The future of financial reporting 2012: problems and solutions

A discussion paper based on the British Accounting and Finance Association's Financial Accounting and Reporting Special Interest Group (FARSIG) Symposium, 13 January 2012.

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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.

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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-oriented 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 calls of the Economic and Social Research Council (ESRC)/Advanced Institute of Management (AIM) for relevant and rigorous research conducted from a combination of practitioner and academic perspectives.

The authors would like to express their thanks to the five main contributors, both for their presentations and for their subsequent time and comments during the development of this discussion report. The authors have tried to capture faithfully the flavour of the original presentations. Nonetheless, although the original authors were shown the commentary on their presentations, any errors or omissions remain our own. Thanks are also due to ACCA for hosting the symposium and for its support in the publication of the discussion report. Finally, for any readers who wish to learn more about FARSIG or to become FARSIG members, please contact either of the authors.

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

The future of financial reporting 2012: problems and solutions

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Foreword

ACCA was pleased to host the 2012 Future of financial reporting conference and now to publish this summary of the event.

The FARSIG conference in recent years has, not surprisingly, taken as a theme the global financial crisis and interaction of that crisis and financial reporting. This publication makes clear that the global financial crisis continues to roll on and the implications of it continue to develop. In the first phase of the response to the crisis, there was a list of items identified with financial reporting that needed fixing – disclosures, off balance sheet vehicles, fair values of financial instruments and the delay in recognising losses on loans. Since then some of these have been addressed by the standard setters such as the IASB. But even five years on, not all have been. In many ways the list of what needs fixing turns out to be more extensive and more deep-rooted. Beyond the financial reporting issues, we still seem far away from deciding on the right way to regulate and structure banks, let alone producing the answers to the ethical and cultural failings that might have been fundamentally responsible for the crisis.

The 2012 conference covered some of the range of financial reporting issues. Insights into how the investors, as those using the financial statements and the information they contain, are viewing the accounting. How the standards are being enforced and what happens when they are not. Some problems of setting the right standards in the first place were aired, as were challenges about whether a rather different system of reporting might not provide more useful information.

The conference provides a contact between accounting academics with an interest in financial reporting as represented by FARSIG on the one hand, and accountants preparing, auditing or using financial reports as represented by ACCA on the other. That interaction is more important than ever. The accounting standards that determine so much of practice will increasingly need to be developed on firm evidence and research. Academics can clearly play a major role in that. Equally there seems to be a trend to need to justify research on the basis of its social relevance and impact in practice.

Thanks to Mike Jones and Richard Slack for organising the event and as ever an interesting panel of speakers and topics, but also in providing this excellent summary of it all.

I look forward to next year's.

Richard Martin
Head of Corporate Reporting, ACCA

Introduction

Perhaps everyone is now becoming more accustomed to terms such as 'global financial crisis', 'austerity', 'reforms', and 'economic downturn'. For five years since the start of the current crisis in 2007, there has been debate on its causes, consequences and implications and it may seem that there are no new issues to address. Far from it! The magnitude and complexity of the financial crisis in all areas of the economy have made this a unique time to question and discuss key issues. This includes a debate on the challenges faced by accounting and financial reporting. Once again, the annual FARSIG symposium, held on 13 January 2012, benefited from the valuable insights of a number of senior practitioners, standards board and regulatory body members and academics. The forum provided an opportunity to hear their perspectives on current challenges faced in accounting as well as their views on the future. The symposium facilitated an interface of professional practice, the regulatory environment and academic thinking on key topic areas. The five speakers in order of appearance were:

i. Richard Dunbar, investment director, Scottish Windows Investment Partnership, 'Increasing rules and complexity: but are we getting any wiser?'

ii. Michael Mainelli, executive chairman, Z/Yen Group and Emeritus Professor of commerce, Gresham College, 'Confidence accounting: reporting for uncertainty?'

iii. Stephen Cooper, IASB board member, Liability 'Measurement; wrestling with a persistent and troublesome problem'

iv. Carol Page, director, Panel Operations, Financial Reporting Review Panel, The Financial Reporting Review Panel's role in achieving consistent application of accounting standards.

v. Michael Jones, professor of financial reporting, University of Bristol, Creative Accounting, Fraud and International Accounting Scandals.

As can be seen from the main titles of each presentation, these five presentations discussed a wide range of views on a variety of topics from varied practitioner, regulator and academic perspectives. As usual after each presentation there was a lively and informed discussion among the symposium delegates.

1. BACKGROUND TO THE SYMPOSIUM

The symposium took place at the start of 2012 and was thus, as in previous years, set against the continuing volatility of the global financial crisis and provided a dynamic backdrop against which to discuss several key issues within accounting. These ranged from accounting recognition and measurement issues, financial statement presentation, the complexity and transparency of accounting, the regulatory framework and environment, through to creative accounting, fraud and international accounting scandals. All the speakers gave individual presentations but the areas above also provided some emergent common themes for the symposium, as well as linking into themes from past years, especially around aspects of accounting measurement, accounts presentation and regulatory interface. All these topics will be discussed in greater length after the commentaries.

Before introducing the commentaries, it is worth noting some of the key events that occurred during 2011, which help to set the context of the symposium. The events were both political and economic and will help shape the global political economy for many years to come. It is that global political economy within which accounting is set. Throughout the year, there was continuing economic and political volatility in Europe with constant concerns about the more vulnerable PIGS (Portugal, Italy, Greece and Spain) economies and worries about the economic contagion spreading to other countries. In particular, there was concern about the integrity of the Eurozone.

January to April 2011 onwards
Tunisia, Egypt, Bahrain and Libya: 'Arab Spring'.

February and March 2011
Election defeats for Irish prime minister, Brian Cowen, and Portuguese premier, Jose Socrates, as a backlash against economic austerity and IMF bail-out terms.

August 2011
US Congress agrees on a massive austerity plan and on raising the US debt ceiling. On 6 August, Standard and Poor's cuts the US credit rating from its top-flight triple-A for the first time in history.

October 2011
European Union leaders reach a groundbreaking deal to save the Euro as a single currency, including a new rescue of Greece, a trillion-Euro bailout fund, and a deal forcing banks to share the burden of the two-year debt crisis.

November 2011
Greek socialist prime minister, George Papandreou, stands down after sparking chaos in the EU with his plan for a referendum on the 27 October economic rescue deal. He is succeeded by vice-president of the European Central Bank, Lucas Papademos. Silvio Berlusconi resigns amid Italy's 1.9 trillion euro debt burden.

December 2011
EU leaders back tighter budget policing in efforts to save the Eurozone; Britain vetoes a new EU treaty.

As a result of the global economic and financial crisis, there has been a continued attempt to grapple with accounting and economic issues. In many cases, these issues remain unsolved from generation to generation. The fundamental nature of accounting, the correct regulatory balance and burden and the balance between national and international regulations are three, but by no means the only, issues.

The fundamental nature of accounting is still actively being debated with no sign of a resolution. The conceptual theory is, for example, currently being revisited by the IASB. A particular problem is whether the stewardship or the decision-making objective should be paramount. Stewardship, closely linked to accountability, is seen as a fundamental purpose of accounting by many accounting academics and practitioners. They see this traditional role of accounting as being central to assessing the past performance of management. By contrast, the standard setters seem, on balance, to prefer decision making as the dominant objective. They see stewardship as a subset of decision making.

Following on from this dissensus, is a disagreement about the role of the statement of financial position. If decision-making is to be the primary role of accounting, then it follows that measurement systems that are geared to providing market-book values will be followed. Thus, fair value becomes a favoured measurement system. Using this approach, historical cost, which records the original cost of an asset, becomes outdated and useless. Alternatively, if the purpose of accounting is seen primarily as a stewardship/accountability role then historical cost is comparatively more important.

The nature and function of the regulatory system is also of continuing interest. Over time accounting has become more regulated. Nonetheless, there is still tension between those who favour the flexibility inherent in professional judgement and those who prefer tight regulatory control. This debate is still in progress and is particularly vigorous in the banking sector. There are many who see the laxness of the regulatory framework as a major reason why the banking sector got into so much trouble. Those voices in favour of still tighter regulation are unlikely to die down given the recent LIBOR revelations in the UK, where major UK banks were found to have 'fixed' the inter-bank lending rate. Fresh revelations about creative accounting and fraud also serve as a rallying post for those who advocate more regulation.

The balance between national and international standards is also subject to current scrutiny. The IASB remains the only global standard-setter despite calls for competitors. For example, Walker (2010: 150) concludes that 'the world should consider establishing at least two new global accounting standards: for "liberal market economies" and for "coordinated market economies"'. FASB, the US standard setter, is still working with the IASB on a new conceptual framework. However, at present, the US still seems no nearer to adopting IFRS.

