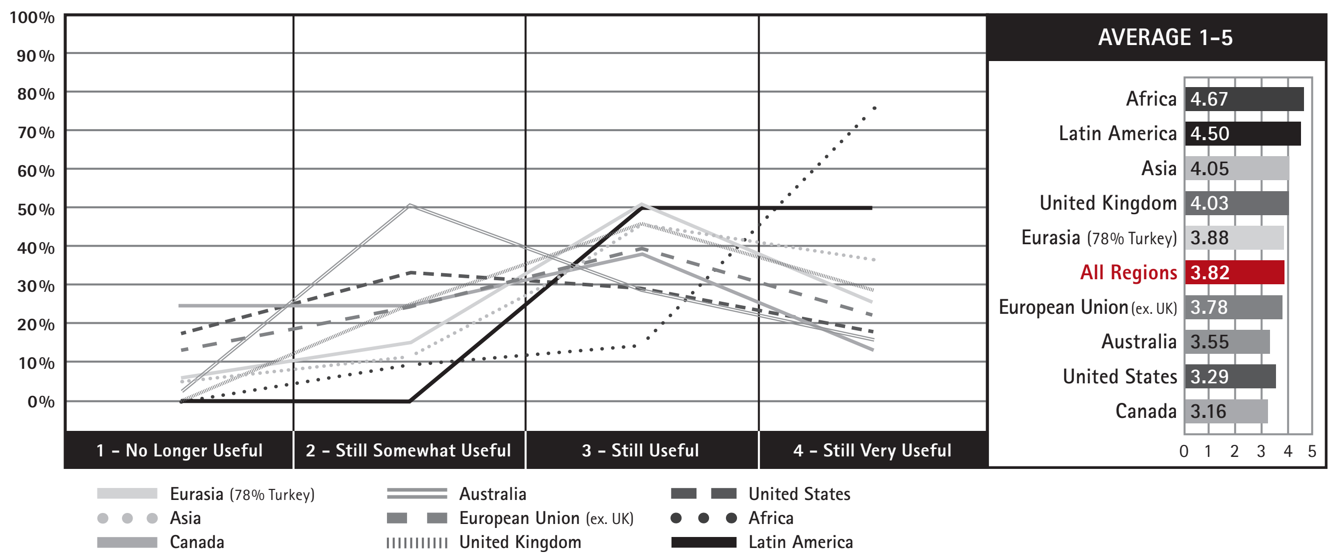
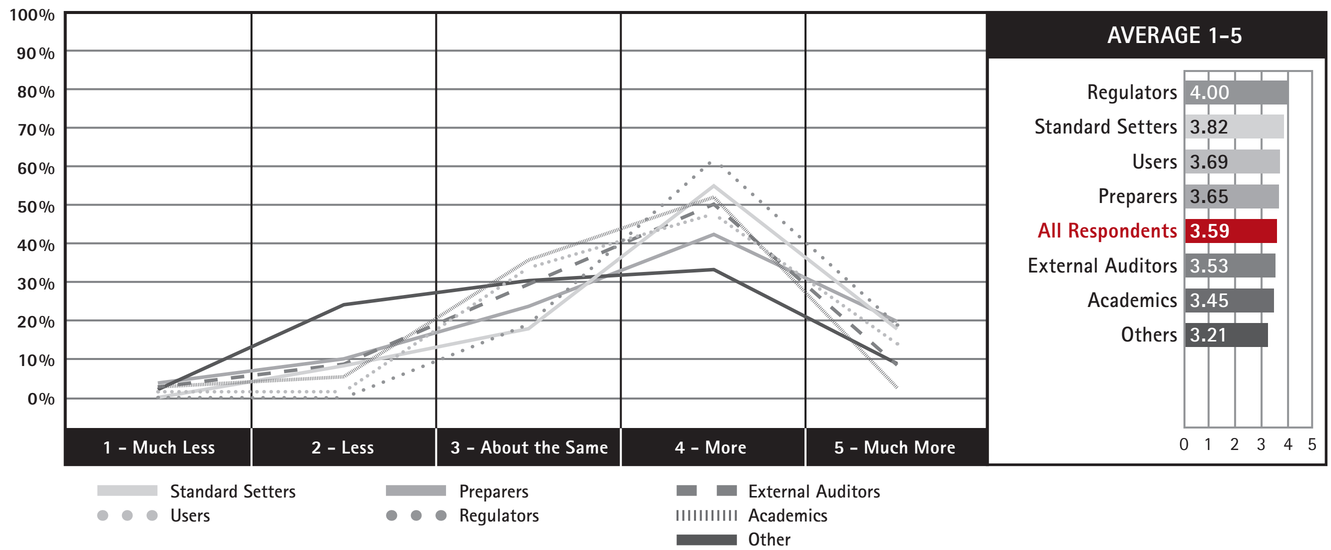


5.5 Do you feel that generally financial reports in your country have become more or less relevant over the last 5 years?

