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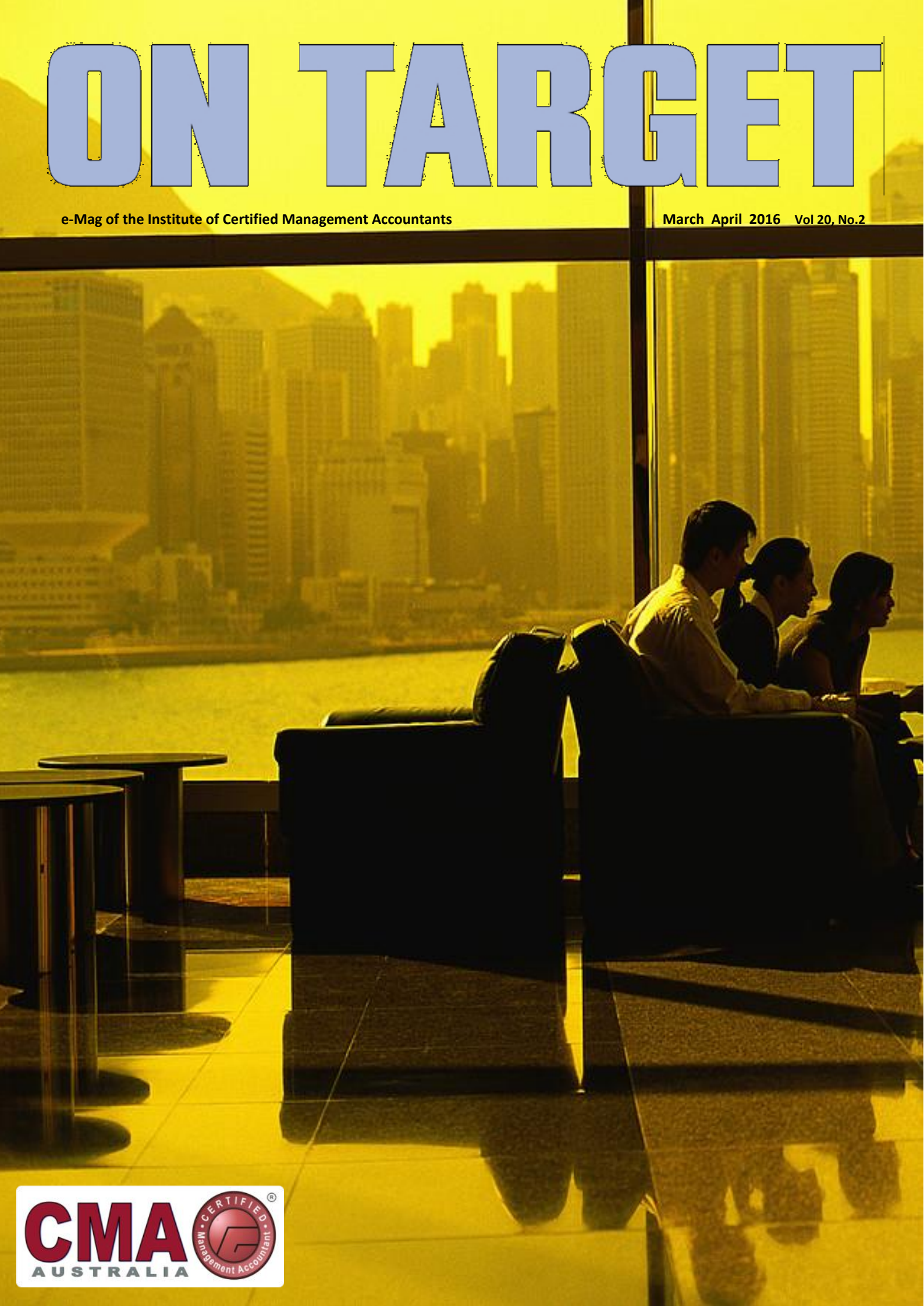

CMA AUSTRALIA

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CEO Message

Applying Disruptive Technologies to Audited Financial Statements

Professor Janek Ratnatunga, CMA, CGBA
CEO, ICMA Australia

A financial statement audit is the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The auditor's report must accompany the financial statements when they are issued to the intended recipients. The principal recipients are the shareholders, especially of listed companies where the audited financial statements are attached to the Annual Report of the company. In today's economy, much of the shares in listed companies are held by large shareholder investment groups such as pension funds. However, there are a significant amount of ordinary (retail) shareholders. Both these shareholder groups depend of the information provided in the financial statements for managing their portfolios.

