



ICGN

International Corporate Governance Network

ICGN Accounting and Auditing Practices Committee

'What Investors Want from Financial Reporting' Position Paper

This document is a living document and whilst it is an indication of the key issues for investors in financial accounts at this point in time it is not necessarily complete and will be continually improved and updated.

I. The objective of financial accounts

Financial accounts have many different users but their main objective should be to provide information that is useful to present and potential equity investors as the providers of risk capital and bearers of residual risk. Accounts should provide them with the information they need for the purposes of deciding to buy, sell or hold their shares and to help them fulfill their responsibilities as owners, stewardship, – assessing company management and the strategies adopted for the longer term.

ICGN recognises that reporting is expected to meet a growing set of needs and that some consider it should also be aimed at other stakeholders, such as creditors – including purchasers of traded debt - employees, bankers, customers and suppliers. However, these other stakeholders are protected by contractual and other rights that are not shared by equity investors. If equity investors' needs are satisfied, then ICGN believes the needs of other external users should be also.

II. The qualitative characteristics of the reported information

To be decision useful, ICGN considers that accounting standards should ensure that the information reported has the following qualitative characteristics.

- **Relevant** – Financial information should be relevant to the decisions being made. It should enable investors to evaluate risks, past and present performance, and be able to draw inferences regarding future performance.
- **Complete, Reliable/ Faithful Representation** – Financial information should be a faithful representation of the events it purports to represent. Thus the information should be neutral and report activity in a fair and unbiased way that is not skewed towards a particular result. There should be substance over form. Any off-balance sheet items should be appropriately disclosed.
- **Verifiable** – Financial information should be verifiable so that when a systematic approach and methodology is used different parties reach the same conclusion (e.g., different people counting cash reach the same total amount of cash).
- **Timely** – Financial information that is material should be disclosed in a timely manner. Information is material if its omission or misstatement could influence users' decisions

based on that information. (Material information is that an investor would reasonably want to know before making an investment.)

- Comparable and Consistent – Financial information is not static and to enable it to be evaluated, it should be presented in consistent manner to enable comparison to be drawn of both the entity's performance overtime and against other entities.
- Transparent – Financial information should provide the transparency equity investors need for optimal decision making.
- Understandable – Financial information should be presented in a way that can be understood by users.
- Prudence - - A degree of caution is exercised when making judgments and estimates where there is a degree of uncertainty, such that assets and income are not overstated and liabilities and expenses are not understated.
- Matching - The matching principle requires that expenses be matched with revenues.
- Going Concern - Substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in the future.

III. Measurement

Procyclicality

Accounting should not mitigate procyclicality in that a distinction needs to be made between the financial reporting requirements of listed companies to the market and the prudential requirements of financial institutions as required by the regulator. It is the role of the regulator to determine capital adequacy requirements from the reported numbers which should operate to smooth cycles - tighten requirements when conditions appear benign and credit in the system has grown and ease them when the pain has been taken. Accounting requirements, on the otherhand, should ensure that the performance of the business is reported to the market. They should not be set with the objective of achieving financial stability in that this is the preserve of the regulator.

Fair or market values

The reporting of fair or market values provides important information to investors. Current rather than historic values is more relevant to investors in that they are interested in how values have moved over time and are likely to move in the future. It also represents the most appropriate basis for measuring some assets and liabilities in the financial statements although it will be less suitable for others. ICGN supports standards setters in the use of the mixed attribute approach with the accounting reflecting the relevant characteristics of the assets, liabilities and income streams as well as the nature of the business model of the entity in question.

Broadly speaking, ICGN considers that fair values are more appropriate where the value of assets and liabilities fluctuate in an uncertain manner over time and are traded in liquid markets or are otherwise susceptible to accurate and reliable valuation. Cost-based approaches work better when these features are not applicable, where transaction amounts are of key relevance to business decisions and where assets are held to match liabilities that themselves cannot be easily measured at fair value. They wish to see accounting which is coherent and useful for the purpose both of informing investment decisions and in allowing the stewardship of the company's resources to be assessed.

Notwithstanding fair values being the more appropriate basis for measuring some assets and liabilities in the statement of financial position, it may be more useful to consider performance by reference to cost-based accounting principles and the income statement should be presented accordingly. Investors will nevertheless be likely to achieve a fuller understanding if informative disclosure of fair values (or side-by-side comparisons are reflected directly on the financial statements) is made where cost-based accounting is employed in the primary statements.