RESPONDENT TYPE



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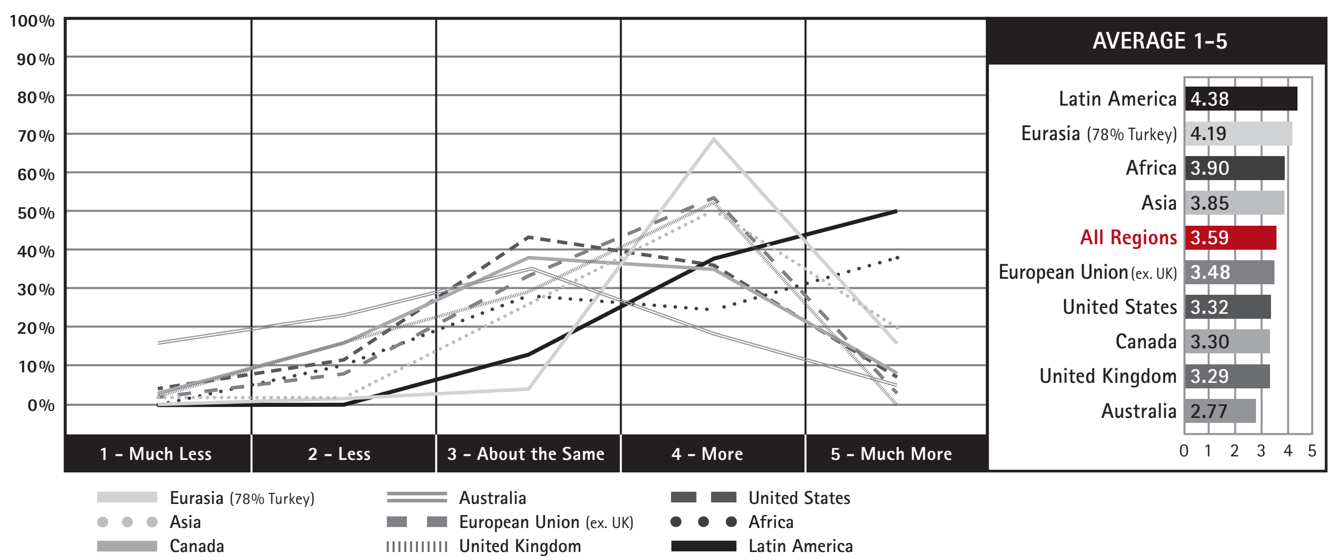
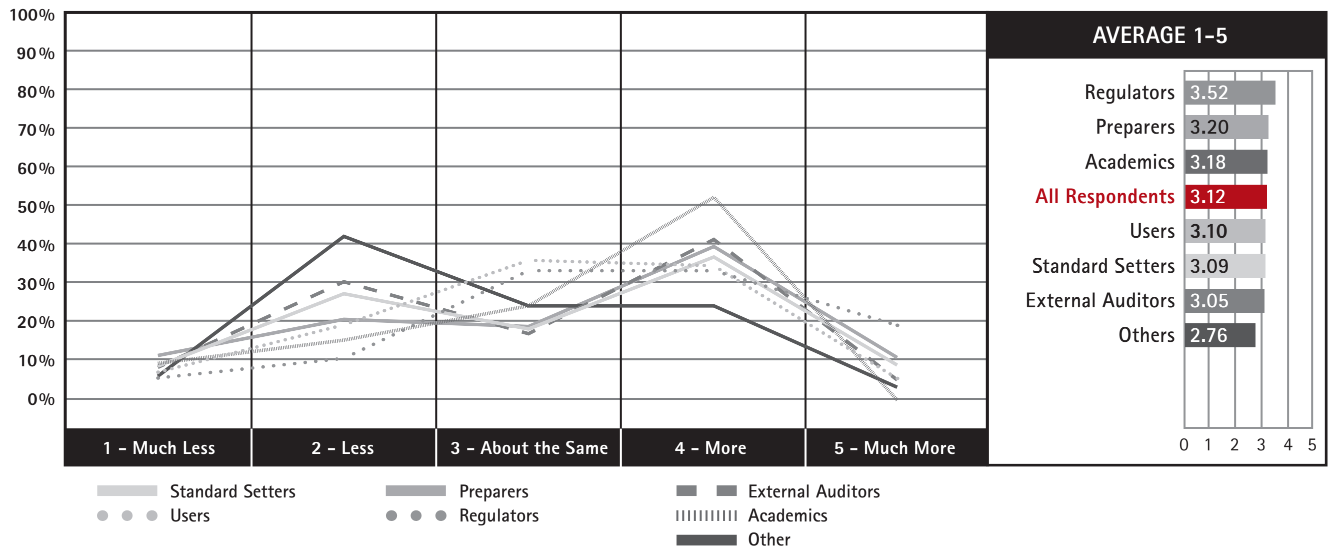


5.6 Do you feel that generally financial reports in your country have become more or less understandable over the last 5 years?

