Some ideas on the implementation of the International Financial Reporting Standard (IFRS) from the Central Bank perspective

Presentation of an International Accounting Standard (International Financial Reporting Standard) (IFRS) by Drs. A.G. Romero, Executive Director Bank van de Nederlandse Antillen, (Joint KPMG and BNA initiative) 8-9 april 2003

The Economist, August 17-23, 2002: “I swear….. that, to the best of my knowledge (which is pretty poor and may be revised in future) my company’s accounts are (more or less) accurate. I have checked this with my auditors and directors (whom I pay) and they agree with me.”

1. Introduction

Financial reporting in general has gained more (inter)national attention in recent months after the bookkeeping scandals of Enron, WorldCom, TYCO, Xerox, KPN Quest, and AHOLD. In a sense, this increased attention has helped all stakeholders -- be they employees, creditors, shareholders, government, board of directors, or audit firms - to become more interested in the real value of businesses. What is, or what might be the mysteries behind the figures presented in financial reports?

Financial reporting and particularly the annual reports of companies play an important role in achieving adequate corporate governance here and around the world. In recent years, the Bank has been at the forefront in promoting the implementation of sound Corporate Governance principles within the financial sector. We continue to emphasize to the managing and supervisory board members their responsibility to fully and adequately enforce the guidelines on Corporate Governance in general, and in particular, to provide more transparency through adequate information and financial reports.

Through financial reporting, the managing and supervisory board members of companies provide their shareholders and other stakeholders with the past results of the business being managed and supervised. These reports give more in-depth insight into the income statement and balance sheet, and they, therefore, help the users of these reports better understand and assess the financial performance of the business. In general terms, accountants tend to view financial reporting more retrospectively, while supervisors have to balance past performance with their perspective on the future of the institutions. It also is important to know that all stakeholders base their (investment) decisions mainly on the financial reports, thus reinforcing the importance of providing adequate and accurate information. Therefore, financial reports are a crucial management tool while at the same time, providing the board with an opportunity to explain to stakeholders the institution’s performance and achievements during a reporting period.

Since the bankruptcy of Enron, the accounting regime worldwide is being reformed rapidly to ensure that company accounts are more reliable and that they keep abreast of generally accepted accounting standards. In the United States, this reform effort led to the Sarbanes-Oxley Act, which in essence prohibits audit firms from undertaking non-audit work (consultancy services) for their audit clients, thereby limiting possible conflict of interest of the auditors and enhancing their independence. In our view, this is a very good first step in assuring stakeholders that the audited financial reports are useful and reliable instruments for assessing the financial health and the performance of companies, and we welcome this step.

A publication of ‘Bank en Effectenbedrijf’ (November 2002)[1] contains an interesting article on why the informational value of financial reports became more tainted by external circumstances and, most specifically, what propelled company scandals in the United States.

One of the first factors that affected the financial reporting of companies was the collapse of the stock markets after years of extraordinary growth due to ‘speculative’ investments in internet companies and in the telecom sector. Investment portfolios and business results linked to performance in these sectors in the four years preceding 2000 grew without apparent limit until the market sentiments turned against these sector-specific investments during 2000. After three years of commotion in the markets, we witness many cases today where not only institutional investors but also many individuals have seen their portfolio value reduced to only a fraction of what it was worth during the ‘good days’. This loss of portfolio value had to be compensated one way or the other and this led to certain notorious cases of ‘creative accounting’.

A second reason for corporate scandals is that many senior company officials in recent years have made a greater part of their remuneration dependent upon the outcome of the company’s share-value through straightforward option
bonuses. Under these circumstances, senior managing board members have a greater than normal personal interest in better short term performances of the (stocks of) institutions being managed, even if this means that the underlying information is incorrectly presented in the financial reports. In fact, since the remuneration of senior management depends largely on the company’s performance, management is more inclined to put aside accounting standards to reap the fruits from misleading information/reports.

Both factors contributed greatly to the scandals we have seen in recent years. Therefore, both the option bonuses and the over-concentration of investments in certain sectors or companies should be limited through supervisory guidelines. We will elaborate on that later.