The picture elsewhere in the world is, however, somewhat different. More and more countries are institutionalising IFRS both for their multinational companies, but also for domestically listed companies and other enterprises. Nonetheless, it is not always clear that IFRS are suitable for small enterprises in what can be loosely called 'macro' accounting countries (ie those that are not equity-driven). In the UK, for example, before the 2012 symposium, the UK government was considering restructuring its accounting regulatory system. This was done in July 2012, arguably resulting in a 'downgrading' of the importance of national standards.

These issues formed the sometimes-unspoken context of the symposium. Against this broad background, the speakers discussed a variety of issues such as financial regulatory enforcement, creative accounting and fraud, traditional single-figure accounting for accounts presentation, liability measurement and disclosure, and the financial reporting of banks.

2. ISSUES RAISED BY THE SYMPOSIUM

There was a fundamental examination of some of the basics of accounting during the symposium and the subsequent audience discussion. Some of the issues raised and discussed were, in many ways, old favourites that continue to present many people (practitioners, standard setters and academics to name a few) with complex challenges, such as asset and liability recognition and measurement. For a historical overview of these issues, which had been raised at earlier symposiums, please refer to Jones and Slack (2008; 2009, 2010 and 2011). Recognition and measurement continue to be hot topics and, with the increasing complexity of financial instruments and areas such as insurance and pensions, associated problems are unlikely either to be easily solved or to get any simpler in the future. As always, the debate centres, first, on the recognition of liabilities or assets and their subsequent disclosure, and, second on how, if disclosed, the item should be valued and the debate between historical cost and fair/market value. For fair value, complexity depends upon the sophistication of the market and the availability of market prices. Fair value has become a particularly contentious topic as a result of its perceived role in the global financial crisis. Fair value proponents argue that it merely records the present value of assets or liabilities in line with their market value and is, therefore, a mirror of the current financial situation. By contrast, its detractors see it not merely as a recording instrument, but as a measurement tool that reinforces trends and, in effect, drives asset prices. Thus, in times of falling asset prices, balance sheet values are driven down. Fair value, in some contexts, and the credit crunch is argued to exemplify this, exacerbate asset trends, causing a pro-cyclical (or self-reinforcing) trend.

If one considers the debate around accounting recognition and measurement, it is not surprising that a variety of both conservative and aggressive accounting treatments are pervasive across similar asset and liability classes. Such variety, although compliant with accounting standards, presents further challenges to the usefulness and transparency of financial statements. From a regulatory perspective, the differing bases of measurement may well be appropriate and in accordance with accounting standards, but from a user perspective they are more problematic. The permitted variety potentially serves to erode the confidence of users, particularly less-sophisticated users, in financial statements when they are seeking comparability. Again, there is no easy solution. This is why issues of recognition and measurement will long be discussed, from both theoretical and practical perspectives.

The fair (faithful) reporting of the underlying transactions enhances confidence in the financial statements. Unfortunately, as businesses face continuing economic uncertainty, the possibility emerges that accounting will become more 'creative' or even fraudulent. It is not that accounting scandals are new, but rather that they have been around as long as accounting itself. Nonetheless, the incentives for creativity increase in times of economic stress. Complexity itself may increase the risk of fraud and both auditors (internal and external) and regulators face increasing difficulty in unravelling, or recognising, areas of potential accounting misdemeanours. This may be mitigated somewhat in that companies that adopt aggressive, but permissible, accounting policies are more closely observed by the market and regulators.

Given the current debate about measurement this may be an opportune time to challenge the very basis on which financial statements have traditionally been prepared. It has long been accepted, or recognised, that financial statements are prepared using single-figure values for all income/expense and asset/liabilities/capital categories. While the measurement and disclosure methods may have changed over time, the use of single discrete figure values has remained securely cemented into the mindsets of those preparing and using accounting information. Nonetheless, in view of the complexity of transactions and reporting one possibility that is discussed below is to consider ranges of reporting values rather than single figures. Such an approach would give preparers, auditors and users the flexibility to show a range of possible valuations for key elements of the financial statements

The symposium formed a useful forum in which some of these basic accounting, regulatory and technical issues were discussed. The five speakers provided a range of informed, interesting, and above all, provocative opinions. These are now presented, and then discussed in more depth, below.

Increasing rules and complexity: but are we getting any wiser?

RICHARD DUNBAR, INVESTMENT DIRECTOR, SCOTTISH WIDOWS INVESTMENT PARTNERSHIP

Richard gave his personal insights into the usefulness to users and transparency of financial statements. This was set against the variable accounting treatments adopted in response to the Greek debt downgrading. Richard has 20 years of fund management experience and provided a review of accounting from a user perspective. His main focus was on the European and UK banking sector and in some respects was a follow-on from the insights provided by James Clunie in 2011 (see Jones and Slack 2012 for a commentary on that presentation).

Over the last two decades, there has been a dramatic increase in the volume of reporting provided by companies. For instance, within the banking sector, the oft-cited HSBC annual reports since the mid 2000's have spanned over 400 pages, (for instance the annual report for 2005 was 424 pages) compared with the equivalent report in 1991, which was just 60 pages and that included photographs. Over the years, photographs, charts and graphs have been used mainly to spice up the front end of the annual report. It is interesting to reflect that such photographs and images generally get dropped when companies are struggling with earnings or in the midst of an economic downturn, as at present. Overall, however, it is important to note the huge scale of UK bank reporting, such as that of HSBC, whose balance sheet's value equals the size of some European economies and hence the significance of its, and other banks', reporting to users. This set the scene for Richard's main focus on accounting choices, the variety of accounting treatments adopted by European banks and the signals these choices send to users and the equity markets.

Richard illustrated current bank reporting and calls for increased transparency with two extracts from the *Financial Times* dated 14 and 15 November 2011, respectively. The first was a letter from Chris Lucas, group finance director of Barclays (14 November 2011: 12).

The 2007–08 financial crisis prompted calls from the Group of 20 and many others for an overhaul of financial instrument accounting. The urgent need for improvement has been highlighted by the banking industry's recent results, with many banks reporting large unrealised gains through marking down the value of their own debt as their credit spreads have widened. This reporting of so-called own credit gains and losses is an accounting requirement which is widely viewed by the market as one that misrepresents actual business profitability, makes results difficult to explain to investors and is unhelpful from an industry that wants to **rebuild confidence through transparency in financial reporting** [emphasis added].

The IASB recognises that this accounting treatment needs to be improved, and the new rules it has been working on would address this issue. Nevertheless, four years after the financial crisis began, European companies still have to report large unrealised gains and losses through income as a result of revaluing own debt. **Thus financial reporting is more opaque and complex than it need be** [emphasis added].

It is clear that the letter is a plea for increased transparency of reporting and appropriateness of accounting treatments and choices in order to provide meaningful financial statements to users. Nonetheless, the following day (15 November: 20) the *Financial Times* carried a comment from Jonathan Guthrie highlighting accounting choices made by banks, including Barclays, in effect, to suit their own needs.

Barclays announced third- quarter results [which] included a £2.9 billion non-cash gain, generated, with mirror logic, because the market of loans to the bank had fallen, reducing their notional buy-back cost. We should [also] remember that Barclays' results also featured £559m in hedging gains and a writedown of its investment in investment manager Blackrock, which taken together made underlying trends rather hard to analyse...we should also recall that this year Barclays bought back the Protium loans vehicle that it had parked off balance sheet for a while lest, according to some, it spoiled the look of the profit and loss account.

The above extracts were used by Richard to highlight on the one hand calls for increased transparency and then on the other hand to provide clues to users about the nature of corporate accounting reporting choices. There was a seeming lack of transparency, as if one step forwards was being followed by two steps backwards.

From a wider perspective, Richard then highlighted the impact of Greek debt downgrading and Greece's potential default on the accounting of European banks. IAS 39 (classification of sovereign debt holdings) requires that financial assets are classified into one of four accounting categories: Fair Value through P&L; Available for Sale (AFS) (shown as Fair Value in the Balance Sheet); Loans and Receivables; and Held to Maturity (HTM) (both at amortised cost). Consequently, depending on the accounting treatment adopted (for instance, between AFS and HTM) different write-downs can be justified. On 21 July 2011, the Institute for International Finance (IIF) calculated a 21% haircut on Greek bonds being offered up for exchange. Given the turmoil in financial bond markets and the inherent vulnerability of Greek government debt in particular, it might be expected that 21%

would be the very minimum level of impairment. In the second reporting quarter of 2011, Greek debt impairments ranged from 21% to 51% with a variety of accounting approaches adopted by banks and insurance companies and no consistent approach enforced by auditors. Richard commented that the accounting treatments, in general, reflected the individual banks' own current financial position and solvency, so that those banks that could effectively afford it (such as HSBC, Allianz) showed large write-downs compared with those of other banks that were in a weaker position (such as Dexia). In general, the most conservative were UK banks and the least conservative were French banks. Large write-downs could have further implications for the Euro. Richard questioned the role of regulators and auditors in respect of consistency and transparency of accounting choices between European banks in their individual accounting treatment of Greek debt. He consequently questioned whether financial statements really presented a true and fair picture to users, specifically enabling appropriate intra-sector comparisons between financial institutions.

