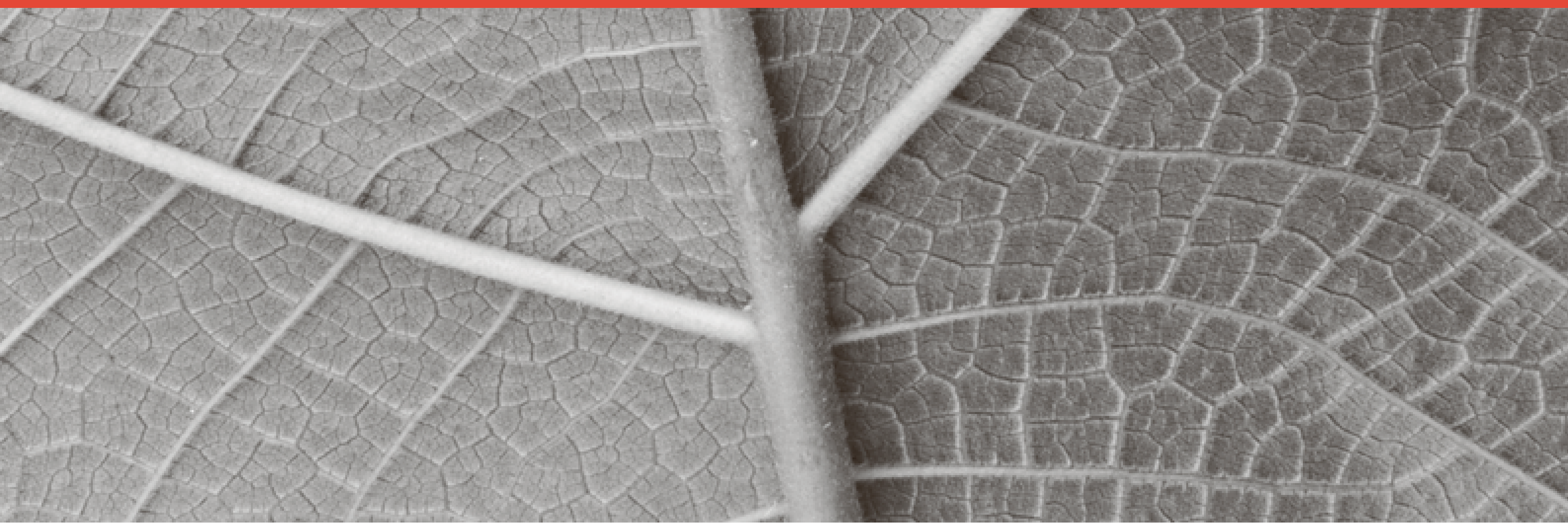
The future of financial reporting 2011: global crisis and accounting at a crossroads



BRITISH ACCOUNTING ASSOCIATION

A discussion paper based on the British Accounting and Finance Association's Financial Accounting and Reporting Special Interest Group (FARSIG) Symposium, 7 January 2011.

ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 147,000 members and 424,000 students in 170 countries, helping them to develop successful careers in accounting and business, and equipping them with the skills required by employers. We work through a network of 83 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote the appropriate regulation of accounting. We also conduct relevant research to ensure that the reputation and influence of the accountancy profession continues to grow, proving its public value in society.

ABOUT FARSIG

The Financial Accounting and Reporting Special Interest Group (FARSIG) is a group set up under the aegis of the British Accounting and Finance Association (BAFA). The main purpose of FARSIG is to further the objectives of BAFA and for that purpose to:

- encourage research and scholarship in financial accounting and reporting
- establish a network of researchers and teachers in financial accounting and reporting
- enhance the teaching of financial accounting and reporting
- provide support for PhD students in financial accounting and reporting
- develop closer links with the accounting profession in order to inform policy
- publish a newsletter and organise targeted workshops
- develop and maintain relationships with the BAFA and the professional accountancy institutes
- provide a forum for the exchange of ideas among accounting academics.

The symposium, which is one of an annual series that started in 2007, provides a forum for academic, practitioner and policy-orientated debate. Such forums are useful for expressing and developing rounded opinion on the current meta-issues facing financial reporting. Furthermore, they serve to illustrate the policy relevance and impact of current academic thinking and outputs in accordance with the Economic and Social Research Council (ESRC)/Advanced Institute of Management (AIM) calls for relevant and rigorous research through a combination of practitioner and academic perspectives.

We would like to express our thanks to the five main contributors, both for their subsequent time and comments during the development of this discussion paper. We have tried faithfully to capture the flavour of the original presentations. Nonetheless, although we ran our commentary of the presentations past the original authors, any errors or omissions remain our own. We would also like to thank ACCA for hosting the symposium and for its support in the publication of the discussion paper. Finally, for any readers who wish to learn more about FARSIG or to become a FARSIG member, please contact either of the authors.

Mike Jones is chairman of, and Richard Slack, secretary to, the FARSIG Committee.

The paper is available in pdf from **http://www.accaglobal.com/general/activities/library/financial_reporting/other.**

The future of financial reporting 2011: global crisis and accounting at a crossroads

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Foreword

ACCA was pleased to host, once again, the FARSIG annual discussion of the future of financial reporting. The meeting remains a valuable opportunity for interaction between the sectors interested in the current important themes in this area. This year's meeting comprised presentations from an accounting academic, an adviser for the World Bank and an investment director (who are both also visiting academics), and two representatives of the accountancy profession.

The title of this year's discussion paper hints at the lack of progress in two key areas: a recovery from the financial crisis beginning in 2008, and the move to full global convergence in accounting standards. The obstacles to progress in the short-term present an opportunity to continue the debate on the main issues such as the valuation of financial instruments, the implementation of IFRS in individual countries, and the roles of the national standard setters and endorsers. The forum which FARSIG provides for these discussions remains as valuable as ever, bringing together views from the key sectors involved and responding to developments, both anticipated and unexpected.

Equally, issues can and do arise with regard to certain existing individual requirements. We have reached a critical stage in the application of IFRS, now that practically a full suite of standards has been published, and is being applied in practice by numerous entities worldwide. Further changes will need to be relevant to the questions which have arisen from the application of IFRS in practice.

The future will see a potential transformation as integrated reporting, encompassing sustainability, may become the norm. The debate has begun on the fundamental issue of the overall role of financial reporting. It is now becoming clearer that along with the more obvious desire to 'cut clutter' in reports, there are also calls for increased disclosure in certain areas. In this context, what has not changed is the need to identify who are the valid stakeholders in the corporate reporting process, and how to respond to their needs.

Equally, the influence of financial reporting is still being questioned. Financial reporting was once viewed as having a neutral effect on the economic climate, but following criticisms of fair value accounting, a debate has arisen as to whether financial reporting should now serve to stabilise the effects of economic changes. The questions raised here may well become another matter to resolve in the process of establishing a platform for full international convergence. This and other ongoing debates will no doubt be shaped by further developments during 2012.

Many thanks to Mike Jones and Richard Slack for facilitating this year's publication, and not least their introduction and conclusions, which bring all of the themes raised into an overall context.

Richard Martin
Head of Financial Reporting, ACCA

Introduction

Although the global financial crisis originated in 2007, we are still experiencing its continuing severe effects. We are, however, now getting a clearer idea of the nature and role of accounting involvement in the accounting and regulatory issues. It was against this current discussion of accounting's role and the continued debate about the spread and adoption of IFRS that the annual FARSIG symposium was held at ACCA, London on 7 January 2011. The symposium dealt with a range of contemporary financial reporting issues, including the aftermath of the banking crisis as well as the future of accounting. The five speakers in order of appearance were:

i. Pauline Wallace, Pricewaterhouse Coopers, *Where Next for Financial Reporting?*

ii. David Cairns, Visiting Professor, LSE and World Bank Centre for Financial Reporting, *IFRS Five Years on: Will the Global Accounting Experiment Continue to Survive?*

iii. James Clunie, Visiting Professor, University of Edinburgh and Scottish Widows Investment Partnership, *Financial Instruments from a Financial Analyst's Perspective.*

iv. Alan McGill, PricewaterhouseCoopers, *Carbon Accounting: Is This the Future for Reporting?*

v. Richard Barker, Visiting Professor, Said Business School, *Is Fair Value Still Appropriate in the Future?*[1]

As usual, after each presentation there was a lively and informed discussion among the 61 delegates. A wide variety of topics were discussed.

