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Research Project 1: Exploring the Horizons of Financial Reporting

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ABSTRACT

In response to an increased demand for information by capital market participants (IFAC, 2021), there is a global move to increase reporting requirements around items relevant to enterprise value such as sustainability and intangibles. As policymakers explore these horizons of reporting, the challenge is to enhance relevance without sacrificing the unique competitive advantage of regulated financial reporting as the most credible information source in the marketplace (Davern et al., 2019).

Using focus groups and stakeholder interviews, we explore the “reporting pyramid” from full recognition and measurement down through mandated and voluntary disclosure. Our findings highlight the nuances in issues of measurement uncertainty and the credibility of financial reporting. We evidence that recognition and measurement heightens scrutiny over the quality of the underlying data that is the input to financial reporting. This provides a strong motivation for increased recognition and measurement as opposed to simply expanding disclosures.

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We find in the case of reporting related to environmental sustainability and carbon, that the measurement uncertainty is driven more by regulatory uncertainty that makes assessing financial impacts challenging, whereas by contrast the physical characteristics (e.g., of carbon sequestration or carbon emissions) can be measured with comparatively high degrees of precision.

Further to pushing for greater recognition and measurement we find evidence suggesting recognition where measurement numbers are “soft” is informative to investors, provided there is clarity around the extent to which reported information is “soft” as opposed to “hard” or objective. This has implications for the scope for preparers to exercise judgment in financial reporting, and a corresponding increased importance for expert assurance. It also emphasizes the role of principles versus narrow rules in regulating reporting, while ensuring comparability and consistency are not unduly compromised.

In summary, we see a bright future for financial reporting, on a broader range of items than has traditionally been the case, and the essential role of professional judgement in all aspects of financial reporting (preparation, assurance, and use).

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