In his concluding remarks, Richard reflected back to the 1980s and how, at that time, Polly Peck and Trafalgar House both pushed accounting to the limit. Aggressive accounting choices are recognised by the equity market which reacts accordingly and perhaps gives analysts and other equity market participants more insight into those companies by raising questions as to why they are making such aggressive accounting choices.

Richard posed the question: so where does this leave users? He suggested we look for clues that lie behind accounting choices. It was always thus and through time companies will look to justify aggressive accounting choices through application of rules, although not perhaps working within the spirit of those rules. In doing so, companies will exert more pressure on standard-setters to provide additional guidance, frameworks and standards for greater transparency within a highly complex financial world.

QUESTIONS

David Cairns (LSE) asked why banks are adopting different (or aggressive) accounting treatment of items if users, including the equity market, can see through this. Richard commented that, in general, banks are aware of the potential market reaction to accounting treatments. Nonetheless, he also noted that in some instances companies were surprised at the reaction when they had adopted treatment that was within the rules.

Mike Jones (University of Bristol) and Paul Moxey (ACCA) wondered (1) whether, even though analysts are informed users, they identified all the accounting choices made by companies, and (2) whether users really used financial statements or were they more concerned over rating agency or analysts' reports? Richard stated that analysts by nature will be following a sector and thus will have a good knowledge of aggressive accounting choices. Such knowledge may also be reflected in meetings with management, effectively setting the tone for corporate reporting. Richard Slack (Durham University) expressed concern over analysts' close, perhaps dependent, relationship with the banks they follow. He felt they would thus be less likely to sound alarm over aggressive accounting treatments.

Mike Jones and Paul Moxey continued the discussion. They raised the question of how difficult it really is to regulate the very large banks effectively, given their economic significance. In response, Richard commented on the increased focus on Tier 1 capital rules to preserve bank assets and that UK banks were in many ways easier to regulate than those banks in more crisis and debt-affected European economies such as Spain and Greece.

Mark Clatworthy (Cardiff University) asked whether an increased discount rate should be applied against bank valuations, because of levels of risk and variable accounting treatments. Richard commented that discount rates for valuations resembled a jigsaw of both firm-specific, sector and market considerations and thus would be flexed depending on the specific bank.

Confidence accounting: reporting for uncertainty

MICHAEL MAINELLI, EXECUTIVE CHAIRMAN, Z/YEN GROUP, EMERITUS PROFESSOR OF COMMERCE, GRESHAM COLLEGE, AND VISITING PROFESSOR, LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Michael provided a thought-provoking presentation questioning the value of financial statements as they are currently presented, particularly in the light of the continuing financial crisis and levels of uncertainty that face all companies and banks. Given that financial statements are increasingly complex and that accounting standards reflect this level of complexity, he argued that surely chasing a single number for balance sheet, profit and loss and cash flow entries, and associated notes to the accounts is effectively impossible. More worrying, perhaps, is that such single numbers constitute the financial statements upon which auditors provide their opinion along with the underpinning assumption of going concern. While auditors and preparers have been criticised, mainly in connection with accounting failures such as Enron and more recently over the varying accounting treatments adopted by banks (see also the commentary on Richard Dunbar's presentation), that criticism rarely relates to the basis of preparation, in particular the continued use of single figures for accounts presentation.

Michael asked why preparers, regulators, standard setters and users continue to support this basis of financial statement presentation and do not question it in terms of measurement science. He questioned why such stakeholders and, in particular, auditors and preparers do not practice measurement science as a more effective way of financial statement presentation in a world of great uncertainty. It is common practice in other areas of the economy to present information showing a range of possible values or outcomes, for instance, the Bank of England's economic projections. In accounting, many of the assumptions underpinning the financial statements rely on projections such as going concern (for the foreseeable future) and thus it is not inappropriate to consider a more radical basis for their presentation. Further, many values in accounting are subject to a great deal of inherent uncertainty; for example, the valuation of intangible assets, work-in-progress valuation and the future value of pension liabilities. Michael continued this line of argument, proposing that although we may think that scientists crave accuracy, in fact, scientists normally view measurement as a process that produces a range of outcomes (or values). Rather than using point estimation, they will use interval estimation such as the value being X +/– Y, where Y expresses the characteristics and 'certainty perception' of a distribution, rather than a single point, or value, of measurement X.

'Confidence accounting' is the term used for showing such interval estimations rather than discrete valuations (see www.longfinance.net) in an attempt to make accounting and auditing more closely resemble other measurement sciences. Thus financial statements would show distributions for all major entries, for instance the value of freehold land in the balance sheet might be stated as £9m +/– £2.5m, reflecting the illiquidity of freehold land or the possibility of future rising prices if the land is in an area with potential for development. Next to the value would be the confidence level, eg 95% confidence that another audit would also have produced such a range. This type of presentation would allow for the comparison of future values against the confidence interval to enable users to judge both the quality of the financial statements and the auditors. Michael showed an illustrative example of a histogram distribution of net income ranges and equity. For equity this is shown in Figure 1 and tabulated in Table 1 below.

Figure 1: Illustrative example of a histogram distribution of equity

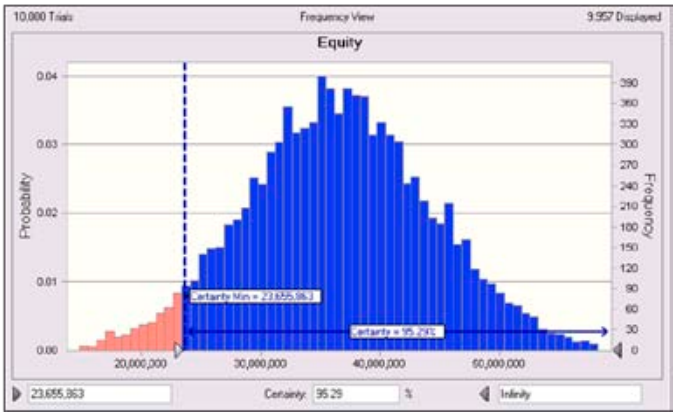

Table 1: Net income and equity interval estimations

	Net income	Equity
Mean	6.7 billion	36 billion
Minimum	–5.9 billion	6.5 billion
Maximum	20 billion	65 billion
95th percentile	0.7 billion	24 billion

This shows that the directors are 95% confident that net income will be at least 0.7 billion and the value of equity at least 24 billion with corresponding mean, maximum and minimum values. If the value of equity, over the period, falls below or exceeds the confidence level values then this could call into question the quality of the balance sheet figures and also that of the audit, as the financial statements should reflect the levels of confidence used in their preparation. A more comprehensive worked example of how a full set of accounts might look has been developed as part of a research project for ACCA and the Chartered Institute for Securities & Investment, along with the Long Finance initiative: *Confidence Accounting: A Proposal* (Harris et al. 2012).

Dealing in intervals enables financial statements to present the complexity of accounting estimates more realistically, rather than being 'straitjacketed' into point (or single-figure) estimates. Further, it enables users to evaluate auditors' performance on restatements, especially where these have fallen outside confidence intervals. Markets will price the value of higher confidence intervals and will be able to evaluate future performance against those intervals, so providing users with meaningful accounting information.

QUESTIONS

Mike Jones (Bristol University) and Paul Moxey (ACCA) commented on the level of aggregation and on how interrelated factors in determining value intervals would be determined. Michael contended that the intervals were intended to give a better estimation of key values and would not be extended to minute detail, as that would be counterintuitive to the argument for their use. Further, he contended that current point estimates of market values showed only a single point in time rather than an ability to reflect a range of values which would give a truer picture.

Stephen Cooper (IASB) asked what the distribution represented – was it uncertainty over the future or current estimates against market values? He further commented that as informed users would generally use value ranges in calculating equity value, are interval values not already being used? He thus queried whether or not we need alternative presentation. A lively debate followed concerning the use of point versus interval values and whether of not interval values did provide more value to users, both informed (such as analysts) and uninformed (such as small shareholders).

Liability measurement: wrestling with a persistent and troublesome problem

STEPHEN COOPER, IASB BOARD MEMBER

Stephen's presentation reflected his depth of knowledge from his work with the IASB. This enabled him to provide his own personal insight into the complexities of liability measurement and the implicit difficulties associated with accounting for liabilities. These ranged from insurance contracts, pension obligations and non-financial-based liabilities such as environmental clean-up costs. There are many different liabilities and many different measurement treatments under IFRS, some of which are persistent problems. Some treatments are comparatively recent and reflect the complexity of accounting; these include the use of probability and expected values (IAS 37); discount rates used and own credit values (IAS 19 and insurance) and risk margins (IAS 19, IAS 37 and insurance). There are a number of active IASB projects on liability measurement, such as those concerned with insurance, pensions, non-financial liabilities, leasing, deferred grants and deferred taxation, highlighting the significance of the area under discussion. Additionally, there are areas not yet covered by IFRS where liabilities exist, such as emissions-related obligations. Stephen focused his presentation on four main areas: financial liabilities; insurance; pensions; and non-financial liabilities where both the issues and their related measurement have become both more complex and apparent. Brief summaries of the four areas are shown below, followed by the key areas of difficulty outlined by Stephen in his presentation.