BACKGROUND TO THE SYMPOSIUM

The symposium took place at the start of 2011. This symposium was thus set against the background of several long-term trends in financial reporting and the continuing fall-out from the global financial crisis. These, in combination, provided an interesting backdrop for the discussions.

The first long-term trend was the continued spread and development of IFRS. The International Accounting Standards Board (IASB) was founded in 1973. Since then it has gradually grown in importance. In its formative years, the International Accounting Standards Committee (IASC) was concerned with, first, documenting accounting practices globally and then with cutting down the number of accounting options. This can be seen as the first phase of International Accounting Standards development. Initially, IAS were developed, then from 2002 these were renamed as International Financial Reporting Standards (IFRS) by the IASB.

The second phase involved a more widespread acknowledgement of international accounting standards. In essence, this can be seen as a transition stage where the balance between national and international standards changed. The key event in this stage was the agreement with the International Organization of Securities Commissions (IOSCO), whereby IOSCO agreed to support the IASC's high-quality accounting standards and allowed their members (individual stock exchanges) to use them. This immediately meant that IAS would be considered, even if they were not used, by all the world's major listed companies. Indeed, as listed companies are the dominant and most international business enterprises globally, this agreement opened the door to widespread global use of IFRS.

After this endorsement by IOSCO, increasing numbers of both companies and countries adopted IFRS. In effect, the IASB became a major player in global accounting. The importance of international standards and standard setting increased while national standards and standard setting decreased. There was also much interest by European regulators. As a result, from 2005 European listed companies were required by the European Union to use IFRS. This changed the reporting landscape dramatically. As a result of European adoption, many other countries adopted IFRS. Nonetheless, the US remains the exeption. Currently, there is a convergence programme with the US but no definitive final decision has been made.

1. We are unable to provide a commentary on this presentation owing to copyright issues. We have referred to the presentation as part of the general symposium discussion because of the significance of fair value.

A second major trend has been the growing complexity of both the measurement and disclosure of financial information. This is reflected, for example, in the growing length and number of accounting standards produced over time. This complexity can be seen not only in particular areas, but also in the basic underpinning measurement models. A particular area which has grown in importance over time is financial instruments. These have grown in sophistication and complexity and caused huge problems for standards setters and users. In addition, the size and scope of annual reports has increased steadily, with some annual reports becoming as long as books.

There is also an increasing reconsideration worldwide of the basic measurement model underpinning accounting. Historical cost, which has been the dominant measurement model, has come under threat. In the 1970s there was experimentation with current value methods such as net realisable value, economic value and replacement value. Current purchasing power was also used to attempt to cope with the problems of changing prices. More recently, there has been a move both in the US and in international accounting standards towards fair value. Whereas historical cost is objective, but does not generally reflect market value, fair value is subjective, but its proponents argue that it more closely reflects a market value. In practice, fair value is much more difficult to determine. It involves a set of rules and guidelines whose implementation can be problematic. In addition, fair value is predicated on market values. Its utility in situations with no market price or where stock markets are less efficient (ie in developing countries) has, therefore, been severely questioned.

A third major trend over time has been the increasing value of non-financial information included both in the traditional annual report (which has grown longer over time) and in specialised reports such as the sustainability report. This non-financial information is varied in context and presentation. In terms of content a whole range of issues are typically included, such as strategy, environmental context, and of particular interest to this symposium, environmental issues.

In terms of presentation, there is also a growth in accounting narratives (such as the Business Review) and corporate governance and societal and environmental information. There is a growing interest in stand-alone sustainability reports and in integrated accounting that combines financial and environmental concerns. This reflects growing societal concerns with climate change and carbon accounting.

Set against these long-term trends was the international financial crisis. This occurred in 2007 and was explained in detail in *The Future of Financial Reporting 2010* (Jones and Slack 2010). This crisis originated in the US with an over-heated housing market. Essentially, mortgages had been mis-sold to those with poor credit records or low income (sub-prime borrowers), which led to high levels of default. This, in turn, led to a reduction in house prices. Once this began there was a corresponding reduction in the value of the assets in the bank's balance sheets. This, considered with higher levels of default rates, led to a collapse in liquidity and confidence in the financial services sector and, indeed, to many bankruptcies both in the US and elsewhere.

This banking-led crisis led to economic problems, particularly in Western economies. The US and UK economies ran into severe problems. Even worse, several European countries, most notably Portugal, Ireland and Greece, faced economic meltdown. In the UK, after the May 2010 General Election, the new coalition government of the Conservatives/Liberal Democrats introduced a set of severe economic retrenchment measures. These are currently being implemented. And within Europe, after the severe economic problems of Ireland and Greece, two other countries, Spain and Italy, ran into problems in 2011.

In addition, to these financial and economic problems, there continue to be repercussions within the corporate world. For example, in the US Madoff was jailed for indulging in a Ponzi fraud scheme while a fund manager was also convicted of insider trading. Such cases would arguably have not come to light had there not been a global financial crisis.

The Global Financial Crisis caused a requestioning of accounting and also of the current long-term trends in the development of IFRS, the complexity of accounting standards and of the role of fair value. Generally, underpinning this reconsideration was a critical evaluation of the role of accounting. In particular, did accounting contribute to the global financial crisis?

The global financial crisis also caused serious questioning about the appropriateness of the current IASB and specific standards. For perhaps the first time since the IASB was formed there has been serious discussion about whether the IASB is the most appropriate global standard-setting body. The possibilities for a European set of standards and a US set of global standards have been raised. Walker (Jones and Slack 2011), for example, suggest that more than one set of global standards are needed: one for liberal market economies such as the UK's and one for coordinated market economies such as Germany's.

One particular standard that ran into considerable trouble and, some believe, contributed to, if not exacerbated, the global financial crisis was IAS 39 on financial assets. This ran into severe problems. The IASB, as Wild sets out (Jones and Slack 2011), was criticised for its lack of consultation and due process. It came under attack particularly from the European Union (EU). The EU at one time contemplated EU-franked IFRS. The EU also set out a fast-track endorsement process.

Fair value has also been severely criticised. At the theoretical level, fair value not grounded on actual market data is seen as unreliable. In addition, fair value's role in the financial crisis has been much debated. Some observers consider fair value to be a neutral reporter of value. In other words, fair value just reflects the effect of the financial crisis rather than being implicated in it, but other contributors have been more sceptical of its role. Although it is generally acknowledged that accounting per se did not cause the financial crisis, it is argued that accounting, in particular the use of fair values, exacerbated the crisis (procyclicality).

In simple terms, the argument ran that the value of the underlying assets such as asset prices (and the mortgage bundles that underpinned them) rose. This encouraged an asset bubble to be created. Thus, fair value fuelled an asset-led bubble. Then, when the recovery ran into trouble, the assets that underpinned the companies' balance sheets declined. This then created a downward cycle of asset devaluation. Thus, it was argued that accounting exacerbated the asset increases, but also accentuated the asset decreases. Under traditional accounting, with assets being valued at historical cost, this would simply not have happened. Asset values would have remained at their original purchase cost. Critics argued that, although not reflecting market value, historical cost introduced an element of stability and certainty into accounting.

The symposium was thus held against the background of increasing worldwide adoption of IFRS, the complexity of accounting, the growth in non-financial information and a basic re-questioning of accounting concepts such as financial instruments and fair value. Our speakers addressed some of these issues, as shown below.

Where next for financial reporting?

PAULINE WALLACE, HEAD OF PUBLIC POLICY AND REGULATORY AFFAIRS, PRICEWATERHOUSECOOPERS

Prior to joining PricewaterhouseCoopers, Pauline's industrial background was banking and, since the outset of the financial crisis, she has been actively involved in discussions with European and global regulators on the implications of the crisis for the accounting and auditing of financial institutions. Pauline's presentation contained personal reflection and thoughts on the future of financial reporting. At present, the future role and content of reporting are at a crossroads. The presentation covered the historical regulation of financial reporting; the impact of the financial crisis; reassessing the role of reporting; and looking ahead to the future, and the commentary follows those four areas.