Audits have become increasingly common as the complexity of the two primary accounting frameworks, *Generally Accepted Accounting Principles* (GAAP) and *International Financial Reporting Standards (IFRS),* have increased; and because there have been an ongoing series of disclosures of fraudulent financial reporting by major companies.

The problem is that *Audited Financial Reports*, that have not changed in their presentation format, or in their method of delivery, since the dawn of the industrial era or the age of the corporation (about 1850) when tangible assets such as land and machinery were the engines of growth. As a result, the Balance Sheet still shows that it is mainly these tangible 'non-current' assets' that drive business value. Today's big businesses are knowledge-economy companies such as Google, Apple, Facebook, Microsoft, Uber, Air B&B, etc., with significant intangible assets which are not reported in the financial statements prepared under GAAP and IFRS. This has resulted today in knowledge-economy companies reporting audited financial statement (book) values that are widely divergent of their market values.

Despite this divergence between market and book values, readers of financial statements have little option but to rely on the numbers certified as 'true and fair' by the auditors. Very little analyses can be done on the veracity of the reported numbers by the *readers* of the financial statements. The reason is that the audited financial statements are provided to the intended recipients in *paper (word or pdf) format*. In large companies these are attached to the *printed* Annual Reports that contain other reports such as the chairpersons statement; directors' reports; operating and financial reviews and increasingly corporate social responsibility (CSR) reports.

Once received in paper form, or as part of a printed and bound document, very little analysis can be done with these audited financial reports. If the intended recipients want to analyse the reported numbers beyond the operating and financial reviews provided in the Annual Report itself; they would first need to re-key the numbers in the profit and loss (P&L) account; balance sheet (BS); cash flow (CF) statement and 'notes to the accounts' into excel spreadsheets. Then they would need to: (1) adjust the P&L performance numbers and BS asset values based on the 'notes'; (2) undertake financial ratio analyses including trend analyses and interfirm comparisons; and (3) make estimations of future income based on assumptions of future trends in sales, costs and investments.

Serious financial analysts can undertake further more in-depth analyses. They can use the CF Statement as a basis for calculating 'free-cash flow' (after adjusting for investment growth in fixed assets and working capital) in order to calculate the '*shareholder value-added (SVA)'* and the *'economic value added (EVA)'* of the company. For these last two computations, the *weighted average cost of capital* (WACC) needs to be ascertained; which is not reported directly in the financial statements.

All of the above analyses require a substantial amount of effort by the readers of these hard-copy *Audited Financial Reports*. However, even if they were to spend considerable time and effort to analyse the financial statements; they still must rely as the starting point of their analysis the numbers as reported in the financial statements. They must take a 'leap of faith' that these reported numbers have been arrived at by the preparers of the financial statements (and the auditors) by correctly interpreting GAAP and IFRS!

Unfortunately, this is often a too big 'leap of faith''; because despite the introduction of IFRS and IAS worldwide, the approach to accounting standards still varies in different countries. For instance, the United States still employs a rule-based approach, while Europe follows a principle-based approach. Some accountants claim that compliance with rules (form) does not mean reports present a true and fair view (substance) of a company's situation. Others believe that both approaches are subject to vagueness and manipulation as the foundation upon which accounting reports and related standards are based upon are fundamentally outdated, especially in the measurement and valuation of assets.

This vagueness and manipulation is very much present in rules pertaining to assets, with issues such as (1) how companies' account for goodwill; (2) when should expenses be capitalized into assets, or (3) the current value of assets, continuing to be

controversial. This flexibility in accounting policy choices provided by the vagueness of rules opens the door to opportunistic behaviour of managers seeking to maximise their own utility so that accounting numbers may not necessarily reflect the real operating performance of the firm. For example, a study examined the extent to which firms make policy choices in five areas that either align with US GAAP or with IAS options that are not acceptable under US GAAP. The five areas were tangible assets, available-for-sale marketable securities, identifiable intangible assets, research and development expenditure and goodwill amortization periods. The firms studied were domiciled in the United Kingdom, France, Germany, Japan and Australia, and it was found that foreign listing (especially in the US) and leverage were significant factors for policy choice.