FINANCIAL LIABILITIES

Measurement base: fair value or amortised cost (except financial guarantees measured using IAS 18 and IAS 37)

Fair value is used to reflect current and future discounted cash flows where market data are available. This highlights the inherent problems with fair value on the availability of market price, the uncertainty of future cash flows and the relevant discount rate to be used to give current valuation. Amortised cost similarly reflects future cash flows discounted at the original effective yield.

INSURANCE

Measurement base: currently diverse accounting bases

Insurance and related liabilities are the focus of an IASB/FASB project. The Insurance Discussion Paper addresses the measurement attribute of fair value (and the same issues identified above for financial liabilities, namely the uncertainty of future cash flows and appropriate discount rate) and the exit value for the liability. Insurance margins are discussed: these comprise the risk margin of the insurance and the service margin – effectively what one would have to pay to someone else to take on the product, including the risk margin, and to continue to service the obligation. The Insurance Exposure Draft issued in 2010 highlighted fulfilment value as the measurement attribute: it is based on what the insurance company would have to pay if the policy were executed. This looks at measurement from an entity perspective, reflecting the full discounted cash flow associated with the liabilitythat the policy covers. Again, the issue arises as to what the appropriate discount factor should be. The margin would reflect only the risk margin and not the service margin as the liability is not transferred.

PENSIONS

Measurement base: currently IAS 19 measurement attributes present value (less pension plan assets at fair value)

Now pension scheme and associated liabilities are increasingly more complex than in the past. It is no longer a simple classification of defined benefit, with related company obligations on final salary versus defined contribution schemes. There has been an increasing use of options and guarantees associated with contribution promises as well as future deferred liabilities on pensions. Fair value has been proposed for contribution-based promises, but the proposal has been dropped for the revised IAS 19.

NON-FINANCIAL LIABILITIES

Measuement base: currently IAS 37

Under IAS 37 the measurement attribute is based on the amount to settle (or transfer if lower), but there is uncertainty over whether this is settlement today or at a time in the future. In practice, there is diversity of treatment with difficulties arising around cash flows based on the 'best estimate' of expected value and whether or not to include risk margins. The proposed revision to IAS 37 in 2010, which was not implemented, considered the maximum amount that would rationally be paid to be relieved of the obligation. This would be based on expected cash flows, even if these cash flows were binary (two outcomes), in determining measurement value; for instance, the expected value of clean-up costs for an environmental liability (including subcontractor's margin) being based on a liability occurring or not occurring with an appropriate probability for each outcome. In practice, given that most outcomes are based on a wide range of probabilities of occurrence, binary outcomes are a simplification.

Because the complexities presented centre on just four key areas, Stephen then concluded his presentation by summarising and highlighting four key problems and areas of difficulty.

PROBLEM 1: PROBABILITY AND EXPECTED VALUE

When should liability measurement be based on expected cash flows? Is 'best estimate' an expected value?
There has been little real debate about the use of probability-weighted expected cash flows within a portfolio (eg warranties or guarantees and the problem of binary-outcome single liabilities where there are only two realisable values: either zero or full liability). Overall, the IASB is more supportive of expected values than the FASB. Further problems arise over the timing of liabilities settled today or the eventual cost of settling in the future. The measurement problem is thus linked to the recognition of liability in terms of time period as well as estimated amount.

PROBLEM 2: DISCOUNT RATE AND OWN CREDIT

When should the measurement of liabilities reflect own credit? Should changes be included in the Profit and Loss Account (P/L)?
Counterintuitive results occur if changes due to own credit are put into the P/L and there has been very strong general opposition to this. In IFRS 9 the fair value option and preservation of fair value is attributed with own credit and taken to other comprehensive income (0CI) as opposed to IFRS 9 derivatives where own credit is shown in the P/L. For insurance, own credit was included in the Discussion Paper but removed from the Exposure Draft.

PROBLEM 3: DISCOUNT RATE AND LIQUIDITY

Should a liability discount rate reflect the expected return on funding assets? What is a risk-free rate for an illiquid liability?
There is no asset-based discount rate in IFRS, but for liability measurement there are calls for the use of a link between the return on assets held by a pension fund and the related pension fund liability discount rate. For insurance, the Discussion Paper refers to a risk-free rate plus an illiquidity premium so the rate reflects the characteristics of the liability. In contrast, the Exposure Draft has the same objective but permits a 'top down' method of estimation.

PROBLEM 4: RISK MARGINS

When should a risk margin be added to a liability measurement? What does a risk margin represent? How should risk margins be calculated?
Risk margins are a key feature of the Insurance Exposure Draft, but the FASB disagrees with the use of risk margins. Risk margins are included in IFRS 13. It is unclear what IAS 37 requires in terms of risk margins; also risk margins are not included in pension measurement so there is divergent treatment of risk margins across different liability categories.

QUESTIONS

Richard Dunbar (Scottish Widows Investment Partnership) raised the issue of the market value of insurance companies whose shares are traded at a discount to their embedded value. If we assume that the market is efficient and thus valuation is correct then any problems over asset and liability measurement are non-market-based, accounting, problems only. Stephen commented that market value per se does not capture the full picture and that there needs to be a move towards more consistent valuations and, in part, to remove anomalies in reporting because financial statements are complex enough without mixed-measurement bases.

Ken Moore (Sheffield University) asked whether, in Stephen's view, expected values of binary outcomes (occurrence versus non-occurrence) were dead in the water. Stephen affirmed this and that they had been shelved re IAS 37. Nonetheless, the issue remains and thus will need to be dealt with in future. In reality, most companies do not have single binary outcomes, but rather a portfolio of outcomes and more work on their measurement needs to be done.

Andrew Lennard (ASB) made a more general comment on the conceptual framework debate, which addressed issues of measurement and valuation particularly in the light of Stephen's presentation, highlighting the current diverse treatment in liability measurement.

The Financial Reporting Review Panel's role in achieving consistent application of accounting standards

CAROL PAGE, DIRECTOR, PANEL OPERATIONS, FINANCIAL REPORTING REVIEW PANEL (FRRP)

Carol explained that her presentation would focus on three areas. First, the aims and objectives of the Financial Reporting and Review Panel (FRRP); second, a review of what might be meant by the phrase 'consistent application' and, finally, consistency in the sense of the Panel's internal processes and procedures and its international engagement. Carol hoped that her talk might 'lift the veil' on certain aspects of the Panel's work.

In terms of its aims and objectives, the Panel has a statutory function, delegated to it by the secretary of state, to ensure that the reports and accounts of public and large private companies complied with the Companies Act 2006. This includes not only accounting standards but also other aspects of company law – the Business Review within the Directors' Report, for example. In addition, the Panel is authorised to keep under review compliance with certain aspects of the FSA's Listing Rules. The Panel has a wide remit covering all listed, AIM-quoted and large private companies. It takes a risk-based approach to the selection of accounts for review and, where appropriate, writes to company boards for further information and explanation about the accounting treatments and disclosures provided in their accounts. The Panel does not go on 'fishing expeditions' and will write to a company only if there are potential points of substance to enquire into and where there is a question of possible non-compliance – in the words of the Companies Act, 'where there is, or may be' a question. The Panel has the power to apply to the court for an order requiring directors to revise defective accounts. The court could also hold the directors liable for the cost of the revision and the re-audit. This power has, however, never been exercised, although the Panel has come close to applying to court on several occasions.

The Panel's preference is to work on a consensual basis with companies. Companies prefer this approach – audit committee chairmen have communicated this to the FRRP. The Panel is, however, fully prepared to go to court where the circumstances merit. If a company receives a letter saying that the Panel is minded to go to court, one can be sure that it is prepared to do so. The Panel never bluffs. The Panel also still responds to complaints and encourages the investment community to bring any corporate reporting concerns it may have to the Panel for investigation.

The monitoring of financial information for reporting compliance is the key function of the Panel. It also has other aims and objectives as set out on its website. It liaises with other authorities to 'foster consistent application of accounting requirements' (with particular focus on the Financial Services Authority, FSA, and its joint contribution to the work of the European Securities and Markets Authority, ESMA – previously the Committee of European Securities Regulators, CESR). The Panel also 'seeks to contribute to and, seeks to sustain, an approach to enforcement that is vigorous, consistent and cost–effective'. Consistency is a key factor within the Panel's work, whether it is focusing on processes or on outcomes. When the Panel thinks about what 'consistency' actually means and whether it is always a virtue, one quotation comes into mind, courtesy of the American poet, Ralph Waldo Emerson:

'A foolish consistency is the hobgoblin of little minds'

Interestingly, it is a quotation that is often misquoted – commentators often overlook the word 'foolish' which completely turns the statement on its head. Correctly quoted, it is a valuable concept to have in mind as in thinking about the phrase 'consistent application' in the context of financial reporting. We should, Emerson advises, beware of consistency for its own sake. To understand better what 'consistent application' might mean in the context of financial reporting, Carol looked first to the IASB's Conceptual Framework. If financial information is to be useful to investors then it needs to be relevant and faithfully represent what it purports to represent. The usefulness of that information is increased by comparability – investors can look at different sets of financial accounts and compare and contrast the reporting outcomes. Treating like things in the same way is clearly helpful, but consistency is not the same thing as comparability. It is, however, presented as an aid to delivering comparability. This is how the Framework describes it:

'The use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities'.