THE REGULATION OF FINANCIAL REPORTING.

This has changed over time to reflect the increasing complexity of accounting and related accounting standards alongside increased regulatory and political influence over the standard-setting process. In 1970, when the UK Accounting Standards Committee was established, the regulatory framework and accounting standards were relatively simple. Since then, both the complexity and volume (for instance, see the 2010 HSBC annual report) of modern financial reporting mirror a more complex financial world and the general regulatory environment has changed likewise:

1973 IASB and FASB established

1981 4th Directive in UK law

1990 ASB replaces ASC

2001 IASB replaces IASC

2005 Adoption of IFRS

2011 Continuing debates over IFRS adoption and US/IASB convergence.

THE IMPACT OF THE FINANCIAL CRISIS

Pauline referred to the extensive media coverage of the crisis, with accounting on the front pages, and the impact of this on standard setters and the ensuing political debate around fair value. She illustrated this with a number of quotes including the following.

> *It is one thing to have a bank report losses because some of the loans on its balance sheet went bad. That is part of the business of banking. It is something else, however, for a bank to report a multibillion-dollar loss from taking some risk that had never been mentioned in its financial statements.*
> (*New York Times*, 28 February 2008)

> *So controversial has accounting become that even John McCain, a man not known for his interest in balance sheets, has an opinion. The Republican candidate for the American presidency thinks that 'fair value' may be 'exacerbating the credit crunch'.*
> (*The Economist*, 18 September 2008)

The quotes illustrate the general level of interest in criticism of accounting, and the role of reporting, in the financial crisis and the implied need for a regulatory response as a result.

THE ROLE OF FINANCIAL REPORTING

It is apposite for a reassessment of the role and content of reporting in the wake of the crisis and media-led public debate. Pauline outlined the traditional view of financial reporting as playing an integral role in the financial system of bedrock importance to capital markets, through providing unbiased, transparent and relevant information at a snapshot in time. Further, the annual report has also served to safeguard stewardship, (though this is now not necessarily perceived as an important role – see the discussion paper, Jones and Slack 2009), and is useful to a wide range of stakeholders. As reporting has increased in complexity, three main issues were highlighted.

1. Measurement: does financial reporting actually reflect what a business does? The increasing complexity in transactions has been reflected in the complexity of standards. However there is now a lack of connection between financial reporting and the entity's business model. Prudence has also been lost as a fundamental accounting concept.

2. Disclosure: too much disclosure in some areas, not enough in others. There is increasingly voluminous reporting relating to mandatory disclosure, but limited disclosure in some key areas such as financial risk and volatility that would be useful to stakeholders when they are making decisions.

3. Comprehension: are financial reports useful to stakeholders? With a growth in the volume of reporting and its complexity coupled with a lack of comparability between different GAAPs (UK versus US in a non-uniform world), there are now questions over the usefulness of reporting to stakeholders and their comprehension over what is reported, leading to a consequently reduced reliance on financial statements.

In response to these, Pauline made some suggestions. These were for greater regulatory focus; a single global business model; that financial reporting was a reflection of the business model and formed part of an integrated corporate report. These were then further developed as a concluding part of the presentation.

THE FUTURE FOR FINANCIAL REPORTING

Greater regulatory focus is needed: regular meetings between supervisors (such as the Bank of England, FSA) and standard setters to reduce reporting asymmetry, to increase reporting relevance and to balance the demands between regulation and achieving an unbiased report of economic performance are needed to satisfy the needs of the market and so to increase the market participants' use of, and reliance on, financial reporting. The Financial Stability Board (FSB) should continue to monitor relevant standards and review broad governance frameworks.

A single global accounting model: the SEC is to decide on adoption of IFRS, although the earliest timescale for convergence, given the current global economic situation, is likely to be 2015–16. This process may result in a new role for national standard setters, with the expectation of an increase in US influence in the standard-setting process. In practice, there remain other challenges before any global adoption can take place, such the integration of emerging economies, in particular China, Brazil and India, and the development of standards required for areas such as Islamic banking, common control and foreign exchange transactions. Overall, there is a need for the recognition of greater simplicity in reporting and the fundamental resolution of the conflict of dominance between principles-based and rules-based accounting.

A reflection of the business model: the process has already begun through IFRS 7, 8 and 9. Overall there is a need for fewer rules and more principles in standards to facilitate clearer reflection of an entity's business model with clear disclosure over what a business does. The focus is on meaningful disclosure that will satisfy capital market users.

An integrated corporate report should reflect the business as a whole and the risks that it faces, with financial reporting embedded into this, alongside non-financial reporting, to give a full picture of the business and enable better decision making. The establishment of the International Integrated Reporting Committee will help the drive towards concise, clear and more comprehensive business reporting, helping companies and stakeholders make more informed and better resource-allocation decisions.

QUESTIONS

Richard Martin (ACCA) asked whether there was a temptation towards separate accounting standards for banks to provide greater regulatory influence over bank reporting. Generally, it was believed that this is not appropriate given the complexities now associated with all businesses, including banks and, further, where should the line be drawn to differentiate between financial and non-financial entities? For instance, Tesco has a financial services part that cannot easily be separated out from the overall business entity.

Paul Andre (ESSEC) asked about the conflict between rules and principles and, given that the US has a rules-based system, how would this be compatible with convergence and the notion of a more principles-based approach? Overall, it was believed that there was a need for convergence and greater consistency of global reporting for capital market users. As a separate fundamental issue, there was then the need for greater work towards a principles-based approach that would cover all countries.

Ismail Misirlioglu (University of the West of England) reflected on the different needs of regulators compared with the needs of capital markets. Financial reporting was used by regulators as the basis for prudential supervision and, in turn, unbiased financial data would be more useful to capital markets for decision making.

Tony Hines (Portsmouth University) asked how auditors could help companies more fully achieve or implement an integrated reporting model. Pauline suggested an increase in accounting education and the need for companies and auditors to work together to establish the bigger reporting picture for the longer-term development of better reporting beyond current financial reporting.

IFRS Five Years On: Will the Global Accounting Experiment Continue to Survive?

DAVID CAIRNS, VISITING PROFESSOR, LONDON SCHOOL OF ECONOMICS, AND CONSULTANT, WORLD BANK CENTRE FOR FINANCIAL REPORTING

David's presentation looked at the present and future of IFRS, particularly in relation to the European Union. Veron (2007) described the EU's decision to abandon national standards for listed companies in favour of IFRS as the global accounting experiment that was not only the most momentous of financial market policy initiatives but also a key influence triggering moves in other jurisdictions. Veron also warned that the sustainability of the experiment depended on the legitimacy of the IASB, the acceptability of the IASB's authority to stakeholders and the consistency of IFRS implementation.

David looked at the role of the EU in the global accounting experiment. Van Hulle, the senior staff member dealing with financial reporting at the EU Commission, argued in 1992: 'The particularities of the Member States are not sufficiently reflected in IAS. This is the main reason why [IAS] are hardly applied by companies in the [European] Community.' In spite of this criticism, the EU began to change course within two years. It first allowed large listed companies to use IAS (or US GAAP) instead of national GAAP. This facilitated EU global players' access to international capital markets. Then in 2000, it proposed a requirement for listed companies to use IAS in their consolidated financial statements instead of national GAAP and EU Directives. This was to facilitate the creation of a single EU financial market and allow EU companies to trade their securities on EU and international financial markets on the basis of a single set of financial reporting standards.

