Shaping global accounting standards

Financial reports can be used both to estimate future cash flows associated with debt and equity capital and to provide information about the management and oversight of the firm. Research by ***Stefano Cascino*** *and colleagues indicate that objectives make an important difference to the type of information investors gather and how they use and value that information. This has contributed to an increased emphasis on the stewardship principle as a cornerstone of financial reporting globally.*

Impact Case -- Research Excellence Framework (REF)

What was the problem?

Financial statements provide essential information about a firm's performance. Stakeholders that provide resources to firms, whether they are shareholders, banks, or suppliers, rely on financial accounting information to support their decisions.

International Financial Reporting Standards (IFRS) are based on the International Accounting Standards Board's (IASB) *Conceptual Framework for Financial Reporting*. These common standards for financial reporting enhance global corporate transparency, strengthen accountability, and improve capital allocation. Over 50,000 companies listed in 166 countries are required or permitted to use IFRS to prepare their financial statements.

The *Conceptual Framework* establishes a comprehensive set of concepts to assist the IASB in producing and revising accounting standards. The framework ensures there are consistent accounting policies and assists firms, auditors, and users (equity investors, creditors, lenders) in preparing, understanding, and interpreting financial statements.

Financial reports can be used both to estimate future cash flows associated with debt and equity capital (the "valuation role"); and to provide information about the management and oversight of the firm (the "stewardship role").

When the *Conceptual Framework* was revised in 2010, the IASB removed the principle of stewardship as a separate objective. Instead, it focused on a single "decision usefulness" objective for financial reporting, intended to cover both the valuation and stewardship objectives of financial statements.

However, some national standard-setters and accounting regulators expressed concern this would impair the usefulness of financial reporting information for holding the managers of public companies to account. High-profile corporate failures underscore the importance of managerial accountability and effective stewardship as fundamental concerns for investors, accountants, and regulatory and standard-setting bodies.

What did we do?

Our research investigated whether the stewardship objective of financial reporting could be subsumed under a single overall "decision usefulness" objective encompassing *both* a valuation objective *and* a stewardship objective.

From a systematic review of academic literature on the use of financial information, we found that research exploring the effects of stakeholders' objectives on how useful they rated accounting information was limited. The review concluded that there is significant variation in capital providers' use of information, and that they sometimes have competing objectives when using different sources of information in conjunction with financial statements.

To address the lack of direct evidence on this issue, we designed a series of innovative survey experiments. We conducted 81 face-to-face interviews with investment professionals in 16 countries. This examined their assessments of the usefulness of the *same* financial reporting information for *different* purposes. The results indicated that objectives make an important difference to the type of information investors gather and how they use and value that information. In particular, the research showed that the relevance of financial reporting information is contingent upon whether it is being used for stewardship or valuation purposes. When assigned a stewardship objective, investors prefer information that excludes factors beyond managers' control; for valuation, they prefer information that helps them in forecasting future cash flows and understanding the business.

The findings of this research raise questions about the feasibility of a truly "general purpose" financial accounting regime prepared under a single "decision usefulness" objective. Specifically, these findings strongly challenged the focus in the 2010 *Conceptual Framework* on the valuation role alone by highlighting the potential shortcomings of assuming that a single set of financial information can serve multiple purposes. One size does not seem to fit all in financial reporting. Who is assessing the information shapes how useful the information is for them.

What happened?

This body of research has helped to restore standard-setters' focus on both aspects of financial reporting. The evidence it provided catalysed and informed discussions in the international financial sector in the run-up to the IASB's publication of its revised *Conceptual Framework* in 2018, and provided independent evidence reviewed by the IASB as part of the revision process. In line with the research recommendations, the revised 2018 version of the *Conceptual Framework* emphasises the importance of financial reporting information in assessing "stewardship" – managers' responsibility to protect shareholders' interests.

The Institute of Chartered Accountants of Scotland (ICAS) and the European Financial Reporting Advisory Group (EFRAG) made use of the research to lobby for the reintroduction of the stewardship objective as a central tenet of the *Conceptual Framework*. Responses submitted by other major professional bodies – including the Financial Reporting Council – also cited the research and were notable in strengthening the case for these changes.

The research findings were presented at the IASB's board meeting in early 2014, and its Exposure Draft subsequently suggested increased emphasis on the provision of information for assessing managerial performance. The stewardship objective received much more emphasis by the time the final revised draft appeared in 2018.

The 2018 *Conceptual Framework* specifically clarifies why information used in assessing stewardship is required to achieve the overall objective of financial reporting. In particular, it states that users need information about the resources of an entity, not only to assess that entity's prospects for future net cash inflows, but also to understand how effectively and efficiently management have discharged their responsibilities.

As a result of these changes to the *Conceptual Framework*, the research has contributed to an increased emphasis on the stewardship principle as a cornerstone of financial reporting globally. Since the *Conceptual Framework* provides the fundamental principles guiding the IASB's standard-setting process, the impact of its revision extends to individual financial reporting standards and their post-implementation assessments. Our work has therefore contributed to improvements in regulatory practice, including improving regulators' understanding of the ways in which capital providers use financial reporting information. It also has very wide-reaching indirect implications for the financial reporting practices of companies globally, as well as auditors, investors, lenders, and many other stakeholders.

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Notes:

- *This blog post appeared first as LSE's Research Excellence Framework impact case study.*
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