That description, whilst not described as foolish, certainly raises a few questions. Are there not instances where, even faced with a similar set of facts and circumstances, one would not be surprised to see different treatments or disclosures? For example, in certain – albeit limited – circumstances, IFRS offers options that provide management with the opportunity of selecting what is most appropriate to the matter under consideration. This allows for variations in facts and circumstances and in the economic substance of similar transactions.

The possibility of adopting standards early, in advance of the statutory implementation date – and often the encouragement to do so – means that some corporates will apply what may be very different requirements to what are essentially the same transactions or circumstances. The IFRS-Interpretations Committee's so-called 'non-decisions' may, themselves, refer to different treatments in practice. And what about the bedding down of a new standard? Might one not expect some degree of difference/experimentation unless and until peer pressure and regulatory intervention combine to create a drive towards broad consensus?

IFRS provides a principles-based approach to financial reporting which does not specifically identify every situation and required reporting response. It does, however, provide the element of flexibility necessary to enable companies to respond to complex or new developments in practice. A rules-focused regime would require a never-ending stream of interpretations to address every new situation that arises. A principles-based regime necessarily requires a greater degree of professional judgement to be applied. At its highest level, consistent application means accounting treatments or disclosures that comply with the provisions of IFRS and are acceptable within what they permit.

Carol then looked at how the Panel seeks to achieve compliance with IFRS. A starting point is the Panel's Operating Procedures, which are approved by the Secretary of State and a copy of which is included with every initial letter to a company. This means that companies know how the Panel enquiry is to be conducted; what they might expect by way of process and who will be making the decisions in respect of their case (ie the Procedures are carried out with the consistent process to which Carol referred earlier).

The Procedures bind the Panel to the principles of good regulation.

- Transparency
  The Panel is open to the extent that it can be under the current law and preferred practice (this precludes publishing Panel enquiries until the matters are resolved).

- Accountability
  Some, though not all, Panel findings are publicised through press notices and the Panel reports on outcomes in an Annual Report.

- Proportionality
  The Panel must be proportionate in what is raised with companies: to focus on potentially material items and have other ways of dealing with less significant items; it will draw these to the attention of management without necessarily requiring a response.

- Consistency
  The Panel must be consistent in the process that is applied and in the judgement that is brought to bear in relation to any particular issue.

- Targeting
  The Panel must take a risk-based approach to the selection of accounts for review. At times it conducts focused reviews of specific areas of final reporting.

Looking further into the detailed processes, Carol explained the various stages of a Panel review. First, there is the informal enquiry. All reports and accounts that come to the Panel for review are initially considered by Panel reviewers who identify issues they consider should be raised with companies to determine whether there is an issue of potential non-compliance. Those reviews and draft recommendations are considered by Panel Case Officers who conduct a further review of the accounts and who may add to, or eliminate, potential questions raised by the reviewers.

Their recommendations are then considered by the Panel Chairs in the context of whether there is, or may be, a question of non-compliance. The Chairs make the final decision about whether the FRRP writes to a company and whether any specific issue is raised – bearing in mind the principles of better regulation.

This is an iterative model of review, which is applied to every company response to a letter from the Panel, to help drive consistency and quality of approach and outcome. At every step, there is a sense check of what is proposed in terms of regulatory intervention, building on the experience and judgement of the combined Panel Team – until such time as closure.

The exchange of letters, supplemented occasionally by informal meetings, may continue over some months. There may come a time, however, where the company does not accept the Panel's preliminary view and where the case is escalated to a Panel Group – the 'formal enquiry'.

A formal enquiry is where a group of Panel members are brought together to consider a specific case where staff have not been able to secure commitment to improved/corrected treatment in future. It may be a difficult case – dealing with complex or controversial issues – or it may be that the company is not yet minded to accept the Panel's view. To provide consistency in the judgement that is brought across all cases, the Panel Chair and one of the deputies will form two of a five-member team. In practice, it is not uncommon for companies to accept the Panel's preliminary and informal view at this stage, and avoid a formal enquiry, given the potential cost of continuing a case against the perceived benefits.

The membership of the Panel is a mix of professionals operating at the very highest level of their specialist area – whether that is accounting, law, audit, business or regulation. The skills of Panel members are the critical strength of the Panel and lend it a very high level of credibility, enabling a process of genuine peer review to be applied. When reviewing a company's report and accounts, there are a variety of points or concerns that may prompt further enquiry. For example:

- whether the audit opinion is qualified for non-compliance with the relevant accounting framework
- whether, on desk-top review, there is apparent divergence from IFRS – and where there may be a question of non-compliance
- where there are inconsistencies between the front and back end of the report – the so-called 'pantomime horse' approach to corporate reporting.

Another not uncommon initiator for action arises from questions relating to accounting policies. These may include voluntary changes in policy; for example, where the rationale for the change is not clear or where references to exceptions to the norm call for investigation. These and other issues are pursued with the company through exchanges of correspondence and meetings. All documentation is stored electronically in a case management system, which enables the FRRP to search for previous cases where there have been similar questions in respect of certain paragraphs within a standard and which would be a helpful aid to consistency between the eventual judgement and those made in previous cases.

Finally, Carol turned to the international dimension of the Panel's work. It would be fair to say that, before 2005 and the adoption of IFRS by the EU, the Panel had little engagement with overseas regulators. At the same time, the EU Commission announced its intention to liaise with member states to develop a common approach to enforcement – primarily, through the Committee of European Securities Regulators (CESR), now known as the European Securities and Markets Authority (ESMA). This was a laudable aim, but the Panel, as the UK's enforcer of financial information, is not a securities regulator, was not a member of CESR and had no legitimate position to enable it to attend the meetings specifically set up to drive this enhanced area of operations. That role belonged to the FSA as the UK's securities regulator.

This situation prompted a revisiting of the Panel's relationship with the FSA. The Panel acted as the FSA's adviser on the committee charged with establishing the new role. This enabled the Panel to participate fully in the development of the two CESR Enforcement Standards – currently under revision – and the establishment of EECS (European Enforcers' Co-ordination Sessions) to which all national competent authorities are full members, whether or not they are securities regulators. Currently, that minority group includes the UK, Germany (where enforcement action is initiated by a private independent body modelled on the UK Panel) and Sweden (where monitoring activity is currently in the hands of the Exchanges).

The two Enforcement standards are principles based. They are intended to provide for, if not a single approach across Europe, then at least systems that meet a small number of high-level requirements and a degree of consistency to help achieve the so-called 'level playing field' for EU-listed issuers. For example:

- power to require information from companies and auditors
- proactive monitoring of financial information
- risk-based selection of accounts.

EECS provides a forum in which national enforcers meet to exchange views and discuss enforcement experiences. National enforcers are invited to submit details of enforcement decisions they have taken to the CESR database.

The database is confidential to CESR and is intended to be a source of information to foster appropriate application of IFRS. The Panel is required to consult the database when contemplating similar decisions. EECS then meet every six weeks or so to discuss a selection of those decisions that merit debate: perhaps to get a better understanding of the facts and circumstances, to clarify the rationale supporting the decision taken or, sometimes, to challenge the basis on which a decision has been taken. EECS is not, however, a decision-making forum. It neither rejects nor approves decisions that have been taken by its members.

Periodically, EECS publishes extracts from its database as a means of sharing with issuers, auditors and users those accounting treatments that are broadly considered to be within the acceptable range of those permitted by IFRS or IFRIC interpretations. This is intended to contribute further to consistent application of IFRS in the EU.

Carol thought that at the outset a number of members were sceptical of the value of the committee and what it might achieve. The early meetings were not particularly fruitful. Although all members committed to the high-level principles of the CESR standards, they seemed to be poles apart in terms of culture, behaviours and the level of detail they considered – and in the regulatory tools that were available to them. Over time, however, the sessions had improved in the substance of the items being discussed and in the rationale and level of sophistication being applied. The panel had learnt and is continuing to learn through shared experience.

QUESTIONS

Kathryn Cearns (Herbert Smith LLP) raised issues over materiality, at an entity level and on an individual component level, regarding audit selection by the Panel. Carol referred to the risk-based criteria for selection and to the focus on specific areas of reporting. While in general it would be larger listed companies that would be targeted for review, owing both to their size, hence materiality, and to the public interest. It is also important to recognise that the Panel can and does review any listed and AIM-quoted companies, regardless of size, as well as large private companies.