This change in EU strategy occurred around the same time that the IASC was restructured as the IASB. The EU and IASB were, however, on a collision course as they had contrasting ideas about accounting standards and financial reporting. In the European Union, the Fourth and Seventh Company Law Directives had set only minimum standards for financial reporting and had not been substantively changed for over 20 years. The EU and the European Commission had done little to resolve subsequent accounting issues, such as the emergence of new financial instruments, or to remove the free choices of accounting treatments permitted by the Directives. The European Commission had also historically been very reluctant to work with the IASC. The IASB was aiming at 'gold standards' that focused on the needs of capital markets. Its vision was ' to identify the best in standards around the world and build a body of accounting standards that constitute the 'highest common denominator' of financial reporting' (Tweedie 2002). The IASB had a hand-picked board which drew heavily on the national standard setters who had participated in G4+1. These people thought differently from the European Commission and, in reality, were not very sympathetic to the interests of Europe.

The collision course between the EU and IASB was all the more evident because the US, not the EU, was the major influence on the IASB. 'This strong factual necessity of the IASB to seek compatibility for its standards with US GAAP has a strong impact on the scope of influence the EU can have on the standardization process of IASB ... it can be questioned whether the EU position will be 'strong' enough to act as an equivalent counterbalance to the US influence' (Haller 2002).

David pointed out that the effect of IFRS on the consolidated financial statements of EU listed companies was very mixed. The accounting for many day-to-day items, for example revenue and operating expenses, often did not change. Nonetheless, there were major changes for some items, such as:

- derivatives and hedge accounting (IAS 39)
- share-based payments (stock options) (IFRS 2) and
- business combinations and goodwill (IFRS 3).

There were also detailed changes elsewhere, for example, on lease classification and the scope of consolidation (including SPEs). Importantly, there was much more disclosure, something that many companies did, and continue to, complain about.

To the surprise of many, the transition to IFRS resulted in predominantly 'historical cost-based' financial statements. Fair value accounting was required for derivatives and equity investments, but relatively little else. Virtually all EU companies use the historical cost model for property, plant and equipment (IAS 16), intangible assets (IAS 38), loans and receivables (IAS 39), payables and own debt (IAS 39) (see for example, Cairns, Massoudi, Taplin and Tarca 2011).

There were other impacts of IFRS. The 'Big Four' audit firms, which dominate the audits of listed companies throughout the EU, agreed their own technical positions at a European, if not global, level. As a result, engagement partners were often not permitted to make 'local' judgements about the interpretation of IFRS. Finance directors/CFOs were often forced to await guidance from the 'Big Four' technical departments in London. There was also a need for increasing coordination among regulators. Consistent enforcement was a necessary condition for both EU adoption and potential US adoption. National regulators/enforcers within EU agreed to adopt common standards and to share information through the Committee of European Securities Regulators (CESR).

The EU had adopted IFRS in a benign economic environment. The financial crisis changed everything. It has focused attention on: fair value measurement; loan loss provisioning; off-balance sheet finance; and the possible conflict between the interests of investors/capital market regulators and depositors/prudential regulators.

New actors emerged on the international standard-setting scene, in particular G20, the political leaders of the world's 20 largest economies. They gave strong support for a single set of high-quality global standards. They put pressure on the IASB to deal with off-balance sheet finance, loan impairments and fair value measurement. The Financial Stability Board (FSB), which consists of finance ministers and bank regulators, reinforced these messages. But the unanswered question, according to David, was whether G20 and the FSB will support the implementation of the resulting new and revised accounting standards in their jurisdictions.

David concluded by outlining two scenarios for the next five years. Under Scenario 1, the EU retains the IAS Regulation. The G20 and FSB support the implementation of IASB changes to off-balance sheet finance, loan impairments and fair value measurement within their jurisdiction and resist national pressures for relaxation of those requirements. The US requires domestic issuers to use IFRS. The IASB slows the pace of change and works closely with key stakeholders so that the particularities of the EU member states are reflected in the IASB's due process and EU companies are willing to apply IFRS. In addition, the Big Four audit firms adopt a more principles-based approach to the interpretation and application of IFRS. David saw this as a positive scenario that would lead to the continuation of the global accounting experiment.

He also outlined a negative 'scenario 2' under which the global accounting experiment might wither. The EU abandons (or waters down) the IAS Regulation. A European standard setter emerges from a changed European Financial Reporting Advisory Group (EFRAG). The US retains US GAAP for national issuers. The G20 and the FSB bow to national pressures and fail to implement the IASB's changes to off-balance sheet finance, loan impairments and fair value measurement. Under this scenario the IASB becomes a coordinating body for national and regional standards. Against a backdrop of increasing financial market turmoil David's preference for a more positive and long-term, more unified outcome is consistent with the general need for accounting to be international in its scope, in order to achieve the consistency and transparency so demanded by those capital markets and other stakeholders.

QUESTIONS

Alan Graham (Portsmouth) wondered what evidence David had for Scenario 1. David pointed to the replacement of David Tweedie by a combination of Hoogervorst and Macintosh as a demonstration that the trustees recognised these issues. The IASB recognises a business model that is very amorphous and hard to define.

Paul Moxey (ACCA) asked whether there were some loan adjustments in the transition to IFRS (own debt issues). David, although not a banking expert, did not think there was a change. Under IFRS most own debt is carried at amortised cost.

Salle Pilot (Black Sun plc) thought there was uncertainty around the business model. How are we going to get a more consistent view of the business model? David said that the IASB have just published a 'best practice model', but that lower down the income statement (eg hedging) there appears to be a conflict between correct IFRS and business reality. EFRAG have set up a group to look at this.

Financial Instruments from a Financial Analyst's Perspective

JAMES CLUNIE, INVESTMENT DIRECTOR – UK EQUITIES, SCOTTISH WIDOWS INVESTMENT PARTNERSHIP AND VISITING PROFESSOR, UNIVERSITY OF EDINBURGH

James's presentation reflected his own opinions and perspectives as a fund manager and his knowledge and experience of analysing UK equity sectors. At the start of the presentation, James identified two interrelated major issues that he would discuss: too much disclosure of information and the technical complexity of that disclosure. Within his presentation, James set out initially to review some key areas relating to banks, focusing on new capital instruments, re-categorisation of assets, accounting arbitrage, adjustments made by analysts and whether accountants can help with these problems. This was followed by a review of other topical issues, including leases and hedge accounting.

The typical capital structure of a bank is, by nature, more complex than that of a normal public company, and this is coupled with the different expectations by capital market participants of the role of, and risk involved, in the banking sector. Briefly, bank capital structure is divided into Tier 1 equity capital, Tier 2 subordinated debt and Tier 3 funding categories. Tier 1 capital must have a high degree of permanence and includes equity, preference shares and certain types of bond. Beyond this, more innovative Tier 1 instruments have so-called 'step-up' features that are limited to 15% of Tier 1 capital (such as Barclays' 'Reserve Capital Instruments'). Since the advent of the global financial crisis, a new wave of capital instruments, 'contingent convertibles', has been seen as banks seek to build up Tier 1 to restore liquidity. In 2009, Lloyds Banking Group issued £7.5 billion of 'Enhanced Capital Notes' which are classified as Tier 2 hybrid debt. Should the core Tier 1 capital fall below 5% of total assets, the instruments would then convert into equity and thus increase Tier 1. Analysts struggle to categorise these instruments owing to the potential convertibility, which for simplicity is often ignored. James wondered whether a probabilistic approach would offer an alternative to reporting. Under IAS 39, a bank's financial assets can be classified by management in one of four ways:

- financial instruments at fair value through profit or loss ('trading book')
- loans and receivables
- investments held to maturity
- financial instruments available for sale.

An amendment to IFRS 9 and IAS 39 in October 2008 allowed banks to re-categories categorise instruments between 'Financial instruments at Fair Value', 'Loans and receivables' and 'Available for sale' under certain conditions. A transfer from 'Financial instruments at Fair Value' to 'Available for sale' could be used to reduce the P&L impact of mark-to-market losses and to boost capital. Such a transfer would reflect a management decision on how to categorise assets held. Analysts are concerned that re-classifications appear 'suspect' as they might be being used to hide mark-to-market losses and boost capital adequacy ratios.

Currently, through IFRS 9, the plan is to reduce the number of categorisations to two by 2013. The Lloyds Banking Group's annual report (2009/10) states, 'it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39'. It raises an important issue for analysts and their understanding and analysis of financial statements if banks themselves cannot determine the impact of future changes to reporting.