RESPONDENT TYPE



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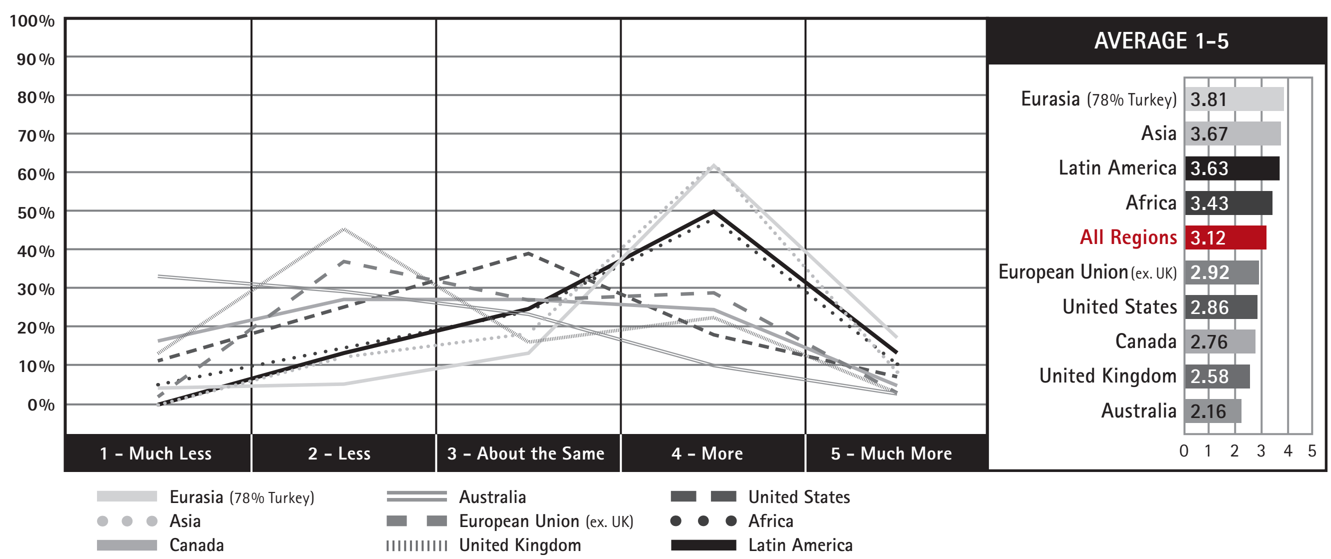
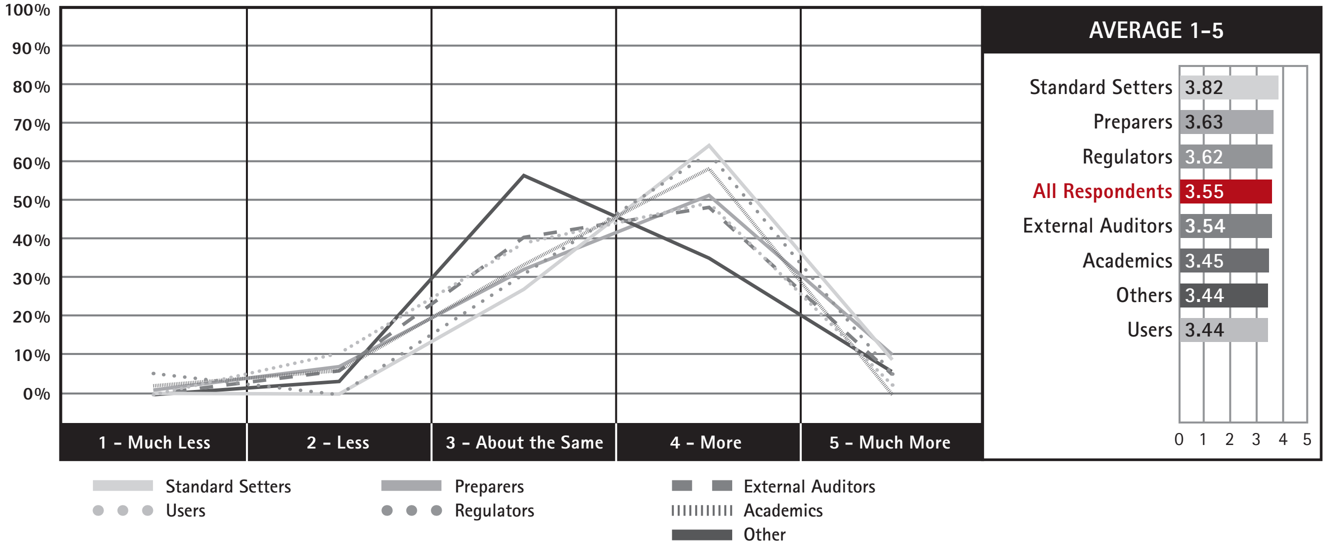


5.7 Do you feel that financial reports in your country have generally become more or less reliable over the last 5 years?

