F1 Chapter 1 The Regulatory Environment

Regulation of financial reporting

Entities are required to produce financial statements to be made available to the public. There are various laws and regulations regarding the preparation of these statements.

Definition

Financial reporting

The process of producing financial information to be used by a company's stakeholders.

Stakeholders

Any group who has an interest, or a stake in what a company is doing.

Key stakeholder groups that use financial statements include:

- Shareholders – A company's owners
- Management – Directors running a company
- Lenders – Institutions like banks who lend money to companies
- Governments – National governments and tax authorities

The need for regulation:

- Ensures financial information is reliable
- Enables consistency of information across multiple companies

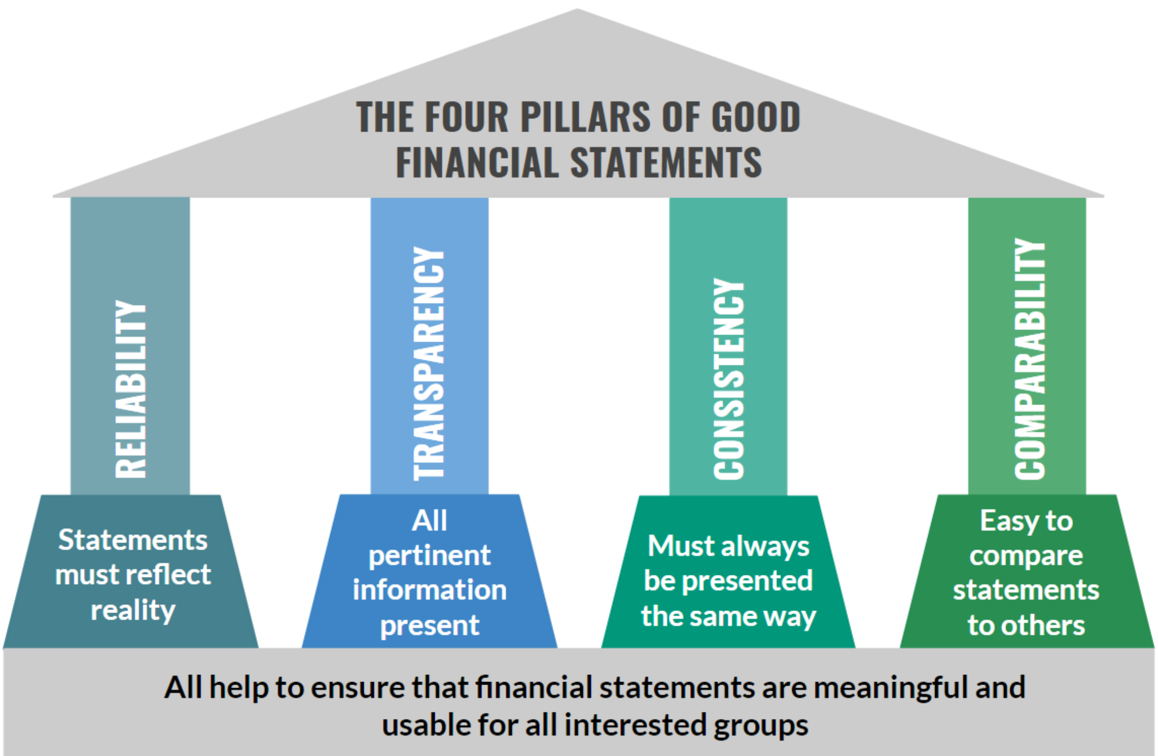
The financial statements	
Statement of financial position	Shows an entity's assets (e.g. buildings), liabilities (e.g. bank loans) and equity (e.g. the amount owed to shareholders).
Income statement	Shows income (e.g. sales) and expenses (e.g. bills) to give a profit or loss for the period.
Statement of cash flows	Shows the cash usage of an entity in terms of operating, investing and financing activities.
Notes to the accounts	Explains the practices used in the accounting period.

Accounts can often include other information:

- Chairman's statements
- Strategic review
- Sustainability/environmental review
- Governance review/statement

The four pillars of good financial statements

There are four key principles to making financial statements useful to users:



Elements of the regulatory environment

Local regulatory frameworks

The regulatory framework within a particular country is governed by three main factors:

- Accounting requirements of the national law
- Accounting standards applying in that jurisdiction as set by local accounting regulators
- Accounting requirements laid out by that country's stock exchange

International regulation

In addition to local regulation there will be an international dimension consisting of:

- The requirements of relevant international accounting bodies
- International financial reporting standards
- A **conceptual framework** developed at an international level

The extent of use of international accounting standards varies from country to country but the influence of international accounting standards is increasing.

Gradual approach to international convergence

The process of adopting the international accounting standards involves a gradual approach of transition and adaptation for companies and governments.

Generally accepted accounting practices

Combining all of the above elements means that within any country there is a generally agreed approach to accounting. This will change over time due to:

- The gradual adoption of international standards
- The introduction or updating of local standards

Definition

Generally Accepted Accounting Practice (GAAP)

The standard framework of guidelines for financial accounting used in any given jurisdiction. These include the standards, conventions, and rules that accountants follow in recording and summarising and in the preparation of financial statements.

Regulation from country to country

Differences in law and tax	Each country will have its own laws and tax policy, meaning each country will need a different regulatory approach.
Nature of the political system	The political system in place may impact the degree of control over accounting information exerted by the government.
History and culture	The particular business culture may impact disclosure requirements.
The nature of the shareholding public	The typical types of shareholders within a country can lead to differences in requirements of the statements.