In addition to asset re-categorisation, banks can also change the basis of asset valuation such that this could be viewed as accounting arbitrage. For example, Barclays transferred assets between the 'level 1' and 'level 2' valuation bases in 2010. These assets consisted primarily of government bonds that had become less actively traded owing to changes in bond market liquidity. Liquidity can be a valid reason for changing asset valuation methodology but 'level 2' valuations provide greater discretion over determining the price of an asset. Analysts, while recognising liquidity issues within markets, would generally prefer unbiased transparent information as opposed to changes to asset valuation.

James highlighted the potential distortive effect caused by the valuation of 'own-credit'. James suggested that one of the helpful changes, as a result of amendments to IFRS 9 made in October 2010, was that movements in fair value relating to own credit risk in financial liabilities will now be presented in 'Other Comprehensive Income' instead of through the profit and loss account. Specifically for a bank, fair value gains and losses on debt issued by the bank itself can be large relative to earnings and arise from fluctuations in credit spreads – highly volatile in periods of financial crisis. As market sentiment changes over time, most analysts have excluded any gains or losses from their own analysis of sustainable earnings. Where a bank purchases its liabilities in the market at a discount, however, a profit can be realised to reflect asset trading.

James then outlined issues associated with proprietary trading,(ie situations where banks trade on their own, and not their customers', behalf), seeking to make a short-term profit. Bank regulators have been seeking to curtail proprietary trading by banks (for instance, see the Volcker rule and the Dodd-Frank financial reform legislation in the US). James outlined a definitional problem of what constitutes proprietary trading and whether or not accounting bodies can help with this; for instance do 'market makers' engage in proprietary trading?

The presentation then drew attention to two current topical issues: leases, and IFRS 9 Financial Instruments. An IASB Exposure Draft on leases was published in August 2010 that recommended eliminating the operating/finance lease distinction and bringing all leases onto the balance sheet. For most firms using leased assets, the proposed changes would increase reported debt and could alter capital structure and subsequent valuation multiples. In general, credit rating agencies already adjust for all forms of leases and given that lease information is provided in annual reports, equity values should reflect this in an efficient market. Nonetheless, if full recognition for all leases had not previously been incorporated into ratings or value then some adjustments may result, with a change in valuation. For Financial Instruments, IFRS 9 is intended to replace IAS 39. One of the stated goals of IFRS 9 is to align hedge accounting more closely with risk management, resulting in more useful financial information from an analyst's perspective.

In conclusion, complex financial instruments such as bank 'contingent convertibles' can create accounting challenges and problems for analysts. James suggested a possible probabilistic valuation methodology to recognise convertibility. Banks continued to reclassify assets and to change valuation bases, whereas analysts would prefer a more transparent valuation base, rather than management preference depending on market conditions. Overall, the interaction between accounting and financial analysts remains an interesting, if messy, space.

QUESTIONS

Richard Slack (Northumbria University) suggested that analysts' reclassifications and their ability to unravel accounting arbitrage made any changes to future accounting neutral in terms of their effects on capital market values. James agreed that this would be true if the whole market acted in this way, but stressed that the composition of both market participants and bank reporting is complex, and while some analysts may spot arbitrage others may not, and so subsequent valuations may not reflect a unified market view or be free from adjustment error.

Pauline Weetman (Edinburgh University) raised the usefulness of the 'Comprehensive Income' measure. James thought it was good to help rebalance the focus of analysis more widely beyond just profit and loss.

Ruth King (Loughborough University) asked about the extent to which analysts may over-discount valuations and whether this backfires on banks that seek to report through 'rose-tinted glasses'. James recognised the sell-side bias to buy recommendations but also that banks, like any other companies, are aware of their capital market reporting reputation and that analysts are following both good and bad news in annual reporting and announcements.

Paul Moxey (ACCA) asked that if a true and fair view was 100% where would banks be in a reporting spectrum, and what changes James would like to see in their reporting. James, not surprisingly, viewed this question as difficult to answer owing to differences between all banks as well as their financial complexities, but suggested about 30%. This would be improved with simpler accounting, for instance no contingent convertibles and just plain debt/equity classifications, and the removal of obfuscation in reporting.

Carbon accounting – is this the future for reporting?

ALAN McGILL, PARTNER, SUSTAINABILITY AND CLIMATE CHANGE, PRICEWATERHOUSECOOPERS

With the increased media and public attention given to climate change, carbon emissions and associated carbon accounting have become a hot topic in discussions on how businesses report specifically in relation to the now-prevalent climate change agenda. Businesses need to address this agenda and carbon accounting and reporting provide one avenue for maintaining environmental credentials and public legitimacy. Alan's presentation gave a valuable insight into and overview of carbon accounting, drawn from his own practice-based knowledge as a partner in the sustainability and climate change team. Carbon reporting, financial and non-financial disclosures are increasing in complexity alongside global legislation and reporting guidance.

Historically, the role of reporting was to focus almost exclusively on financial performance, whereas greater attention is now being paid to non-financial aspects and related disclosures, reflecting, for example, carbon reporting, biodiversity and water use. For effective carbon reporting, Alan outlined four key questions.

1. How is carbon impacting your market place? This reflects the external drivers for reporting, the regulatory environment, sector benchmarks and sector levels of reporting.

2. Is carbon effectively addressed in the business's strategy? To what extent does the business strategic plan reflect carbon reporting and its fit within risk and governance frameworks?

3. How is carbon impacting your business model? What are the resource implications and how are these reflected in the business model and KPIs?

4. How is your company performing? What carbon reporting targets are set, how is carbon reporting managed between financial, operational, social and environmental disclosures and performance?

Alan addressed why carbon accounting is important today and how leading organisations are responding to this. As with any development, the starting point is normally the need for risk management and compliance, ensuring brand protection, continuing organisational legitimacy (licence to operate) and identification of cost inefficiencies. Leading organisations move away from a risk and compliance approach to carbon accounting to realising greater, more embedded, business opportunities, with an ability to differentiate themselves in their sector through brand enhancement, innovation, cost efficiencies and extending their positive stakeholder (internal and external) impact. Carbon reporting is not greenwash; it is innovative and signals a significant change in sustainability reporting. Through this more embedded approach, carbon reporting is effectively built into the business model and strategy. New opportunities may arise through carbon innovation and company carbon positioning in the sector. Alan highlighted some practice based-examples including:

- Asda, with lower energy spend resulting in cheaper consumer prices 'Asda – saving you money every day'

- Procter and Gamble, 'brilliant cleaning at 15C' – effective, environmentally friendly and cheaper in use

- BMW, energy efficiency and performance.

Within the UK reporting environment, carbon accounting and reporting have moved from purely voluntary disclosure to more mandatory disclosure, which will be seen over the decade spanning 2010 to 2020.

2010	Carbon Disclosure Project: voluntary reporting, tracking supply chain carbon emissions
	Carbon Reduction Commitment: Mandatory director sign-off for organisations with 6000 megawatt use, and public sector bodies
2012	UK Climate Change Act will come into force, with a move towards mandatory reporting. 2013 EU Emissions Trading Scheme Phase 3, increase in scope to include all airlines flying in European air space
2020	Climate Change Act targets should now be achieved, with the emission reduction target being 34% of 2010 level

Alan then provided brief overviews of the Carbon Disclosure Project (CDP), Carbon Reduction Commitment (CRC) and Defra guidance on reporting greenhouse gas emissions. CDP is an organisation based in the UK which works with shareholders and corporations to disclose the greenhouse gas emissions of major corporations. CDP provides a forum in which large corporations and governments may analyse their supply chains and reduce carbon output. CRC (recently renamed the CRC Energy Efficiency Scheme) is the UK's first mandatory carbon trading scheme. The initial phase of the CRC is compulsory for organisations that consumed over 6,000 MWh (6,000,000 kWh) of half-hourly metered electricity during the period from January 2008 to December 2008.