RESPONDENT TYPE



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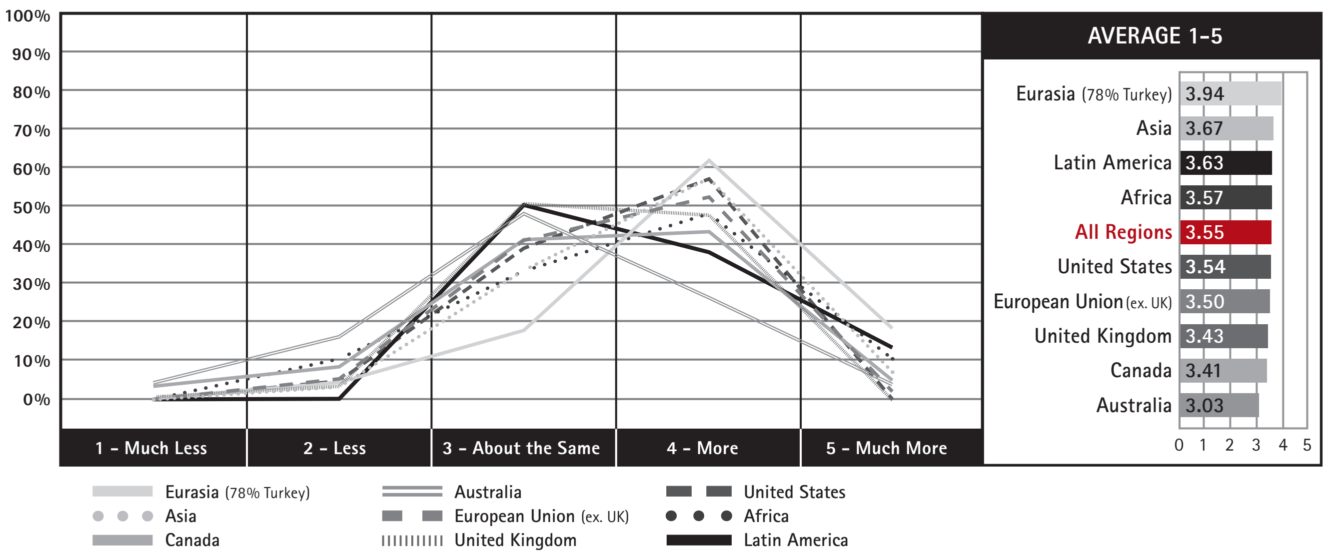

5.8 In your opinion, what have been the good things and what have been the not so good things that have happened over the last 5 years in regard to the usefulness of financial reports in your country?

Good things: ______________________

Not so good things: ______________________

5.9 Do the following areas need more or less reporting on to further improve the usefulness of financial business reports in your country?

	MUCH LESS	LESS	STAY THE SAME	MORE	MUCH MORE	AVERAGE 1–5
Operating and financial risks	0.0%	2.7%	19.1%	37.6%	40.6%	4.16
Strategic plans and their implementation	0.3%	2.1%	21.0%	36.8%	39.8%	4.14
Critical accounting judgments	0.3%	3.0%	20.7%	41.0%	35.0%	4.07
Operational and financial objectives	0.6%	1.8%	21.3%	43.2%	33.1%	4.06
The adequacy and effectiveness of internal controls	1.5%	6.4%	26.4%	34.8%	30.9%	3.87
Governance policies and compliance issues	0.9%	6.1%	33.0%	33.6%	26.3%	3.78
Fair value information	6.1%	6.4%	21.6%	37.6%	28.2%	3.76
Social and sustainability issues related to their business	2.1%	7.6%	30.6%	36.7%	23.0%	3.71

5.10 Do any other areas need more or less attention to further improve the usefulness of financial reports in your country?

Areas that need more attention: ______________________

Areas that need less attention: ______________________

Part 6: Finalizing the Survey

6.1 Do you have any additional comments with regard to the financial reporting supply chain, its participants or the financial reports that are being issued?

(Please specify): ______________________

6.2 If you would like to receive an electronic copy of the report that will be written based on this survey, please supply your name and email here below. This information will be kept strictly confidential.

Name: ______________________

Email: ______________________

Thank you for completing this survey.

APPENDIX B:

PEOPLE INTERVIEWED FOR THIS SURVEY

Name	From	Title
Mike Willis	USA	Partner, PricewaterhouseCoopers
James Quigley	USA	Chief Executive Officer, Deloitte Touche Tohmatsu
David Phillips	UK	Partner, PricewaterhouseCoopers
Bob Laux	USA	Director External Reporting, Microsoft Corporation
Kuah Boon Wee	Singapore	Chief Executive Officer, Southeast Asia and Singapore Terminal, PSA Singapore Terminals
Guylaine Saucier	Canada	Independent director and former member of IFAC Board
Bob Herz	USA	Chairman, Financial Accounting Standards Board
John Hegarty	International	Head, Centre for Financial Reporting Reform, The World Bank
L. Nelson Carvalho	Brazil	Chairman, International Accounting Standards Board's Standards Advisory Council
Jean-Luc Peyret	France	President, Association Nationale des Directeurs Financiers et de Contrôle de Gestion
Claude Lamoureux	Canada	President and CEO, Ontario Teachers' Pension Plan
A regulator	Australia	Preferred not to be named in the report
Tricia O'Malley	International	Board member, International Accounting Standards Board
Martin Cubbon	Hong Kong	Executive Director (Finance), Swire Group, Hong Kong
John Plender	UK	Chairman, Quintain Estates and Development, Senior Editorial Writer and Columnist for the *Financial Times*
John Coombe	UK	Chair, Hogg Robinson, and non-executive director, HSBC
Paul Lee	UK	Director, Hermes Investment Management Ltd.
Bill Connell	UK	Chairman, Steering Committee of IFAC's Enterprise Governance report
Bob Bunting	USA	IFAC Deputy President, and Partner, Moss Adams LLP
Jeremy Newman	UK	Managing Partner, BDO Stoy Hayward LLP
Richard Raeburn	UK	CEO, Association of Corporate Treasurers
Paul Spencer	UK	Company Director
Georgene Palacky	USA	Director, Financial Reporting Policy Group, CFA Institute
Jim Allen	USA	Director, Capital Markets Policy Group, CFA Institute
Göran Tidström	Sweden	Chairman and Senior Partner, PricewaterhouseCoopers Sweden and IFAC Board member

APPENDIX C:

