



Australian Government
Australian Accounting Standards Board

Memorandum

Subject:	ICAS/EFrag Research Paper	Meeting:	AASB meeting 151
Contact(s):	Teng Zhou tzhou@aasb.gov.au (03) 9617 7642	Agenda item:	12.2
		Date:	5 April 2016
		Decision-Making	Low
		Project status:	Report to Board

Objective of this paper

- 1 The objective of this paper is to:
 - (a) note the Institute of Chartered Accountants of Scotland (ICAS)/EFRAG Research Paper *Professional Investors and the Decision Usefulness of Financial Reporting*; and
 - (b) decide whether to take any action and, if so, what steps to take.

Attachments

- Agenda Paper 12.3 *EFRAG Research Paper* March 2016
- Agenda Paper 12.4 *Comments from Ann Tarca on the EFRAG Research Paper*

Summary of ICAS/EFrag Study

- 2 In March 2016 the ICAS and EFRAG published a research report on professional investors' views on and use of financial reporting information.
- 3 The report identifies that:
 - (a) professional investors attempting to value the firm assessed financial accounting information as more relevant to their decision making than did investors who were attempting to assess the performance of management;
 - (b) the existence of accounting-based compensation contracts has no discernible effect on representational faithfulness;
 - (c) professional investors view income statement line items as more relevant than statement of financial position line items; and
 - (d) professional investors view the corporate governance of a firm as a key determinant of the representational faithfulness of financial accounting data.

AASB Staff Comments

- 4 Staff think that the research method is sound and addresses the intended research questions. Staff also note the following.
- (a) To identify the usefulness of accounting information, a comparison between investors' objectives on firm valuation and managerial performance is too narrow:
 - i. to value a firm, investors will ask a broad range of questions including how good the management is, how good the business is, and where the funding is from; and
 - ii. managerial performance assessment is part of the firm value assessment.
 - (b) It is too simplistic to draw a conclusion that professional investors view information in the income statement as being more relevant than balance sheet line items. A binary comparison among aggregated line items on the income statement and balance sheet does not tell us much detail about why such items are important or not for professional investors.
 - (c) Subclasses and notes of accounting information related to the statement line items could be highly relevant to professional investors. However, the usefulness of subclasses and notes of accounting information is not investigated by the study.

Comments from the IFASS Meeting

- 5 The research report was discussed in the April 2016 IFASS meeting in Toronto. Some observations of the discussion were noted by the Chair:
- (a) the EFRAG research could focus on how well the other comprehensive income statement could be understood by information users;
 - (b) the EFRAG statement of how the profit and loss statement is more important than the balance sheet holds is questionable when viewed across different industry sectors;
 - (c) the results only hold for healthy manufacturing companies, which are privately held, but is not necessarily true for listed enterprises;
 - (d) the information needed for stewardship may be much more granular given at entity or segment level;
 - (e) there is a need to have more discussion of the implications of the EFRAG research; and
 - (f) concern about whether there would be much left in the income statement if all changes outside management control were removed "when investors have the objective of assessing managerial performance.

Staff Recommendation

- 6 Staff think that, if the AASB were to contribute to the debate through its own research, we would focus on:
 - (a) how professional investors use accounting information to help them answer a broader range of questions, including: management quality, quality and sustainability of the business, and the funding model; and
 - (b) what subclasses and notes of accounting information are important to professional investors.
- 7 Given the demands that the AASB is planning to make on the time of investors in 2016 and the extent of available AASB, staff estimate that any such research in Australia would need to wait until at least calendar 2017.
- 8 Staff recommend reviewing the AASB's whole research agenda in the June or August 2016 Board meeting with a view to deciding whether to include a study along the lines of the ICAS-EFRAG research, including whether we would partner with another organisation and, if so, who. If the Board decided to undertake the research, the user forum planned for November 2016 might be a good opportunity to launch the idea of undertaking such a study.

Question 1 to Board members

Does the Board agree with staff recommendations?