Interested readers should see details of both at the following weblinks

CDP:
https://www.cdproject.net/en-US/Pages/HomePage.aspx

CRC:
http://www.carbonreductioncommitment.info/

Defra guidance:
http://www.defra.gov.uk/publications/2011/03/26/ghg-guidance-pb13309/

One of the significant features of CRC is the publication of league tables to show the carbon/emissions performance of organisations within CRC boundaries. By its very nature this will drive increased carbon efficiency as organisations move from a risk and compliance approach to the increasing business engagement which is associated with integrated carbon accounting and reporting.

With regard to UK mandatory reporting, Alan provided an overview of the UK Climate Change Act 2008. As greenhouse gas emissions are a key indicator and driver for change, the UK has a commitment to reduce them by 80% by 2050. From 6 April 2012 onwards regulations will require mandatory carbon reporting with associated supporting explanations, or an explanation of why disclosure has not been provided, although the parameters in terms of organisational size are still to be finalised. This raises questions over data capture in organisations, the internal management of the accounting system and its ability to capture carbon emissions effectively, again raising the question of the level of embeddedness between financial reporting systems and carbon reporting. Alan provided a number of practice-based examples of current internal and external carbon reporting, including British Land, British Airways and Northern Foods.

Finally, Alan provided an international reporting perspective and the challenges of global carbon reporting as opposed to national accounting standards and legislative reporting requirements. He also emphasised the need for increased levels of international integrated reporting to embed carbon reporting into the corporate reporting framework. Clearly businesses need to embrace carbon reporting for many reasons ranging from compliance to business opportunities, the big question is to what extent are they ready to do this?

QUESTIONS

Mark Clatworthy (Cardiff University) asked who should audit carbon reporting and how qualified any auditor should be. In response, Alan said that the Environment Agency audits 20% of returns submitted under the CRC scheme. More generally, sustainability reporting assurance covers over half of the FTSE 100, but future re-skilling away from financial transactions would be required for the effective auditing of sustainability reports and future carbon reporting. In a follow-up to this, Richard Slack (Northumbria University) asked whether equity analysts really cared about sustainability reporting, given that their main focus is on financial metrics.

In a general discussion, it was felt that a greater number of long-term issues would become more important to analysts, especially as all FTSE 100 companies would be engaged in sustainability reporting. Further to that, the impact of global change affects all businesses through potential material cost changes; for instance the floods in Pakistan affected world cotton prices and the increase in material costs for garment producers (such as Next or Marks and Spencer).

Richard Barker (Said Business School) asked whether users of sustainability and carbon reporting are different from users of traditional financial statements and whether this would have any impact on their respective presentation. Alan thought that institutional investors have increasingly used sustainability reports to identify non-financial key issues and risks. He further emphasised the importance of communicating carbon reporting to key stakeholder groups so that they were all fully aware of this and how organisations are responding to carbon accounting in the wider climate change agenda.

Paul Moxey (ACCA) wondered whether reporting would be able to capture all costs, both direct and indirect, and thus questioned its ability to capture the whole supply chain necessary for a full understanding of the product carbon footprint. In a broader discussion, this was generally agreed, on the principle that reporting that does not capture the true overall carbon footprint would be sub-optimal, but that there were considerable challenges to be faced to map out the full carbon footprint on a product basis.

Discussion

These papers were presented in January 2011. Although the immediacy of the global financial crisis had passed, its consequences and fallout still overshadowed the presentations. The credit crunch and continuing financial repercussions of the financial crisis set the general context for the symposium. Pauline Wallace and David Cairns dealt explicitly with the aftermath of the crisis. By contrast, James Clunie and Richard Barker, respectively, looked at the banking sector, which was of course central to the global financial crisis, and fair value which came under great criticism both during and after the crisis. Only Alan McGill's presentation dealt with a totally different topic.

These five presenters, from a wide variety of backgrounds and experience, each dealt with issues in an informed and individualistic way. They can conveniently be divided into three groups. First, Pauline Wallace and David Cairns dealt with the big picture. Wallace's presentation looked at the future of financial reporting. She set the regulatory scene, assessed the impact of the financial crisis and reassessed the role of financial reporting. Cairns, by contrast, took a longitudinal review of IFRS. In particular, he looked at the political and technical aspects of the EU's adoption of IFRS and the subsequent impact of the global financial crisis. Richard Barker and James Clunie dealt with more specific issues. Barker studied the controversial measurement system, fair value, showing its technical complexity and practical limitations. Clunie, however, investigated the banking sector from an analyst's point of view and showed, in particular, the role of financial analysts. Finally, Alan McGill focused on a completely different area, carbon accounting. He discussed the political and regulatory pressures affecting the carbon reporting process and its implications for accountants.

The five speakers thus presented a variety of diverse arguments and ideas with some common themes. A summary of their respective views is presented below with a synthesis of these themes. The papers are not presented in their order of presentation, but have been grouped into broad categories. Wallace and Cairns' presentations are summarised first as they provide a big picture, which framed the arguments. The paper by Clunie then follows, dealing with more specific topics that built on the overview provided by Wallace and Cairns. And, last but not least, there is a summary of McGill's paper on carbon accounting. An overview of the four commentary papers is presented in Table 1.

PAULINE WALLACE

Pauline's presentation, entitled 'Where next for financial reporting?, involved a reflection on accounting's past, present and future. It comprised four main parts. In the first part, Pauline set the scene. She showed how the regulation of accounting in the UK and internationally had evolved, with six major developments over a 35-year period: the establishment of the Accounting Standards Committee in 1970; the setting up of the International Accounting Standards Board (IASB) and, in the US, the Financial Accounting Standards Board (FASB) in 1973; the implementation of the Fourth Directive in 1981; the replacement of the Accounting Standards Committee (ASC) by the Accounting Standards Board (ASB) in 1990; the replacement of the International accounting Steering Committee (IASC) by the IASB in 2001; and the adoption of International Financial Reporting Standards (IFRS) in 2005. She discussed the global spread of IFRS, with 100 countries reporting in line with, or permitting, IFRS; the UK's work towards replacing UK GAAP with IFRS; and the progess of the US towards convergence with IFRS. Financial reporting has become more complex with an increased volume of mandatory disclosures and voluminous financial statements.

In the second part, Pauline showed that accounting was at the heart of the financial crisis. She described how the reaction to the crisis was 'political' engagement by the G20, the setting up of an IASB/Financial Crisis advisory group, knee-jerk amendments by standard-setters and severe questioning of the IASB's governance, financial instruments and the IFRS. In the third part of her presentation, Pauline discussed the traditional view of financial reporting, outlined criticisms of financial reporting and then suggested some potential changes. She showed that financial reporting has traditionally provided a bedrock of stability essential to the smooth running of the capital markets. It has played an integral role in the financial system, providing unbiased, transparent and relevant information. It presents a snapshot in time and reports on the stewardship of managers as well as being useful to a wide range of users. It has been criticised from a measurement, disclosure and understandability dimension and for the complexity of its measurements and the increased volume of its disclosures. The voluminous nature of its financial statements has been widely condemned as reducing comprehension. The

Table 1: Thematic overview of the presentations

Speaker	Perspective	Main topics	Key issues/findings
Pauline Wallace Pricewaterhouse Coopers Head of Public Policy and Regulatory Affairs	Professional accounting	Regulation; impact of financial crisis; traditional role and criticisms; future of financial reporting	The regulation of accounting has evolved over time to reflect the increased complexity of accounting. The financial crisis had brought accounting centre stage and led to increased political engagement. Financial reporting had traditionally been seen as unbiased, transparent and relevant, providing stewardship information and useful for providing providing a wide range of other information to users. Nonetheless, it has been criticised for its increased complexity and increasing volume. In the future, there is likely to be a greater regulatory focus, increasingly a single global accounting model, more reflection of a business model and an increased focus on integrated reporting.
David Cairns Visiting Professor LSE and World Bank Centre for Financial Reporting	Ex standard-setter, visiting professor.	EU adoption of IFRS and their impact; the response to the financial crisis	The EU experiment was the abandonment of national standards for IFRS. The EU was in favour of minimal standards while the IASB wanted the highest common denominator. The IASB was primarily influenced by the US. There were some major changes to accounting, but many items remained the same and the resulting standards were primarily historical-cost. The financial crisis focused attention on issues such as fair value and caused the G20 and Financial Stability Board to be interested. Two scenarios are possible in the future: EU retention of standards or the development of an EU standard-setter.
James Clunie Visiting Professor, University of Edinburgh and Scottish Widows Investment Partnership	Financial analyst, visiting professor	Complex financial instruments in the banking sector.	The capital structure of banks is typically complex. New capital instruments (such as contingent convertibles), the change in regulation (from IAS 39 to IFRS 9), the reclassification of financial instruments, accounting arbitrage, 'own-credit' transactions and proprietary trading and leasing all create problems for the analyst. On the other hand, the changes to the hedging rules appear beneficial.
Alan McGill Pricewaterhouse Coopers, Partner, Sustainability and Climate Change.	Professional accounting	Carbon accounting	Carbon accounting is becoming an increasingly important issue, both nationally and internationally. Various initiatives on carbon have culminated in the UK Climate Change Act that has mandated an emissions reduction target of 34% of 2010 levels by 2020 and an 80% reduction in greenhouse gas emissions by 2050. Companies' reporting and disclosure policies need to reflect these developments.

suggestions that Pauline had for change were a greater regulatory focus, a single global accounting model, a reflection of the business model and the need for an integrated corporate report.