OTHER RELEVANT PUBLICATIONS

General

- IFACnet is the global, multilingual search engine developed by the International Federation of Accountants and its members to provide accountants and others with access to global resources and information. IFACnet can be accessed free-of-charge at **www.ifacnet.com**
- In November 2006, the CEOs of the international audit networks (BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG, and PricewaterhouseCoopers) published a vision statement entitled *The Global Capital Markets and the Global Economy*. They present this paper to start a dialogue within the financial reporting supply chain about how global financial reporting and public company auditing procedures must adapt to better serve capital markets around the world.
- On April 2007, the UK regulator Financial Services Authority published a paper, entitled *Principles-based Regulation - Focusing on the Outcomes that Matter*, setting out its move away from more detailed rules towards a more principles-based regulatory regime to promote efficient, orderly and fair financial markets.
- The Financial Stability Forum is an organization that brings together senior financial representatives of national financial authorities, international financial institutions, international regulatory and supervisory groupings, committees of central bank experts, and the European Central Bank to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance. See also: **www.fsforum.org**.
- The Fédération des Experts Comptables Européens is the representative organization for the accountancy profession in Europe. It issues many comment letters, fact sheets and position papers on issues raised in this financial reporting supply chain survey. See for example, its work on auditors' liability and the 2007 FEE paper *Selected Issues Relating to Financial Statement Audits – Inherent Limitations, Reasonable Assurance, Professional Judgement and its Documentation, and Enforceability of Auditing Standards*. The appendix to this paper also contains a short informal treatment of examples of the responsibilities of participants in the financial reporting supply chain.
- In November 2007, the World Bank opened the Vienna Centre for Financial Reporting Reform (CFRR) in an effort to better assist countries in Europe and Central Asia in meeting the financial reporting standards needed for EU accession and to meet the emerging needs of middle income countries in the Region. CFRR will be working on financial management, auditing and accounting, private sector development, project management and administrative issues. For more information, please visit CFRR's website at: **www.worldbank.org/cfrr**.

Corporate Governance

- The Organisation for Economic Co-operation and Development (OECD) published the *OECD Principles of Corporate Governance: 2004*. The purpose of this guidance is to assist the preparers of enterprise reporting in producing disclosures on corporate governance which will address the major concerns of investors and other stakeholders.
- The United Nations Conference on Trade and Development issued the *Guidance on Good Practices in Corporate Governance Disclosure*. The purpose of the guidance is to help those responsible for preparing company reports to produce disclosures on corporate governance that address the major concerns of investors and other stakeholders.
- Through the following website, the European Corporate Governance Institute is making available the full texts of corporate governance codes, principles of corporate governance and corporate governance reforms both in Europe and elsewhere. See: **www.ecgi.org/codes/all_codes.php**.
- In 2006, the Professional Accountants in Business Committee of IFAC published *Internal Controls - A Review of Current Developments*. This information paper reviews current developments and some of the latest thinking in the area of internal control. See also: **www.ifac.org/Store/**.
- In 2007, Ernst & Young published the findings of an international survey about the current status and future direction of thinking about (internal) controls in a report called *From Compliance to Competitive Edge*. Respondents believe there is competitive advantage to be gained from taking a more professional approach to internal control.
- In 2007, IFAC published the international good practice guidance *Defining and Developing an Effective Code of Conduct for Organizations*. This guidance paper helps organizations to encourage an ethics-based culture and to define and develop a code of conduct. It also refers to the most significant resources in this area. See also: **www.ifac.org/Store/**.
- In 2006, the Institute of Chartered Accountants in Australia published *Accountants and Ethics*, a white paper on key observations arising from a forum on ethics.
- In July 2003, the Fédération des Experts Comptables Européens issued a discussion paper on *The Financial Reporting and Auditing Aspects of Corporate Governance*, which details the elements of good corporate governance relevant to the process of financial reporting and auditing and considers the fundamental relationships and obligations between the company boards, auditors, shareholders and other stakeholders in an effective corporate governance system.