IV. Disclosures

Enhanced and integrated Non-Financial Business Reporting

In a fast-changing, globalising world, information material to investor decision-making is becoming increasingly diverse and dynamic. Long term success in managing a business in today's complex economic, environmental and social landscape is increasingly dependent on factors not reflected in financial statements and in some instances thought to be outside the reporting entity's sphere of concern. The same is true for investors when assessing an entity's present and future valuation and ability to understand its opportunities and risks.

It is important that all disclosure integrates consideration of financial and non-financial risks and factors which may affect the entity's ability to achieve its strategic objectives.

The ICGN has published its detailed views on enhanced narrative reporting in its Statement on Guidance on Non-financial Business Reporting which is available on http://www.icgn.org/files/icgn_main/pdfs/best_practice/buss_reporting/icgn_statement_&_guidance_on_non-financial_business_reporting.pdf

Audit - Enhanced reporting by auditors and audit committees

ICGN believes companies should consider asking auditors to provide enhanced reporting to the Audit Committee which in summary format is shared with investors. The Audit Committee and investors should explore whether the scope of an audit should be expanded. Full disclosure of audit and non-audit fees should be provided both in the notes to the accounts and in the Audit Committee's own report with explanations where appropriate.

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management, and it is important that they place a strong emphasis on fraud prevention, reducing opportunities for fraud and increasing the likelihood of detection. Auditors have a role in this subject to cost considerations.

Making the Standard Auditor's Report more informative is an ongoing objective of ICGN and auditors may consider implementing additional disclosure through auditors' discussion and analysis.

ICGN supports the "Guidelines for Enhanced Disclosure to assist Directors, Audit Committees, Shareowners and Investors" - <http://www.enhanceddisclosure.org/pdf/guidelines.pdf>

V. Format and structure of financial accounts

ICGN believes that financial accounts should be cohesive and provide comparability.

ICGN supports the application of XBRL to public company financial accounts, the use of IDEA (Interactive Data Electronic Applications) and other interactive systems. Filings should be made in interactive format, using a universal language, and should reside on an enterprise-wide database that holds individually-accessible but related information. This is about making information accessible and putting it in a readily retrievable format which is certainly welcome but it is not about the underlying content and substance of the data and should not be seen as a substitute for judgement.

In utilizing the interactive data, users may still need to develop their own templates, in much the same way as analysts currently do. However, such systems should make deeper review of the financial data currently filed much more usable as it will be developed in the users' language and with their priorities¹.

VI. The governance of standard setters

To achieve high quality global accounting standards, standard setters should engage fully with investors globally and their accountability, including funding, should be clear and representative. Full accountability and monitoring needs to be built in clearly and firmly. In particular:

- The Board and trustees should be representative of the constituents whose interests the standards seek to address and over time should seek to have a balance of investor representatives. ICGN supports a diverse board where emphasis is on the competence and skill-sets of the Trustees and Board members and the selection process is free from any political influence.
- Appointment procedures generally should become more transparent.
- All major stakeholders internationally should be consulted on changes to governance structures.
- The standard setting process should be transparent so that stakeholders can trace the evolution of the standard, the consideration of alternative views and the final position. Stakeholders should have the opportunity to provide input to the standard setting process and there should be transparency as to how any concerns are addressed.
- To ensure IFRS are credible, the IFRS Foundation and Board should be fully accountable and have sustainable funding that does not infringe their independence. ICGN considers the burden should be shared globally between a diverse range of sources from the global capital markets and all major economies should participate.
 - Auditing standards should ensure that an audit ensures the integrity of financial reports and audit inspections should ensure the quality of the audit process.]

¹ Other suggestions are:

- Provide links to download data in Excel
- Use minimum 12 pt font, with users able to increase and decrease as needed.
- Include links from the financial statements to the relevant part of the MD&A
- Provide data in different views so for example, users can click from a line item to the discussion of the item in the MD&A and footnotes.
- Allow users to choose what financial information they want such as in U.S. Dollars under U.S. GAAP or in Euros according to IFRS, results on a consolidated or unconsolidated basis, or group results or by reporting segment
- Show percentage and absolute changes between periods by using a percentage change column in the financial statements.