Finally, Pauline elaborated on these suggestions for change. She suggested there would need to be more political intervention with more meetings between supervisory bodies such as the Bank of England and standard setters. In the future, the importance of a single global accounting model would grow. During 2011, the SEC would decide on IFRS adoption, but there was also the global challenge of the emerging economies such as China, Brazil and India. In the future, accounting would therefore need to reflect the business model with fewer rules and more principles. This had, Pauline thought, begun to occur with hedge accounting, now reflecting what people actually do. Finally, Pauline thought that there was need to provide a more integrated reporting, (ie. integrating financial and non-financial information) .

DAVID CAIRNS

David also presented a broad overview of accounting developments, this time, however he concentrated on what he termed 'the EU experiment'. By this he meant the European Union's monumental decision to abandon national standards for listed companies and to replace them with IFRS. David pointed out that in the early 1990s, the EU believed that the international accounting standards (IAS) did not reflect the particularities of member states. By 1995, however, the EU was changing its mind and allowing listed companies to use IAS (or US GAAP). By 2000, it was bringing in legislation to require listed companies to use IAS instead of national GAAP and EU Directives. From 2005, therefore EU listed companies were committed to using IFRS.

As David points out, however, the IASB and the EU did not necessarily share the same vision. Traditionally, the EU has set minimum standards. This was true in both the Fourth and Seventh Directives. By contrast, the IASB, which replaced the IASC after the European Union had signed up to it, was committed to the highest common denominator of standards. In addition, it was the US not the European Union that was influencing developments.

David pointed out that the impact of IFRS was mixed. There was much more disclosure, detailed changes in leasing and consolidation and major changes in derivatives and hedge accounting, stock options and business combinations. Nonetheless, in many cases, there was no change. The transition to IFRS resulted in predominantly 'historical-cost based' financial statements with relatively litte use of fair value (except for derivatives and equity investments). Overall, technical partners of the 'big 4' dominated areas where the adoption of IFRS brought more coordination between regulators

The financial crisis had a great effect on IFRS and the EU. It focused attention on issues such as loan loss provisioning, fair value and off-balance sheet finance. It also caused new actors to appear on the regulatory stage, such as the G20 and the Financial Stability Board.

For the future, David outlined two possible scenarios. Under scenario 1, the EU retains IAS while the US requires domestic users to use IFRS. Under scenario 2, however, the EU abandons or waters down IAS regulation. As a result an EU Standard Setter emerges from a changed EFRAG and the US retains US GAAP. Time will tell which scenario emerges.

JAMES CLUNIE

James provided an innovative analysis of the banking sector from an analyst's point of view and focused on financial derivatives. He outlined the complex nature of bank debt, which consists of senior and subordinated debt. James then discussed a range of issues to do with bank financing that potentially are difficult to understand for the financial analyst. The discussion was illustrated with real-life examples.

A particular feature of bank financing is its innovation and complexity. For example, in 2009, Lloyds banking group introduced £7.5 billion 'Enhanced Capital Notes', contingent convertibles that are classified as 'Tier 2 hybrid debt', but can be reclassified as core capital under certain circumstances. Meanwhile, IAS 39 is being replaced by IFRS 9 on Financial Instruments. Lloyds states it was not possible to determine IFRS 9's overall impact. Another example was the reclassification of financial instruments between various categories (profit or loss, available for sale or loans and receivables). In all these cases, financial analysts may struggle to understand and categorise the transactions.

James then outlined the problems with accounting arbitrage, 'own-credit' and proprietary trading. Under accounting arbitrage, banks can change their basis of valuation of certain assets, for example, from level 1 to level 2 valuations (level 2 valuations provide greater discretion). 'Own credit' transactions can cause enormous gains or losses with changes in the market value of debts. Finally, it is difficult to define 'proprietary trading' and, therefore, difficult to analyse its effect. These three cases, because of their subjectivity, all cause further problems for analysts.

James then outlined the new proposals on leasing and financial instruments. The leasing proposals would affect analysts' opinions of the balance sheet, while IFRS 9 on financial instruments would align hedge accounting with risk management and, therefore, would be welcomed by analysts. Overall, therefore, James described a complex and complicated financial sector that generates problems and challenges for financial analysts.

ALAN McGILL

Alan's presentation dealt with an issue of increasing importance to business and accountants: carbon accounting. Alan started by posing four questions by which companies could assess their carbon accounting. First, how is carbon impacting your marketplace? Second, is carbon being effectively addressed in strategy? Third, how is your company performing? Fourth, how is carbon impacting your business model? Carbon accounting can be seen as a risk, but also as a business opportunity by which companies can differentiate themselves from each other. Carbon is being built into companies' strategies.

Alan outlined the steps towards increased carbon accounting with the climate change levy, the Carbon Disclosure Project and the Carbon Reduction Commitment. The UK Climate Change Act in 2002 was a major move towards mandatory reporting, setting an emissions reduction target of 34% of the 2010 level by 2020 and an 80% reduction in greenhouse gas emissions by 2050. The Carbon Disclosure Project's findings (2010) showed a big gap between the top 50 and the rest of the companies. The Carbon Reduction Commitment is compulsory for large consumers of electricity. Alan provided a number of examples of current carbon reporting from, for example, British Land, British Airways and Northern Foods. Finally, Alan outlined the increasing international regulatory interest in carbon reporting from, for example, the International Integrated Reporting Committee, the SEC, the Climate Disclosures Standards Board and the Global Reporting Initiative (GRI) (currently developing the next generation of GRI guidelines).

The papers in Table 1 have been grouped into three broad categories. In the first category, the papers by Wallace and Cairns give an overview of financial accounting and reporting and of the adoption by Europe of IFRS. Both are presented explicitly in the context of the recent financial crisis. The paper by Clunie tends to take the financial crisis as a given. Clunie looks at a sector that was deeply affected and implicated in the financial crisis, the banking sector. Finally, McGill's paper looks at a totally different area, albeit of great and increasing importance to both business and accounting: carbon accounting.