The problem for the readers and analysts of financial statements is that there is *no transparency* as to how these policy choices were made. The notes to the accounts present the policy choice ultimately made as a 'fait accompli' rather than giving readers a method of ascertaining what the numbers would look like if an alternative choice was made.

The only *technological reason* that the results of alternative policy choices and their impact on earnings 'bottom line' in the P&L and the shareholder value 'bottom line' in the BS cannot be provided is because we are clinging onto an (outdated) print-based presentation of the financial statements.

In the news industry, print media is dying, suffering another year of circulation and revenue drops and staff firings; and while the digital audience is surging, readers apparently do not spend much time surfing the web pages of print sites. At the start of 2015, 39 of the top 50 digital news websites have more traffic to their sites and associated applications coming from mobile devices than from desktop computers. These changing news habits have a tremendous impact on how and to what extent a country functions within an informed society. So too does the state of the organizations producing the news and making it available to its citizens.

The Annual Report should be regarded as an item of 'news', principally to the company's shareholders. Just as different reporters have different interpretations to how the news is reported, researchers have shown that different account preparers and auditors make different policy choices when alternatives interpretations are available. Today, we have the technology to easily show the readers of Annual Reports what the results of alternative policy choices and their impact on the financial statement 'bottom lines' would be. *In other word the Annual Report should go truly digital.*

This does not mean that a pdf of the Annual Report should be made available digitally. Obviously, this is very common practice. *What is being recommended is that different interpretations of the Financial Statements in the Annual reports be made available digitally to the readers in a format such as Excel, so that the readers themselves can undertake various financial statement analyses of these different reports.*

The reports and their order of presentation are suggested as follows:

1. *Cash Flow Statement.* Cash is cash and difficult for any numbers manipulations.

2. *Accrual Based Financial Statements.* This is the traditional mode of presenting financial statements and is based on GAAP and the Historical cost doctrine. Some 'Earnings Management' is possible in the area of discretionary accruals, and it is hoped that the auditors are able ensure that such manipulations are kept to a minimum.

3. *IFRS Based Financial Statements.* Here digital technologies enable *multiple reports* based on different interpretations of IFRS. To avoid information overload, ideally not more than 5 reports should be generated; and that too *only if there are significant variations* in earnings results and book values between different interpretations of a IFRS standard. Areas where different interpretations of standards may result in significant differences in reported numbers are: revenue recognition; accounting for leases; fair-values of major tangible assets, available-for-sale marketable securities, identifiable intangible assets, research and development expenditure and goodwill amortization periods. If the earnings or book values would differ substantially when 'rules' were applied instead of 'principles' (or vice-versa) these should also be shown. Here significant 'Earnings Management' is possible; especially in the area of obtaining opinions of experts as to fair-valuations. Therefore, the auditors should ensure that companies do not

cherry-pick the multiple reports in such a way as to show the public only the results they want published.

4. *Calculation of Multiple Market to Book Ratios.* Providing this information goes beyond that currently covered in current financial statements. Analyst are of the view that there is value in book value (despite the many distortions and vagueness of such values); such as calculating market-book value multiples and comparing within industry averages. One could argue that providing multiple reporting result that are significantly divergent with different interpretations of IFRS standards would enable a better understanding of how these compare with a representative industry standard; and form a more informed basis for value investing. In time, industry 'market-book ratios' under different IFRS interpretations may be available.

5. *Valuation of un-identifiable intangible assets.* This is more of a 'wish list' as IFRS is silent on such valuations. Whilst there are many models developed to value intangibles and even value 'capabilities'; these have still to find its way to conventional balance sheets. In its simplest form, the valuation of un-identifiable intangible assets would be the difference between market value on balance sheet date and the book value on that date obtained under different IFRS interpretations. One needs to recognise that market value is essentially supply/demand, and arguably based on the marginal supply/demand on a given day (the balance sheet day). Therefore, the definition of intangible assets needs to be fairly all-inclusive, and include such factors as the risk premiums incorporated into market price, such as illiquidity premiums, which would not be reflected in conventional definitions of intangible assets.