Richard Martin (ACCA) asked Carol's views on the quality of IFRS compliance in the UK. Carol recognised that there had been a general improvement in the quality of IFRS compliance and reporting over time and in the engagement of companies with the reporting framework and early IFRS adoption.

Creative accounting, fraud and international accounting scandals

MICHAEL JONES, PROFESSOR OF FINANCIAL REPORTING, UNIVERSITY OF BRISTOL

Michael Jones outlined the background and nature of a book he has written and edited: *Creative Accounting, Fraud and International Accounting Scandals* (Wiley 2011). This book investigates the nature of creative accounting and fraud, examines the history of accounting scandals, looks at creative accounting, fraud and accounting scandals in 13 countries worldwide, and draws out some cross-cutting themes.

Michael suggested that creative accounting was analogous to magic. He showed an illustrative cartoon.

He provided four definitions that formed a broad framework for discussion.

1. Fair presentation: using the flexibility within accounting to give a true and fair picture of the accounts so that they serve the interests of users.

2. Creative accounting: using the flexibility within accounting to manage the measurement and presentation of the accounts so that they serve the interests of preparers.

3. Impression management: using the flexibility of the accounts (especially narratives and graphs) to convey a more favourable view than is warranted of a company's results, in order to serve the interests of preparers.

4. Fraud: stepping outside the Regulatory Framework deliberately to give a false picture of the accounts.

Overall, Michael suggested that accounting was a continuum running from no choice of accounting policies, flexibility to give a true and fair view, flexibility to give a creative view and flexibility to give a fraudulent view.

No flexibility	Flexibility to give a 'true and fair' view	Flexibility to give a creative view	Flexibility to give a fraudulent view
Regulatory framework eliminates accounting choice	Working with regulatory framework to ensure users' interests	Working within regulatory framework to serve preparer's interests	Working outside regulatory framework
Within regulatory framework			Outside regulatory framework

Michael identified three types of managerial motivation. First, personal incentives, for example, where managers wished to increase salaries through profit-related pay, bonus schemes, shares and share options and job security. Second, market expectations, where managers sought to meet analysts' expectations by, for example, profit smoothing and, third, special circumstances, such as managing gearing, new issues, mergers and acquisitions, decreasing regulatory visibility and the appointment of a new management team.

Four main methods of creative accounting were identified: increasing income (eg premature sales recognition); decreasing expenses (eg provision accounting or capitalisation of interest); increasing assets (eg enhancing goodwill or revaluing fixed assets); and decreasing liabilities (eg off- balance sheet financing or reclassifying debt as equity). The main methods of fraud were the misappropriation of assets (eg stealing cash, inventory) and fictitious transactions (eg inventing sales or even whole subsidiaries). Michael showed that accounting scandals were persistent across time. He outlined a series of scandals that had existed from ancient to modern times. These ranged, for example, from the doctoring of a cruciform monument in Mesopotamia (by adding inscriptions bolstering the claims of a temple to its revenue) in the second millennium BC, through the South Sea Bubble in 1720, to the railway scandals of the

1840s–1860s in the UK; the Royal Mail Steam Packet Company (UK, 1931); and the Equity Funding Corporation of America, (US, 1973). These scandals have thus taken place across all eras.

In Michael's book, 61 major accounting cases were covered, from 12 countries. Each chapter was written by an experienced academic who outlined details of national scandals since the 1980s. Some of these scandals are well known. So Mulford and Comiskey from the US commented on, inter alia, Enron and Worldcom, while Norton wrote on Lehman Brothers and Madoff Securities International. Meanwhile, in Europe, Melis outlined the Parmalat scandal and Gwilliam and Jackson covered the Mirror Group, Polly Peck, and the Bank of Credit and Commerce International. Other scandals have not had the same coverage: for instance, Livedoor in Japan discussed by Kazuyuki Suda, Satyam in India covered by Bhabatosh Banerjee, and Zhenzou Baiwen discussed by Chen, Hu and Xiao. In all cases, the basic pattern was clear. Scandals occurred in all countries and at all times. When Michael approached the authors originally he was usually greeted with 'What scandals do you want us to write about?', not 'What do you mean, scandals in our country?'.

At the symposium, Michael talked about six scandals in more depth: HIH (from Australia, by Carnegie and O'Connell), Zhenzou Baiwen (from China by Chen, Hu and Xiao), Comroad (from Germany by Hansrudi Lenz), Bank of Crete (from Greece, by Kontos, Krambia- Kapardis, and Milonas), Parmalat (from Italy by Melis) and Skandia (from Sweden by Rimmel and Jonäll).

Michael discussed them in turn. HIH, Australia's second-largest insurance company, collapsed in 2001. There were three main accounting issues: (i) the company underprovided for future expected claims; (ii) there was reinsurance that did not transfer risk (eg, side letters that secretly negated the original contract); and (iii) direct losses transferred to the goodwill account. The result was that the executives were prosecuted, and the accountancy firm Andersen's was criticised for lack of independence, failure of audit committee and consultancy work. More broadly, HIH's collapse led to the Corporate Law Economic Reform Program Act (2004).

Zhenzhou Baiwen was a Chinese company dealing with household appliances. It was the fifth-largest company in China in 1997 and, in 2002, ran into serious problems. There were major accounting issues: fraudulent sales, misused raised capital, capitalised expenses, deferred expenses, inflated assets and related-party provisions. The Zhengzhou auditing company was fined. There were other failures of governance among the board of directors, supervisory board and local government. The consequences were revised corporate governance guidelines for China as well as changes to Chinese law.

Comroad was a German company that supplied GPS satellite navigation equipment. In 2002/3 serious irregularities were uncovered; Renate Daum, a journalist, investigated. Eventually, she uncovered that Comroad had phantom customers and suppliers, non-existent sales via VT Electronics Hong Kong of DM85 million in 2000, and that the CEO and his spouse prepared falsified accounts from a non-existing supplier and had fictitious customers. It was decided that KPMG did not act properly and had not exercised 'professional scepticism' and the CEO Bodo Schnabel and his spouse Ingrid Schnabel were jailed.

The Bank of Crete is an interesting case involving Koskotas, a fraudster. From ages 15 to 25 he committed 64 forgery offences in the US as well as forging academic qualifications. In 1979, Koskotas started work at the Bank of Crete and in 1980 became head of Internal Audit. He stole US$1,555,000 and deposited this with theWestminster Bank, overall embezzling US$32 million. Koskotas forged letters and documents to cover his tracks. In this case, there was external audit failure and the fraud was detected through a special audit. There was also a political connection, as Koskotas had a close connection with Andreas Papandreou, the Greek prime minister.

Parmalat has been seen as the European Enron. In 2003, Parmalat defaulted on a €150 million bond. There were accounting issues: fictitious sales, double billing, fabrication of operating subsidiaries' sales, unrecorded debts, debt recorded as equity, overstated assets and a forged €3.95 billion Bank of America cheque. At the root of Parmalat's demise were governance issues. The Tanzi family dominated the Board, the non-executive directors lacked independence, as did the Audit Committee, and the Board of Statutory Auditors was ineffective. The external auditors failed in their monitoring role. The Parmalat case had national and European consequences. There were changes to audit regulations nationally and on a European level there were changes to the Eighth Directive.

Skandia, the last case, that Michael covered in detail, was a Swedish insurance company. In the 1980s it was very successful. There were a variety of accounting issues: the use of embedded value accounting (a special type of accounting) with variable assumptions which led to the recording of apparently increased sales, increased earnings and decreased cash flow. A revenue of $976 million was recorded in 1999 using embedded value accounting, but it was estimated that the true situation was that the company had a negative cash flow of $454 million. There were also issues with the sale of a subsidiary and with greedy managers who had excessive fringe benefits and over-generous share incentive programmes. The problems at Skandia led to a Swedish Code of Corporate Governance.

Michael identified five major themes: strong personalities, managerial motivations, methods of creative accounting and fraud, failure of internal control and failure of external auditing. The first characteristic common to all these cases was that many of the individuals involved had over-strong personalities. They can be characterised as charismatic persuaders and conmen (such as, for example, Robert Maxwell in UK, Bernie Ebbers at WorldCom in the US, and Mario Conde at Banesto in Spain).

The main managerial motivations identified were the covering up of bad performance, for personal benefit and to meet listing requirements. The main methods of increasing apparent income were: boosting recorded sales through related parties; premature sales recognition; and the inclusion of non-operating profit. To give the appearance of decreasing expenses, there were four main methods: capitalising expenses; provision accounting; deferring expenses; and writing off expenses to reserves. For increasing apparent assets, three main methods were identified: inflating inventory; revaluing fixed assets; and inflating debtors. And, finally, for decreasing liabilities: off-balance sheet financing and understating liabilities were commonly identified.