Financial Reporting

- The CFA Institute is the global, not-for-profit association of investment professionals. In July 2007, it published *A Comprehensive Business Reporting Model: Financial Reporting for Investors* as a framework for developing financial reports and disclosures that meet the needs of investors, such as equity investors, creditors, and other providers of capital. See also: **www.cfainstitute.org**.
- The International Accounting Standards Board (IASB) is an independent accounting standard setter based in the UK. The IASB publishes *International Financial Reporting Standards (IFRS)*.
- In 2007, the Transnational Auditors Committee of IFAC published *Perspectives on the Global Application of IFRS*. This report illustrates the progress made with International Financial Reporting Standards and sets out examples of good practices that the network firms are implementing. See also: **www.ifac.org/Store**.
- The Securities and Exchange Commission (SEC) is the primary overseer and regulator of the U.S. securities markets. Its mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. It is the responsibility of the SEC to interpret federal securities laws; issue new rules and amend existing rules; oversee the inspection of securities firms, brokers, investment advisers, and ratings agencies; oversee private regulatory organizations in the securities, accounting, and auditing fields; and coordinate U.S. securities regulation with federal, state, and foreign authorities. See also: **www.sec.gov**.
- In November 2007, the SEC approved rule amendments under which financial statements from foreign private issuers in the U.S. will be accepted without reconciliation to U.S. GAAP only if they are prepared using IFRS as issued by the IASB. In addition, the SEC plans a Concept Release relating to issues surrounding the possibility of treating U.S. and foreign issuers similarly in this respect by also providing U.S. issuers the alternative to use IFRS. See: **www.sec.gov/spotlight/ifrsroadmap.htm**.
- In a *speech* in November 2007, the European Commissioner for Internal Market and Services, Charlie McCreevy, stated, “Now it will be Europe’s turn to accept accounts in US GAAP. This decision will have to be taken next year. And it is certainly my intention to propose that no reconciliation to IFRS will be needed for companies filing their accounts under US GAAP. This is the only sensible way forward.” See also: **www.ec.europa.eu/internal_market/accounting/index_en.htm**.
- The Financial Accounting Standards Board (FASB) is the designated organization in the private sector for establishing standards of financial accounting and reporting in the US. In 2002, FASB and IASB announced the issuance of a *Memorandum of Understanding*, formalizing their commitment to the convergence of U.S. and international accounting standards. See also: **www.fasb.org**.
- The Canadian Institute of Chartered Accountants, an IFAC member body, has a group devoted to improving "Beyond GAAP" reporting. Its 2004 publication, *Management’s Discussion and Analysis: Guidance on Preparation and Disclosure*, has spawned several other releases, including a paper discussing disclosure of the financial effects of climate change. In early 2008, the group expects to publish a draft release to improve the comparability, consistency, and transparency of the non-GAAP financial measures Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) and Free Cash Flow. This will complement earlier guidance for reporting distributable cash in publicly traded income trusts. All these publications are available through **www.cica.ca/cpr**.
- The Institut der Wirtschaftsprüfer in Deutschland e.V., an IFAC member body, published in 2007 a discussion paper called *Additional Issues in Relation to a Conceptual Framework for Financial Reporting*. It takes the view that a more thorough examination of the cost-benefit concept, of the reliability aspect of decision-useful information, and of the stewardship objective for financial reporting, would indicate that IASB’s preliminary approach to financial reporting may lead to standard setting that focuses on financial reporting outcomes without addressing the financial reporting processes and related costs needed to achieve those outcomes.
- The European Financial Reporting Advisory Group (EFRAG) was set up in 2001 to assist the European Commission in the endorsement of IFRS. In cooperation with the Spanish standard setter, the Instituto de Contabilidad y Auditoría de Cuentas, EFRAG published in November 2006 the following discussion paper: *The performance reporting debate - What (if anything) is wrong with the good old income statement?* This paper identifies the (more technical) issues to determine the future direction of performance reporting that will be further debated in a second paper.
- In cooperation with the Accounting Standards Board, Foreningen af Statsautoriserede Revisor, Deutsches Rechnungslegungs Standards Committee, Komitet Standardów Rachunkowo_ci, EFRAG published in June 2007 a comment on the IASB/FASB conceptual framework project: *Stewardship/accountability as an objective of financial reporting*. It discusses whether stewardship/accountability should be a separate objective of financial reporting in the converged IASB/FASB framework, besides the (overall) objective of providing information that is useful to users in making investment, credit and similar resource allocation decisions.

The Audit of Financial Reports

- The 2008 *Handbook of International Auditing, Assurance and Ethics Pronouncements* includes all pronouncements issued by the International Auditing and Assurance Standards Board as of December 31, 2007, as well as the IFAC *Code of Ethics for Professional Accountants*. See also: **www.ifac.org/Store/**.
- In a project on Improvement of the International Credibility of Korean Accounting Transparency, the Korean Institute of Certified Public Accountants, an IFAC member body, initiated, among other things, the adoption of global auditing standards. See: **www.kicpa.or.kr/english/html/w020101.jsp**.
- The American Institute of Certified Public Accountants, an IFAC member body, has created the Audit Committee Effectiveness Center that presents the guidance and tools to make audit committee best practices actionable. The guidance can be used by

profit, nonprofit and governmental entities. See: **www.aicpa.org/audcommctr/homepage.htm**.

- The Internal Market Directorate General of the European Commission commissioned an independent study on the ownership rules that apply to audit firms and their consequences on audit market concentration: *Ownership rules of audit firms and their consequences for audit market concentration* (October 2007). The study analyzes whether changes to the ownership rules of audit firms might help increase the number of international players in the audit market.
- In September 2006, the International Forum of Independent Audit Regulators was established to share knowledge of the audit market environment and practical experience of independent audit regulatory activity, to promote collaboration in regulatory activity, and to provide a focus for contacts with other international organizations which have an interest in audit quality. See also: **www.ifiar.org**.
- The Public Company Accounting Oversight Board is a US private-sector, non-profit corporation with a mission to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports. See also: **www.pcaobus.org**.