This creates the following problems for multi-national entities:

- Financial statements may need to be prepared on a different basis in different countries
- Difficult for investors to interpret and compare results
- Greater administrative burden
- Obstacle to expanding into new markets
- Difficult to assess potential foreign acquisitions

The process of developing international accounting standards occurs against the backdrop of a **conceptual framework** for accounting.

Definition

Conceptual framework

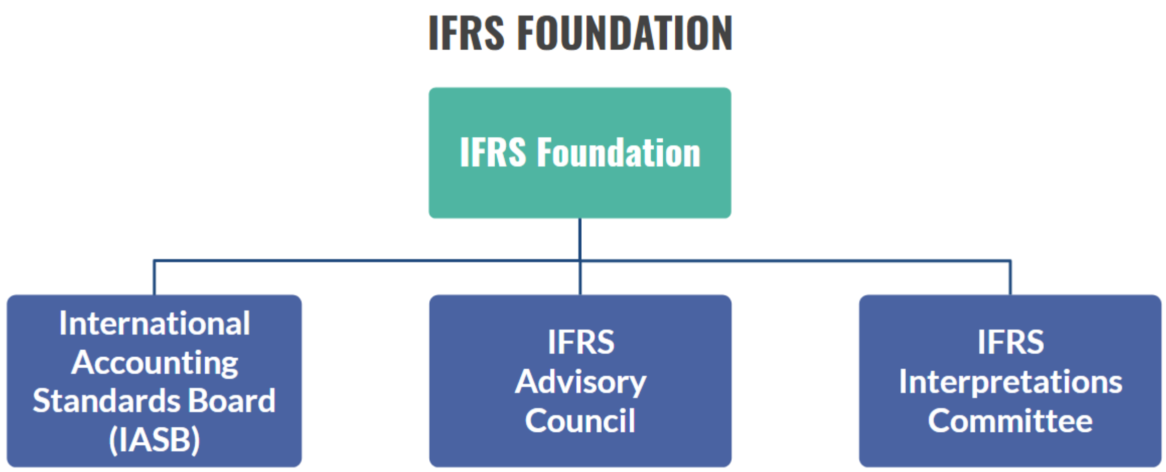
A set of underlying principles from which accounting standards are derived.

Principles-based and rules-based approaches to regulation

Principles-based	Accounting standards emanate from a set of broad principles (known as a conceptual framework)
Rules-based	Regulation is based on a specific set of mandatory rules.

International Accounting Standards Board (IASB)

The IASB are responsible for developing and managing the international accounting standards.



International Financial Reporting Standards (IFRS) Foundation

The body given the responsibility of developing global accounting standards to ensure transparency and comparability in published financial statements.

Core objectives of the IFRS Foundation	
1	Develop a single set of globally accepted financial reporting standards
2	To promote the use and rigorous application of those standards
3	Take account of the needs of a range of sizes and types of entities in diverse economic settings
4	To encourage adoption of IFRSs through the convergence of national accounting standards and IFRSs

Trustees	22 Trustees appoint the members of the IASB, the IFRS Advisory Council and the IFRS Interpretations Committee.
Funding	Funding is provided by the International Federation of Accountants (IFAC),professional accountancy organisations, financial institutions and accounting firms.

International Accounting Standards Board (IASB)

The IASB are responsible for developing and managing the international accounting standards. They liaise directly with national bodies to promote the convergence of national accounting standards.

Key roles of the IASB	
1	Issue exposure drafts
2	Prepare and publish IFRSs
3	Approve interpretations prepared by the IFRS Interpretations Committee

Note: connection between IFRSs and IASs

- **IFRSs** – Accounting standards prepared under the current system of international regulation
- **IASs** – Accounting standards prepared under the previous system of international regulation, all of which have been adopted by the IASB

IFRS Interpretations Committee

The Interpretations Committee provide suggested interpretations of standards in particularly complex scenarios not covered in the standard itself.

Procedure of IFRS Interpretations Committee	
1	Issue a draft interpretation for public comment
2	12 voting members take a decision on finalising the interpretation
3	Gain IASB approval of the interpretation and publish

IFRS Advisory Council

- A minimum of 30 members, appointed for terms of 3 years
- Communicate feedback on ongoing projects, for new and revised standards, from users to the IASB
- Advise on which projects should be on the IASB's agenda

Intentional Organisation of Securities Commissions (IOSCO)

The IOSCO is responsible for promoting consistency between the stock market regulators of different countries. It consists of various national stock market regulators (**securities commissions**).

Stock markets	Exchanges where the issuing and trading of equities (stocks of publicly held companies), bonds and other sorts of securities takes place.
Securities commissions	Organisations that have the task of regulating national stock markets.

Core objectives of IOSCO	
1	Ensure international standards of regulation in securities markets
2	Increase protection of investors and foster confidence in securities markets
3	Exchange their experiences with a view to strengthening securities markets

IOSCO and the IFRS Foundation have a series of protocols aiming to improve consistency in the implementation of IFRSs:

- Information sharing regarding the use of IFRSs in jurisdictions across the world
- Feedback on the impact of IASB standards on securities regulators
- Discussion on enforcement of IFRSs
- Obtaining input from securities regulators regarding time-sensitive IFRS implementation issues

International Integrated Reporting Council (IIRC)

Integrated reporting (<IR>) provides an insight into how a business intends to utilise the resources at its disposal to create value in the short, medium and long term.

The IIRC aims to provide a clear, concise, comprehensive and comparable integrated reporting framework.

And finally…

Stop!

By this stage you should know:

- The need for the regulation of financial reporting
- The elements of the framework for regulating financial reporting

- The structure and goals of the IASB
- The procedure followed by the IFRS Interpretations Committee
- The role of IOSCO and its relationship with IFRSs
- The role of the International Integrated Reporting Council

Got it?

If not, go back and re-read the study text before moving on.

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