For fraud, some popular methods encountered were: misappropriation of assets; (including embezzlement); fictitious transactions; inflating sales; financial documentation and fictitious subsidiaries.

There were frequent examples of failures of internal control. For example, at Zhenzou Baiwen, there was failure of supervisory functions and of the board, independent directors and of state-controlled shareholders, while at Parmalat there was a lack of independent directors combined with supervisory board and audit committee failure.

External auditors also frequently failed. In all seven Chinese cases, there were negligent or complicit auditors. At Parmalat, the auditors failed and were alleged to have let the company post a letter to its Bank asking for verification of a fictitious bank deposit. At Comroad there was a surprising failure of the auditor to spot a non-existent subsidiary. Finally, in Spain auditors at Forum did spot some irregularities, but failed to question sales and repurchase agreements.

The short-term consequences of the scandals were generally: loss of share price, company taken over or went into liquidation, directors jailed or fined, and auditors fined. In the longer term, regulations were often changed. In particular, changes in law or new codes of corporate governance.

Michael developed a theoretical model to reduce creative accounting and fraud. He saw the potential for these as being enhanced by motives and environmental opportunities, but being reduced by environmental constraints (more appropriate reward and incentive structures) and by better regulations and codes of corporate governance (eg better enforcement, code of ethics and enhanced supervision).

Overall, Michael concluded that creative accounting and fraud were perennial problems. In over 12 countries at least 58 different instances of accounting scams were identified. There were many examples of sensational collapses, eg HIH in Australia, Zhenzhou Baiwen in China, Parmalat in Italy and Enron in the US. In addition, creative accounting has proliferated, eg Asian Electronics in India. A great diversity of methods were identified. These scandals often occurred as a result of managerial motivation for personal gain. Moreover, they were often promulgated by charismatic persuaders and facilitated by poor corporate governance and failure of external audit. The overall consequences were that they led to financial loss and increased legislation.

QUESTIONS

Jill Collis (Brunel University) commented that the presentation was very interesting and on the potential links between culture, legal mechanisms, fraud and accounting. Michael concurred that there were clearly links that could be identified but that the book also gave a global perspective on fraud and associated accounting scandals rather than just focusing on those countries that were known for high levels of corruption and lax compliance systems.

Mark Clatworthy (Cardiff University) raised the issue of the increased need for auditors to use their judgement and commercial acumen to establish an overall opinion in the context of some major scandals. Carol Page (FRRP) noted that fraud and scandals have many, often unique, ways of coming to light (such as a journalist's chance investigation) and probably very few were revealed by auditors and therefore there was a need to assess risk and evaluate client-based assumptions.

Discussion: a summary of speakers' presentations

The five speakers presented a variety of diverse themes and ideas, with some common themes being apparent. A summary of their respective views is given below, followed by a synthesis of these themes.

1. RICHARD DUNBAR (INVESTMENT DIRECTOR, SCOTTISH WIDOWS INVESTMENT PARTNERSHIP)

Richard (a fund manager) spoke as a user of financial statements concerning their usefulness to users and their transparency and of the confidence that users can gain from financial statements. While he recognised that reporting volumes are now excessive, part of this relates to the complexity of transactions and to the regulatory demands on preparers. Richard raised concerns about the transparency of reporting and argued that financial reporting has actually become more opaque and complex than it need be, regardless of regulatory demands. He also pointed out the variety of accounting treatments that similar reporting entities could apply to similar assets and highlighted this over the issue of Greek bond downgrades and subsequent asset valuation measures. Such variety calls into question the role of auditors and regulators in meeting consistent application of accounting standards. This is particularly necessary if users are to be enabled to make like-for-like comparisons between similar entities. Informal users often recognised those entities that sought to be aggressive with their accounting policies. Thus one can question the value of such policies when others are, and can be seen to be, more conservative.

2. MICHAEL MAINELLI (EXECUTIVE CHAIRMAN, Z/YEN GROUP, EMERITUS PROFESSOR OF COMMERCE, GRESHAM COLLEGE, AND VISITING PROFESSOR, LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE)

Michael spoke from the perspective of both a practitioner and an academic and provided a challenge to current financial reporting. While there are endless debates over recognition and measurement, Michael questioned why users, preparers, regulators and others continued to accept that financial statements are prepared using single figures for accounts presentation. Michael proposed an alternative that would use interval, not point, estimation and so show a range of potential values for assets, liabilities, income and expenses along with levels of confidence. This would allow preparers to show a clear range of potential values and move accounting away from a single number focus so as to focus instead on a possible range of outcomes. Quality of reporting would be maintained through confidence intervals so that users could see from one year to the next appropriate levels of confidence being used in account presentation. This would enable preparers to present complex financial transactions more realistically, rather then the straitjacket approach of a single figure. It represents a fascinating challenge to mainstream accounts presentation and, whatever the future, opens one's eyes to alternative formats and means of presentation.

3. STEPHEN COOPER (IASB BOARD MEMBER)

Stephen spoke from a standard setter's perspective about an increasingly complex topic: liability measurement. In essence, the presentation covered liability recognition and measurement as many of the issues raised by Stephen were fraught with the dual issue of both initial recognition issues *and* their subsequent measurement. A variety of approaches and accounting treatments are used in liability measurement, reflecting the complexity of the problem, ranging from fair value to amortised cost to discounted present value. Stephen commented on the inherent difficulties of both liability recognition and measurement across financial and non-financial (environmental) liabilities, insurance and pensions, all of which have different measurement bases. Stephen limited his presentation to these four main areas but, worryingly, there are many more issues that are equally demanding in terms of their measurement base, such as emissions-related obligations. Stephen concluded by highlighting some of the further complexities in the area of liability measurement, as if the underlying transactions were not already complex enough. These measurement complexities concerned probability and expected values, discount rates used, own credit and liquidity, and risk margins.

4. CAROL PAGE (DIRECTOR, PANEL OPERATIONS, FRRP)

Carol's presentation was from a regulatory standpoint and provided insights into the operation of the FRRP. Overall, the Panel seeks to ensure that the report and accounts of listed, Alternative Investment Market (AIM) and large private companies are compliant with the Companies Act, 2006. The Panel selects accounts for review on a risk basis as well as by using specific areas of reporting; selection is not a 'fishing trip'. The Panel seeks to work on a consensual and open basis with companies over their reporting requirements if, for instance, there is ambiguity of reporting or further explanation is needed. If there is a discrepancy of treatment that warrants further Panel review, it will work through informal processes before having, if need be, to operate through a formal review. The Panel will use its statutory power if necessary, but ordinarily this is not required. In its review of accounts, the Panel is flexible to ensure that the appropriate accounting treatment is used and would recognise early

adoption of IFRS reporting between two companies of a similar transaction may be different but still appropriate and consistent with the basis of preparation. Carol reminded her audience that it is consistent application that is important, not necessarily consistency per se, as it is the appropriate standards that need to be applied and these may well change over time. Carol reflected on the level of transparency and openness of the Panel, which is part of the overall framework facilitating the production of high-quality financial reporting by UK companies. In answering questions, Carol showed that she was generally pleased with the quality of reporting and IFRS compliance.

5. MICHAEL JONES (PROFESSOR OF FINANCIAL REPORTING, UNIVERSITY OF BRISTOL)

Michael's paper was presented from an academic standpoint and gave valuable academic insights into the text *Creative Accounting, Fraud and International Accounting Scandals*, of which he is the author and editor. Michael spoke with some enthusiasm regarding fraud and its detection, making the point that probably there are a number of frauds that are in their own way entirely successful as they have not been detected and are thus not in the text! Although within the regulatory framework there is great flexibility in accounts presentations, such as impression management and creative accounting, there is, nonetheless a line beyond which accounts fall outside the framework in a deliberate attempt to mislead: ie fraudulent accounts. Michael provided a historical perspective on accounting scandals and associated fraud from ancient times to the present. There has, and always will be, the incentive and the ability to commit fraud for managerial gain, to cover up poor performance and even to meet listing requirements. Similarly, fraud is not unique to any one geographic region but is global and the text, divided into 13 chapters devotes 12 chapters to country studies. The final chapter was reserved for bank failures – very fitting in the current climate. The individual fraud vignettes described by Michael were interesting. He also illuminated his talk with a theoretical model for reduction of creative accounting and fraud, which included the regulatory environment and supervision, code of ethics, reward schemes and incentives. The talk also raised questions regarding audit failure as well as failures of internal control, perhaps a sobering note on which to end.