Usefulness of Financial Reports

- The European Financial Reporting Advisory Group issued in 2006 the discussion paper: *What (if anything) is wrong with the good old income statement?* The paper identifies and analyzes the arguments of those who believe that fundamental changes are needed to the existing performance reporting model, and also explains the reasoning of those who believe such changes are not needed. See: **www.efrag.org**
- On June 27, 2007, the US SEC established the Advisory Committee on Improvements to Financial Reporting to examine the US financial reporting system with the goals of reducing unnecessary complexity and making information more useful and understandable for investors. See: **www.sec.gov/about/offices/oca/acifr.shtml**.
- In 2007, PricewaterhouseCoopers conducted a survey of the views of investors and analysts from the UK, US, Canada, Germany, France and Australia: *Corporate reporting: Is it what investment professionals expect?*
- In April 2007, PricewaterhouseCoopers published *Corporate reporting – a time for reflection* , a survey of the Fortune Global 500 companies' narrative reporting. It investigates what the narratives actually communicate and to what extent companies are meeting the information needs of investors.
- A study by the KPMG International Financial Reporting Group of nearly 200 companies in 16 countries has found that approaches taken in the application of IFRSs are influenced primarily by a company's country of domicile and its previous national accounting standards, rather than by its industry. The study is for sale via **www.kpmgifrg.com**.
- In September 2007, KPMG issued the results of a *Survey of Leading Investors*, which shows that many investors believe that accounts are increasingly becoming regulatory filings rather than documents offering real insight into the ongoing performance of a business, highlighting a need for more information on company strategy and markets in which the business operates.
- In June 2007, KPMG published *International Financial Reporting Standards - The quest for a Global Language*, in which a range of senior industry, accounting and regulatory figures give their views on the implementation to date of IFRS, and the key challenges that lie ahead.
- In 2004, Deloitte, in cooperation with the Economist Intelligence Unit, examined key non-financial metrics in a report titled *In the Dark: What boards and executives don't know about the health of their businesses*. It concludes that the majority of board members and senior executives say they need incisive non-financial information on their companies' key drivers of success, but largely find such data to be lacking or, when available, of mediocre to poor value. A follow-up survey in 2007 called *In the Dark II*, finds many board members and senior executives are still in the dark about the overall health of their organizations and have a lack of high-quality non-financial data upon which they can act.
- Since January 2007, the Dutch government is capable of communicating with entrepreneurs in the XBRL reporting language. The whole financial reporting supply chain is taking part in this initiative: the State, governmental bodies, intermediaries, software suppliers, professional and service organizations and employers' organizations. See the brochure *XBRL for companies. What does it mean for you?*
- Since July 2002, all providers of complex financial products in The Netherlands have been obliged to provide a *Financial Information Leaflet*, which describes all the characteristics of the product and, therefore, gives a simple overview of all the various advantages and disadvantages. See also: **www.afm.nl/english**.
- The article *The Lord of Global Standards* by R. Hussey & A. Ong (2005), is a satire on Tolkien's Lord of the Rings. It provides, in a humorous style, an analysis of the rules vs. principles approach debate to international accounting harmonization.
- In 2007 the European Commission started encouraging Member States to create an electronic network interconnecting the national repositories which store financial information on listed companies. This will facilitate investors' access to historical information on companies' performance and financial position as well as on changes in major shareholdings. See also: *Storage of regulated information*.
- In 2007, the Institute of Chartered Accountants in England and Wales, an IFAC member body, published *EU implementation of IFRS and the Fair Value Directive*. This study evaluates the application of IFRS and the Fair Value Directive across EU industries, market places and member states. It also features an evaluation of the reactions to the transition to IFRS reporting of preparers, users and auditors through an on-line survey and roundtables held across the EU.

APPENDIX D:

CREDIBILITY REPORT: RECOMMENDATIONS AND RESULTS

Rebuilding Public Confidence in Financial Reporting: An International Perspective (Credibility Report) by the Task Force on Rebuilding Public Confidence in Financial Reporting (IFAC 2003)

The main recommendations of the Credibility Report, a brief overview of what has happened since, and the findings in this survey on the results/progress in these areas as well as the recommended next steps are further discussed below.

CREDIBILITY REPORT RECOMMENDATIONS	WHAT HAS HAPPENED SINCE?	WHAT ARE THE RESULTS SO FAR AND RECOMMENDED NEXT STEPS?
1 Effective corporate ethics codes need to be in place and actively monitored.	• Many countries and/or their capital markets have adopted or revised codes of corporate governance to which public companies must adhere and publicly report on. Examples include the *Dutch Corporate Governance Code* (Tabaksblatt), the South African *King Report* or the UK *Combined Code on Corporate Governance*. • Many of these corporate governance codes promoted the use of corporate code of ethics, and many companies have one. Examples can be found at: www.ibe.org.uk/examples. • In 2007, IFAC issued international good practice principles and guidance on *Defining and Developing an Effective Code of Conduct for Organizations*.	• Respondents felt that corporate governance had improved in their respective countries. • Many respondents mentioned that new codes and standards on corporate governance had contributed to the improvement. • Continuous attention to the behavioral and cultural aspects of governance was considered to be the most important priority. • See the chapter on corporate governance.
2 Corporate management must place greater emphasis on the effectiveness of financial management and controls.	• Many countries introduced or revised regulation on company financial management and controls, most notably, the US *Sarbanes-Oxley Act*, but also the Canadian Bill 198, the French *Loi sur la Sécurité Financière*, the revised UK *Turnbull guidance*, or the more recently in Japan *J-SOX*. • Also without specific additional regulation, many public companies have placed greater emphasis on the effectiveness of their financial management and controls.	• Respondents felt that the financial reporting process (including preparation and internal approval) had been improved. • Reasons given for this improvement included boards and management taking ownership of the financial reporting process, as well as improved internal control over financial reporting systems supported by improved technology for preparing financial reports. • Respondents recommended a continuous attention by boards of directors to the quality of the financial reporting process. • See the chapter on the financial reporting process.
3 Incentives to misstate financial information need to be reduced; companies should refrain from providing profit forecasts, determine executive remuneration more independently and be more transparent about executive remuneration.	• Although incentives to misstate financial information have been subject of increased public scrutiny over the past five years, incentives to misstate financial information still exist in many parts of the world.	• Some respondents felt that more disclosure about topics such as executive remuneration, pension obligations and expensing stock options strategy has lead to more transparent financial reporting. • For many respondents executive remuneration is still detrimental to the quality of corporate governance as "All or most accounting scandals involve compensation." • Respondents felt that there needed to be a better alignment of compensation with longer term company performance, and that there should be more transparency in executive compensation. • See the chapter on corporate governance.

