

Whither Convergence?

~ A long term Roadmap ~

Christian Dreyer, CFA

IFRS - Implications of Convergence

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Financial Reporting is made for Users!

- But Users don't seem to care much - or do they?
- AIMR's *Financial Reporting in the 1990's and Beyond* has matured
- Global reach of IFRS leverages User knowledge
- Convergence with US GAAP opens perspective of single global set of high quality standards
- Standard setting is becoming an increasingly political process with patchy representation of investor interests



Directions for Standard Setting from the investors perspective - the *Comprehensive Business Reporting Model*

- Provide a roadmap for future changes to reporting standards in 12 Principles
- Aiming for improved -
 - Clarity
 - Completeness
 - Economic Faithfulness
 - Understandability
- Representing interests of the CFA Institute's 70'000 members strong global base



What issues concern investors?

- How companies create wealth
- How sustainable is the wealth-generation process
- How the wealth is dispersed to the various superior stakeholders, and
- How wealth accrues to the residual common shareowners, the ultimate risk bearers



What information do investors need to answer these questions?

- Resources the company controls
- Obligations to transfer resources to others
- Ability to generate long-term, sustainable net inflows of resources
- Ability to convert new resources to cash
- Risks to which these resource-generating activities and cash flows are exposed, both short-and long-term



I The entity must be viewed from the perspective of an investor in the company's common equity.

- Financial Reporting exists to serve the needs of investors who cannot otherwise command financial information
- All events that can affect investors' wealth, changes in assets, liabilities and equities, should be recognized and explained (ex: off-balance sheet vehicles)
- If common shareowner's information needs are met, other users' needs will be as well



II Fair value information is the only information relevant for financial decision-making.

- Investors' buy, sell, and hold decisions, just as managers' acquisition and divestiture decisions, are based on fair values, and changes in those values, not outdated historical costs
- Consequently, investors require assets and liabilities to be measured at fair values
- If fair value results in greater volatility, it has merely unmasked economic volatility already present



III Recognition and disclosure is based on the information's relevance to investment decision-making, not measurement reliability alone.

- Information is relevant when it can influence an economic decision
 - Not simply when it can be measured
- Reliable information faithfully represents what it purports to represent
 - Not simply certainty of measurement
- Relevant numbers have been moved off balance sheet because they are less reliable
 - Predictability shouldn't be a test for materiality
- Relevance also means timeliness



IV Complete recognition of all economic transactions and events.

- Financial statement recognition and measurement of all events that can affect investors' wealth
 - Including all changes of fair value
- No accounting treatment should permit assets and liabilities, or changes in assets and liabilities to escape recognition
 - All off-balance sheet activities recognized



V Investors' wealth assessments must determine the materiality threshold.

- Materiality must be evaluated from the perspective of whether or not the information would make a difference to a common shareowner's valuation of the investment
- Use of quantitative thresholds to assess materiality does not serve investors' needs
- When in doubt, item should receive separate recognition accompanied by disclosure



VI Financial reporting must be neutral.

- Accounting should be based on what method best captures the economic substance of an item or event, and not on the form of the transaction or the outcome
- Flexibility in reporting has led to abuse, and diminished net income's value as a performance indicator.



VII All changes in net assets must be recorded in the Statement of Changes in Net Assets Available to Common Shareowners.

- Net Income is the result of the recognition of *some* revenues and gains on accounting transactions less *some* expenses and losses.
- No items should escape recognition in the changes in net assets statement
- Current disclosures concerning changes in assets are opaque in articulation
- New Statement replaces Income Statement & Statement of Comprehensive Income



Statement of Changes in Net Assets Available to Common Shareholders

	Current Period Accrual Transactions	Estimates	Valuation Adjustments	Net Change In Net Assets
Operating				
Investing				
Financing				
Net Change in Net Assets before Transactions with Owners				
Net Change in Net Assets				



VIII The Statement of Changes in Net Assets Available to Common Shareowners should include timely recognition of all changes in fair values of assets and liabilities.

- All assets and liabilities should be recorded at fair value
- All changes in fair values should also be recorded
- Recycling of gains and losses will not be permitted



IX The cash flow statement provides information essential to the analysis of a company and should be prepared using the direct method only.

- Direct method provides more information about cash receipts and payments
- The indirect method fails to provide adequate information for analysis
- Difficult to calculate reasonable estimates of gross operating cash flows (direct method) using only the data provided in the indirect format.



X Changes affecting each of the financial statements must be reported and explained on a disaggregated basis.

- Many financial measures are reported on a highly-aggregated or netted basis, causing much important information to be obscured or lost altogether.
- Investors must be able to analyze the individual forces that affect the company's performance.



Reconciliation of Balance Sheet, Cash Flows, Accruals, and Valuation Adjustments

Balance Sheet: December 31, 200X	Cash Flow Statement, Direct Method	Accruals	Valuation Adjustments	Balance Sheet: December 31, 200X + 1



XI Individual line items should be reported based upon the nature of the items, rather than by the function for which they are used.

- Items should be reported by the type of resource consumed, not the purpose for which it is used
- Aggregation by function merges items with different properties, reducing the information content of the items and their decision-usefulness



XII Disclosures must give investors all of the information they need to understand the items in the financial statements, their measurement properties, and risk exposures.

- Disclosure must explain events or transactions, including the models, assumptions and principles that were applied
- Disclosures must enable investors to disaggregate aggregated information
- Disclosures must provide the information investors need to make fair-value and other adjustments



A Comprehensive Business Reporting Model
- open for debate!

- Available online
www.cfapubs.org/doi/pdf/10.2469/ccb.v2005.n4.4001
- Currently in draft, final version expected in May 2006