OVERVIEW OF THEMES AND PRESENTATIONS

As Table 2 shows, there was great variety in the issues covered, from five very different perspectives. Richard Dunbar and Stephen Cooper both spoke about the complexities of accounting treatments. Richard spoke from a user's perspective and Stephen from an accounting standard-setter's perspective. Richard raised concerns about the transparency of financial statements and the variety of accounting treatments adopted by entities faced with similar transactions to report. Stephen spoke on the complexities of liability recognition and measurement, so both speakers raised the key issues of accounting measurement, consistency and transparency of financial statements. It was then interesting to hear Carol Page's perspective as a regulator and about the role of the FRRP in reviewing accounts to ensure compliance with the Companies Act 2006. In the work of the Panel, it is important to note that it is consistent application and flexibility that are paramount when considering the number of potentially appropriate accounting treatments that can be applied to complex transactions. One single approach is not possible. Michael Mainelli questioned the whole basis of accounts presentation that is based on single-figure reporting. He suggested that there is a need to overhaul this completely, in part to help recognise the complexity of modern accounting, by introducing interval estimations with appropriate confidence levels. This is a real challenge to mainstream accounts preparation. Finally, Michael Jones gave an academic and practical view on fraud and accounting scandals. He presented many examples of creative accounting and fraud, drawing on a wealth of case study material. This is not a new problem and is one that raises issues over level of regulation, audit and internal control failures.

Table 2: Thematic overview of the five presentations

Speaker	Perspective	Key issues/findings
Richard Dunbar Investment director, Scottish Widows Investment Partnership	User and investment director	Transparency of financial statements and the consistency of accounting treatment by banks and financial institutions, given that bank financial reporting is inherently complex. Issues around valuation of own debt and so-called own credit gains and losses make reporting more opaque and complex and reduce transparency and hence usefulness to users. Variety of accounting treatments permitted under IAS39 (classification of sovereign debt) and hence differing write-downs and reporting associated with Greek debt holdings. Aggressive accounting treatment, however, does not fool an informed market and raises more questions as to why companies adopt such policies.
Michael Mainelli Executive chairman, Z/Yen Group, emeritus professor of commerce, Gresham College, and visiting professor, London School of Economics and Political Science	Practitioner, emeritus and visiting professor	Current presentation of financial statements by using single-figure reporting rather than a range of values critically examined. Given current financial volatility and the complexity of accounting measurement and disclosure calls for consideration of 'confidence accounting' using interval, not point, estimation and levels of confidence. Interval presentation would enable financial statements to present the complexity of accounting estimates better than being forced to show a single-figure estimate. Markets would understand the value of higher confidence intervals and evaluate performance against those.
Stephen Cooper IASB board member	Standard-setter	Complexities and inherent difficulties of liability measurement and differing accounting treatments. This age-old measurement problem is increasingly complex, reflecting when and what to recognise as a liability covering financial and non-financial liabilities (eg clean up costs), insurance and pensions. Current measurement problems around the use of expected values and best estimates; use of own discount rate in measurement; levels of liquidity and risk margins.
Carol Page Director, Panel Operations, Financial Reporting Review Panel (FRRP)	Regulator	Overview of FRRP: its aims and objectives; the 'consistent application' of accounting requirements: the Panel's internal procedures and international engagement. FRRP is a statutory body but will ordinarily work with companies on a consensual basis. Overall aim to ensure report and accounts of public and large private companies are Companies Act-compliant. Adopts a principles-based approach to reporting to facilitate an appropriate review of complex transactions or new developments in accounting and reporting. Risk-based approach to report selection and a focus on specific areas of accounting. Initial review and then follow-up of any non-compliance issues through Panel case officers. Can lead to a formal enquiry if non-compliance issues are not resolved.
Michael Jones Professor of financial reporting, University of Bristol	Academic	Overview of book, *Creative Accounting, Fraud and International Accounting Scandals*. Levels of flexibility within the regulatory environment (allow impression management and creative accounting) and outside the regulatory framework (giving a fraudulent view, such as fictitious transactions and misappropriation of assets). Scandals and fraud are not new but have existed since ancient times. The book provides a review of a series of scandals on a country basis; six cases were covered in detail for this presentation. Issues were raised over detection of scandals and potential auditor error. Development of a theoretical model to reduce creative accounting and fraud.

Conclusions

The fall-out from the global financial crisis still has repercussions for the global economy, banking and accounting. At the turn of 2011/2012, there remained major economic and accounting issues. Economically, Portugal, Italy, Spain and most particularly Greece were experiencing severe difficulties. At the time of writing this report, in September 2012, these problems are still not resolved. Indeed, in some ways they are getting worse with political demonstrations against austerity in both Greece and Spain. Certainly, there is still no certainty as to whether at least one country will be forced to leave the Eurozone.

In the banking sector, the immediate large-scale write-offs are now fortunately, at least for the moment, things of the past. Nonetheless, the banking sector still remains troubled. The recent banking scandal in the UK over the LIBOR rate-fixing shows that there are serious questions that need to be addressed over the appropriate way for banks to be regulated.

In accounting, the IASB seems to have survived the recent global banking crisis. Even so, in many other areas, things appear much less settled. The objectives of accounting are still fiercely debated as is the nature of the fundamental accounting statements (for example, the correct formats of the Statement of Financial Position and the Income Statement). Whether US companies will move to using IFRS is still uncertain, as is the appropriate use of fair value. Furthermore, the balance between national and international accounting standards remains unclear. For example, in the UK the recent restructuring of the Financial Reporting Council has led to what many consider to be the demotion of the UK's national Accounting Standards process which used to be carried out by the UK's Accounting Standards Board.

The speakers presented their papers against this uncertain accounting and economic background. Just as in previous years (see, for example, Jones and Slack 2009, 2010 and 2011), the speakers considered fundamental issues of the reporting framework, disclosure and measurement. This year there were again specific themes that ran across at least some of the presentations. Whereas in 2010 'the central issue discussed throughout the presentations and associated commentaries and discussion revolved around convergence towards a single set of global accounting standards or full IFRS adoption' (Jones and Slack 2010: 25), the themes in 2012 were much more diverse.

In essence, the two themes were first what happens when firms depart from strict adherence to the regulatory framework and second, the inherent complexity of accounting. The regulatory framework is designed to be flexible so that there is no fixed accounting approach to every possible situation that a company might face. Such an approach would necessitate a vast array of rules and would prevent firms from adjusting to specific environmental circumstances or new and emerging developments. Firms should, however, be providing a fair reflection of the underlying economic reality. This should be achieved through professional judgement.

Inevitably, such flexibility sometimes causes problems. What happens when a company uses the flexibility in accounting not to achieve fair representation, but to serve its own interests? One then enters the world of impression management, creative accounting and even fraud. Two aspects of this were considered in the presentations. Carol Page looked at how the Financial Reporting Review Panel, in its investigations of the accounts of companies, seeks to ensure that companies comply with the Companies Act 2006. The FRRP investigates companies' apparent non-compliance and then seeks, usually through negotiation, to see that conformance is successfully achieved. This can be seen as a monitoring role. Michael Jones also looked at regulatory non-compliance, but his viewpoint was different. He investigated cases of major breaches of the regulations – usually so great that fraud was documented and proved and then a major business scandal occurred. These two talks are thus related. In a very real sense, the effective operations of the Financial Reporting Review Panel should ensure that the number of major accounting scandals in the UK is reduced.

The inherent complexity of accounting was discussed in three very different contexts by Stephen Cooper, Richard Dunbar, and Michael Mainelli. Stephen Cooper looked at liability measurement. As the title of his presentation indicated, it has been 'a persistent and troublesome problem'. There are a number of important liabilities: financial liabilities, insurance, pensions and non-financial liabilities. In practice, these areas are incredibly difficult to quantify satisfactorily, even for professionals, as they involve substantial areas of professional judgement. This professional judgement concerns probability and expected value, discount rates, own credit and risk margins. All these areas involve considerable uncertainty.

Richard Dunbar highlighted the complexities inherent in bank reporting. HSBC's recent annual report, for example, is in two volumes and spans over 400 pages. Focusing on financial assets, rather than the financial liabilities as Stephen Cooper did, his paper provided a natural balance to

Stephen's. Richard showed how financial assets were classified into four accounting categories (Fair Value through P&L, Available for Sale (AFS), Loans and Receivables and Held to Maturity (HTM)). These classifications are inherently complex and Richard commented that the accounting treatments generally reflect the bank's own needs rather than any consistent or true and fair position.

Michael Mainelli took complexity for granted and posed a possible solution. Given that financial statements for companies and banks are increasingly complex, he called for a radical change in presentation. Instead of presenting single numbers for financial items included in the balance sheet, profit and loss, cash flow statement and notes to accounts, he suggested a new reporting and presentational model: confidence accounting. Rather than mask the uncertainty within accounts, this would bring it to the fore. Financial items would be included as ranges rather than as point items. These ranges would be accompanied by confidence levels. Thus, the latent uncertainty involved in financial valuations would be revealed and complexity would be more transparently presented.

The symposium, therefore, as in previous years, discussed issues of key importance in financial reporting. The issues of regulatory compliance and how to deal with non-compliance and the problems of how to cope with complexity are continuing long-term issues. It is likely that accountants and other business professionals will have to grapple with them far into the future. There are no simple solutions to these systematic issues.

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