CREDIBILITY REPORT RECOMMENDATIONS	WHAT HAS HAPPENED SINCE?	WHAT ARE THE RESULTS SO FAR AND RECOMMENDED NEXT STEPS?
4 Boards of directors need to improve their oversight of management.	• Many of the corporate governance codes as mentioned above include provisions on board of directors' oversight of management, the audit function of the board and board evaluation.	• Respondents felt that improvements in board structure are an important reason for improved corporate governance. • Key elements were the increased board independence, the increased awareness of their responsibilities, as well as the improved operation of audit committees. • See the chapter on corporate governance.
5 The threats to auditor independence need to receive greater attention in corporate governance processes and by auditors themselves.	• In 2005, the IESBA amended the *Code of Ethics for Professional Accountants* which has been adopted by many *IFAC member bodies*. • The IESBA plans to issue revisions to the independence requirements contained in the Code. These revisions will strengthen independence requirements in particular those requirements related to audits of public interest entities.	• Respondents in this survey felt that the audit process has become better and that the financial reports have become more reliable. • Reasons given for this improvement included increased awareness, commitment and competence of auditors and audit committees, as well as greater auditor independence and improved auditor oversight. • Respondents felt a continuous focus on audit independence, objectivity and integrity is required. • See the chapters on the audit of financial reports and on the usefulness of financial reports.
6 Audit effectiveness needs to be raised primarily through greater attention to audit quality control processes.	• The International Auditing and Assurance Standards Board issued *International Standard on Quality Control 1* (ISQC 1) as a quality control standard for firms that perform audits and *International Standard on Auditing 220* (ISA 220) as a quality control standard for auditors who perform audits. • Issue of IFAC's *International Education Standards*, both for the initial accounting and auditing education and for continuing development of professional competence. • IFAC issued the *Statements of Membership Obligations* and the *Member Body Compliance Program* to further promote its standards internationally. • The members of the *Forum of Firms* have committed to use of ISAs and ISQC 1. • Also the various (national) regulators have emphasized (and enforced) audit quality processes.	• In this survey also the improved quality review was seen as contributing to a better audit of financial reports. Respondents felt that there are infrastructures in place to facilitate and enhance quality both for the individual accountants and the accounting firms. • Respondents recommend the consistent use of audit and (other) quality control standards within audit firms. • See the chapter on the audit of financial reports.

CREDIBILITY REPORT RECOMMENDATIONS	WHAT HAS HAPPENED SINCE?	WHAT ARE THE RESULTS SO FAR AND RECOMMENDED NEXT STEPS?
7 Codes of conduct need to be put in place for other participants in the financial reporting process, and their compliance should be monitored.	• A number of other participants of the financial reporting supply chain also adopted or renewed codes of conduct, for example, the CFA institute revised its code of conduct for financial analysts. See: *www.cfainstitute.org*	• Respondents indicated that other participants in the financial reporting process should also take their responsibilities. • Further improvement of financial reporting requires an orchestrated effort of all participants in the financial reporting supply chain.
8 Audit standards and regulation need to be strengthened.	• Over 100 countries have now adopted or have based their national standards the International Standards on Auditing (ISAs). Other countries and jurisdictions are in the process of doing so. • The IAASB clarity project is redrafting ISAs to improve their clarity. • External oversight of auditors either by government or by government established independent regulation has been strengthened. • Various national audit regulators are internationally aligning their activities in IFIAR.	• Respondents most common reasons for the perceived improvement of financial auditing quality were the improvement of financial auditing standards and the resulting improvement in the audit of financial reports • Respondents felt that further convergence to one set of global, principles-based auditing standards should continue. • See further in this survey in the chapter on the audit of financial reports.
9 Accounting and reporting practices need to be strengthened.	• International convergence of accounting standards has continued and IFRS is now used in over 100 countries, including the European Union, Australia and China. • The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have agreed on a long-term convergence project. Also, in 2007 the US SEC permitted foreign registrants to submit their financial reports using (full) IFRS without reconciliation to US GAAP. • See also the text box on the Convergence Report in the section "Previous IFAC Reports."	• Although respondents in this survey generally felt that the process of financial reporting, including the preparation and internal approval of financial reports, had become better, they did not think that the resulting financial reports had become more useful. • Respondents recommended various next steps like improving communication within the financial reporting supply chain to determine what information should be reported, simplifying and clarifying financial reporting standards, making financial reports more informative by including more business-driven information, and additional training. • See the chapters on the financial reporting process and on the usefulness of financial reports.
10 The standard of regulation of issuers needs to be raised.	• Progress in implementation of the International Organization of Securities Commissions' Principles of Securities Regulation.	

Comments are welcome on this report and can be sent to FRSC@ifac.org.

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