EMERGING THEMES

From the presentations, it is possible to discern the themes that are discussed below. Please note that these were themes that the authors of the report believed emergeD from reading the presentations.

i) Evolving nature of accounting

Accounting as a social science does not stand still. This was evident from the presentations both at the macro and micro level. Wallace's presentation showed that in the space of a generation the regulation of accounting has changed. Before the 1970s, accounting was relatively unregulated. In the 1970s, the Accounting Standards Committee, the International Accounting Standards Committee and the Financial Accounting Standards Board all introduced a new regulatory dynamism into accounting. This increased regulatory activity persists to this day, with Clunie, for example, pointing out that draft proposals on leasing and financial instruments were set to change accounting once more. Cairns also showed how over time the EU had changed from being hostile to IFRS in the early 1990s to full adoption of IFRS in 2005. Barker, by contrast, showed how fair value has emerged, and has been continuing to develop as the preferred measurement model for the IASB, thus in many ways superseding measurement models such as historical cost, which had preceded it. Finally, McGill showed how carbon accounting has emerged as a major mandatory reporting area, provocatively posing the question: is this the future for reporting?

ii) Complexity of accounting

A major theme touched on by the presenters was the sheer complexity of the business world, which is reflected in accounting measurement and disclosure practices. Wallace pointed to the fact that complexity in transactions has been reflected in the complexity in standards. These standards, in turn, have reflected the complexity of the business world. As a result of this there have been voluminous mandatory disclosures and voluminous financial statements. This complexity was demonstrated particularly well by Clunie, who showed the complexity of the banking sector's financial structure and that of the financial instruments. A result of this complexity is that some banking annual reports, such as HSBC's, are hundreds of pages in length. Nor is carbon accounting any easier, with companies wrestling with how to measure and report such issues. Cairns also outlined some very complex areas, such as derivatives and hedge accounting, stock options and business combinations, pointing out that these have inevitably led to increased disclosure. Finally, Barker showed that although the concept underpinning fair value is quite simple (ie the price received when selling assets or transferring liabilities in the market), in practice, the whole notion of defining a perfect and complete market is fraught with difficulty, especially in certain industries such as pharmaceuticals.

iii) Global financial crisis

The global financial crisis featured strongly in four out of five of the presentations (the exception being McGill), either explicitly (Wallace and Cairns) or implicitly (Clunie and Barker). For Wallace, the financial crisis had placed accounting on the front page of newspapers. Publications such as the *New York Times* and the *Economist* have started to comment and reflect upon accounting. Topics discussed included the fact that many of the risks that banks took were not disclosed on their balance sheets and that in the Presidential debates in the US 'fair value' was discussed as a factor exacerbating the credit crunch. Cairns agreed with Wallace's analysis, pointing to the fact that the global financial crisis has led to a focus on fair value measurement, loan-loss provisioning and off-balance sheet finance. Both presentations also discussed the emergence of a new political interest in accounting. The G20 (the political leaders of the world's largest economies), for example, had pressurised the IASB. A Financial Stability Board consisting of finance ministers and bank regulators was set up. And in the UK, the House of Lords challenged IFRS. Clunie's choice of the banking sector illustrates how the global financial crisis had brought this sector under close scrutiny. He shows that the complexity of the banking sector is still with us and that regulators and analysts are struggling to understand and regulate the sector. Finally, Barker's discussion of fair value is particularly pertinent because in the global financial crisis fair value has been accused of setting up conditions that encouraged the banks to continue lending on the basis of ever-strengthening balance sheets. This contributed to the housing bubble in the US. Then, in the bad times, fair value was accused of heightening the fall in asset prices, thus deepening the economic downturn.

iv) Political nature of accounting

All the presenters have demonstrated either explicitly or implicitly the political nature of accounting. Cairns, in particular, showed the role of politics in the decision by the EU to adopt IFRS. In the 1990s, the EU was increasingly worried by US influence. The IASB was seen as more politically acceptable than US GAAP. Unexpectedly, IFRS then became influenced by the US and US GAAP. Cairns, like Wallace, also demonstrated how the economic and political crisis caused by the collapse in the banking sector led to political interference in accounting standard setting by the European Union and the G20. Cairns outlined two broad political alternatives that might underpin accounting in future: EU retention of IFRS or the emergence of a European standard-setter. McGill showed that carbon accounting is very much a response to the wider political agenda on climate change and outlined a series of regulatory drivers. Behind this is the growing political anxiety to reduce carbon levels, driven by fears of rising temperatures worldwide and possible cataclysmic changes in global climate. At the heart of carbon accounting is a wider political imperative. At the micro level, Clunie also implicitly demonstrated the political nature of the banking sector, with regulators struggling to account effectively for the practices of banks. Finally, Barker showed that behind the increasing use of fair value is the assumption of perfect and complete markets, which is premised on advanced political economies such as that of the US. Its relevance in emerging economies is highly questionable.

v) Alternative methods of accounting

A final theme that emerged from the presentations was the presence of different methods of accounting. In carbon accounting, which is just emerging as a major accounting and reporting area, correct reporting practice is very mixed, as one might expect. But, in financial accounting and reporting, which are centuries old, the practice is also still very mixed. This is not only a problem with standard setting at the national level where, as demonstrated by Wallace and Cairns, there are competing sets of standards such as national standards, IFRS and US GAAP, but also for particular issues. Clunie, for example, demonstrated the diversity of treatment for derivatives and hedge accounting, stock options and consolidation. Meanwhile, in the banking sector, Clunie showed the considerable diversity in new capital instruments, financial assets, financial instruments, accounting arbitrage, 'own credit' and proprietary trading and leasing. He also showed that banks can use these variable accounting treatments to serve their own reporting strengths through creative accounting. Finally, Barker explained that, as regards accounting measurement, fair value and historical cost are very different.

vi) The future of accounting

Three presenters have looked at the future of accounting in depth. All have somewhat different views. Wallace suggested that four developments might shape the future. First, there could be a greater regulatory focus. Second, there might be a single global model. Third, accounting could reflect the business model. And, fourth, financial reporting could be part of an integrated corporate report. Wallace's final point chimes with McGill who questioned whether carbon accounting is the future for reporting. Certainly, it would seem logical, as Wallace suggested, that carbon accounting will grow more important. Cairns also looked specifically to the future. In his future, there are two possibilities. In one scenario, the EU continues to back IAS with other individual bodies, such as the G20 and the Financial Stability Board, supporting it. The US would also adopt IFRS. In a second competing scenario the EU abandons the IAS regulation, a European standard setter emerges and the G20 and the Financial Stability Board does not implement IFRS. Barker and Clunie did not articulate definitive futures.

Conclusions

It is perhaps not surprising that some of the key issues emerging from this year's symposium are similar to those reflected upon in previous years. Indeed, the FARSIG/ACCA 2008 discussion paper highlights three key areas: reporting framework; disclosure; and measurement. At present these three issues remain fundamental questions and challenges to the future of financial reporting. On the reporting framework, the resolution of the debate on global accounting standards continues at many levels, including among global standard setters and more recently political and regulatory influences. US convergence remains an unsettled issue and within this, and at the heart of many of the debates, is the question about the dominance of a principles-based or rules-based framework that should or could be applied to a single global model. Moreover, there is a further need to address convergence and adoption issues associated with the adoption of any global standards by the new 'powerhouse' emerging economies such as China and India.

If the notion of a single global reporting model is accepted, the levels of disclosure that financial markets and other stakeholders demand need to be understood. On the one hand, there is criticism of too much information, which has resulted in the voluminous growth of annual reports and needs to be cut back. On the other hand, there are demands for more and more disclosure to reflect the complexity of transactions and the need for transparency. The conundrum of levels of disclosure, volume and transparency is highlighted in an article about potential UK government moves to simplify and limit the length of company reports:

> *government moves to simplify company reports will make them easier to digest but are raising concern among investors...for investors, the less is more principle holds little sway. In fact more is more would better reflect their views on report content volume* (*Accountancy,* October 2011: 66–7).

Overall, it is uncertain whether the complexity of the annual report has enhanced its usefulness as a reporting document, or whether it is now only understood by technical experts.

The need to incorporate carbon reporting into the reporting framework is also increasingly recognised as an issue. This raises another key question concerning how much should be incorporated into the annual report rather than being published within a separate stand-alone document outside the main financial reporting document. For integrated reporting to become a reality, perhaps the whole purpose of the annual report and what it is intended to achieve needs revisiting.

Finally, the issue of measurement, and the now seemingly endless debate concerning fair value and historical cost. The pros and cons of each measurement basis have been widely rehearsed and played out over the length of the global financial crisis. For instance, the need for market values to be reflected in reporting contrasted with the issues associated with fair value, such as asset price volatility and procyclicality. This measurement debate has been particularly played out in relation to bank reporting and accounting for derivatives (IAS39) – again a feature in common with previous years' discussion papers.

In conclusion, we appear to be no nearer than before to finding answers to some of the fundamental questions facing financial reporting in relation to the reporting framework, levels of disclosure and measurement.

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