6. *Calculation of Cost of Capital.* Calculations of the company's cost of equity; cost of debt and the weighted average cost of capital (at balance sheet date) should be provided; so that advanced financial analysis of the multiple IFRS reports can be undertaken.

Such reporting may make the requirement for an auditor to give a single 'True-and Fair' opinion on a single set of financial statements unnecessary. In the new digital regime that is being recommended, once the (multiple) financial statements are prepared by the accountants of the company, the auditors need to only undertake: (1) planning and risk assessments of the company to gain an understanding of the business its environment in order to assess whether there may be risks that could impact the financial statements; (2) internal controls testing to assess the effectiveness of an entity's suite of controls, concentrating on such areas as proper authorization, the safeguarding of assets, and the segregation of duties; and (3) substantive procedures that involves a broad array of audit procedures to confirm the veracity of the transactions that give rise to the reported numbers (i.e. the historical costs).

Once these basic audit stages are completed, the alternative interpretations of GAAP and IFRS can be presented digitally as alternative valuation outcomes with the auditor attesting to the fairness of presentation of the (multiple) financial statements and related disclosures based on each interpretation.

Further, the requirement of an auditor to give a single audit opinion on a set of financial statements can be replaced the preparers of the accounts making it easy for the readers by the use of 'emoticons' to signify performance in the key business areas. For example, a number indicating 'above average' performance can be accompanied by a smiley face, etc. This is not an outlandish idea. A significant number of studies in the in the financial environment suggest that using cartoon graphics (emoticons) may be superior to conventional methods in both their communication and decision making qualities. Possible emoticons can be as follows:

As one can see, no explanation is required as to the emotional impact of a number that is followed by one of the above emoticons. Of course, the idea of an external auditor providing an opinion whether a figure is over/under performance (regardless of whether using emoticons or words) could be seen as being outside of their skillset and could be seen as highly subjective. Subjectivity will be diminished if the emoticon can be attached to a ratio, in which one has controlled for size, therefore inter-firm comparisons can be made.

There will be concern that the development of Multiple Reports on different interpretations of IFRS will be a time consuming task for the account preparers and the auditors, and therefore that costs will escalate. However, once the basic GAAP statements based on the historical cost doctrine are ascertained, the adjustments required by IFRS on areas such as revenue recognition; leases; fair-values, marketable securities, intangible assets, R&D expenditure and goodwill, etc. will need to be done anyway by companies. Once

this information is collected, simple algorithms can be developed to generate the Multiple Reports based on different interpretations of IFRS, and the application of 'rules' vs 'principles'. These algorithms will automatically change not only the numbers in the P&L and BS, but also the Notes to the accounts.

Such an approach to the presentation of financial statements would be truly disruptive to the traditional account preparation and the audit functions. There may be an argument that preparing such multiple reports will be cost prohibitive; but again this again is a view of someone who has not grasped the power of the disruptive technologies we have at our disposal today.

Food for thought!

Professor Janek Ratnatunga, CMA, CGBA

CEO, ICMA Australia

Members Announcements

The Certified Global Business Analyst (CGBA) Qualification

Advanced Recognition for ICMA Members only

This qualification is tailored to senior managers who have degrees or professional qualifications in all business fields *(marketing, management, finance, banking, accounting etc.).*

To obtain the *Certified Global Business Analyst (CGBA)®* professional qualification, participants undertake only the Strategic Business Analysis (SBA) module of the CMA preparatory program.

It is open for those who have a degree or professional qualification in any business discipline (both accounting and non-accounting). A participant must have at least 5-years of senior business experience to enrol in program. The assessments done are the case studies within the *Strategic Business Analysis* course module.

As such as all ICMA members have completed the above module in their CMA preparatory studies; this designation is automatically available to all CMA for the payment of a fee.

The fee for the CGBA certification is A$ 150 for three years use of the post-nominals CGBA.

Please note that annual membership in the ICMA (at either the FCMA, CMA, AMA, GMA, RBA, RCA, CAT or MAA levels) must be maintained during this period. The *Management Accounting Affiliate (MAA)* membership of ICMA is an open membership for all individuals (accountants or not). If you are not a member of ICMA; then join at least as an MAA, by completing the membership application form.

For more information, and downloading an application form, see here.

Managing Risk from Global Currency Fluctuations - Key Challenge for Corporate Treasurers

With currency shifts making a significant impact on company profits, Deloitte surveyed 133 global corporations on the challenges that 2016 will present in managing currency risk effectively. Over half (56 percent) of respondents to the **2016 Global foreign exchange (FX) survey** report that lack of visibility and reliability of FX forecasts is the biggest challenge in managing FX risk.

The lack of visibility could stem from the fact that nearly one third (31 percent) of corporations rely on three or more sources to identify exposures.

"If you can't see it, you can't manage it. Without accurate measurement, value erosion from negative currency rate movements can't be anticipated or prevented. The challenges in reporting on FX risk have always been around but as companies become ever more international, and a period of relative calm in the FX markets has turned unsettled, this is likely to have an even greater impact," said Karlien Porre, partner in Deloitte UK's **Global Treasury Advisory Services** practice. "How can strategies be developed effectively if the exposure risk information is not being used to shape year-on-year performance as opposed to just the here-and-now? Only 11 percent of those surveyed cited managing year-on-year financial performance as a primary hedging objective."

While more than half of respondents (63 percent) feel that the board and executives receive sufficient information on FX exposure and risk management, only 41 percent report tracking impact on gross margin and other profitability measures such as earnings per share impact.

Nearly a quarter (21 percent) of respondents do not track FX risk management performance at all. Contributing to the challenge of identifying FX exposures is the lack of automation with 62 percent of survey respondents indicating that they use manual forecasts. In fact, inaccurate forecasts, poor communication on changes in the forecasts, and non-transparent exposures make up the top-three sources of ineffectiveness in managing FX risk

"Chances are you are going to hedge less if you don't believe the forecasts. The survey findings show a direct correlation between levels of automation and confidence in these forecasts. Manual information and processes cause late and unreliable forecasts. Therefore corporate treasurers need to share these challenges with executives and global teams, along with a recommendation for investment in the tools and technology to alleviate the problem," added **Niklas Bergentoft**, director at Deloitte & Touche LLP, Global Treasury Advisory Services for **Deloitte Advisory**.

"Conversely, boards should push back on treasurers for greater visibility into stress tests, better staple reporting, and more complex analysis. Companies could be taking a hit now by not supporting the need for treasury's roles to change."

The findings of Deloitte's 2016 Global Foreign Exchange Survey are consistent with the results of the**2015 Corporate treasury survey** where the need for better systems to bring exposure visibility and management of FX risk to the attention of boards was a key challenge a year ago. This year's survey also covers effectiveness of centralized and decentralized models, hedging strategies and transaction exposures, and was created in response to recent FX volatility impact on businesses.

About Deloitte Advisory

Deloitte Advisory *helps organizations turn critical and complex business issues into opportunities for growth, resilience, and long-term advantage. Our market-leading teams help our clients manage strategic, financial, operational, technological, and regulatory risk to maximize enterprise value, while our experience in mergers and acquisitions, fraud, litigation, and reorganizations helps clients move forward with confidence.*

Culture is a Top Priority for Business Leaders

Facing increased pressure to deliver more growth and productivity while addressing workforce mobility trends and skills shortages, 87 percent of business leaders cite organizational culture and employee engagement as their top challenge, according to **Deloitte's Global Human Capital Trends 2015 report**. Responding to this need, Deloitte developed **CulturePath™, a culture-change solution** that enables companies to measure their culture, pinpoint strengths and gaps, and drive behaviors needed to achieve critical business objectives.

*"Organizational culture is top-of-mind for the C-suite today because business is changing more rapidly—and is more competitive—than ever before. To thrive in this environment, companies must understand their employees' beliefs and motivations, and connect those emotionally-influenced decisions and actions to business strategy. Organizations that align people to purpose are more engaged and better able to achieve key business goals." **Anthony Abbatiello**, principal, Deloitte Consulting LLP*

Using an analytics-driven diagnostic, CulturePath™ measures eight specific indices that help the leadership and HR professionals within an organization understand the company's current culture. This includes four foundational attributes that are core to achievement of specific business strategies—collective focus, risk and governance, external orientation, and change and innovation. Plus, four differentiating attributes tied directly to behavioral motivations and emotions—courage, commitment, inclusion, and shared beliefs.

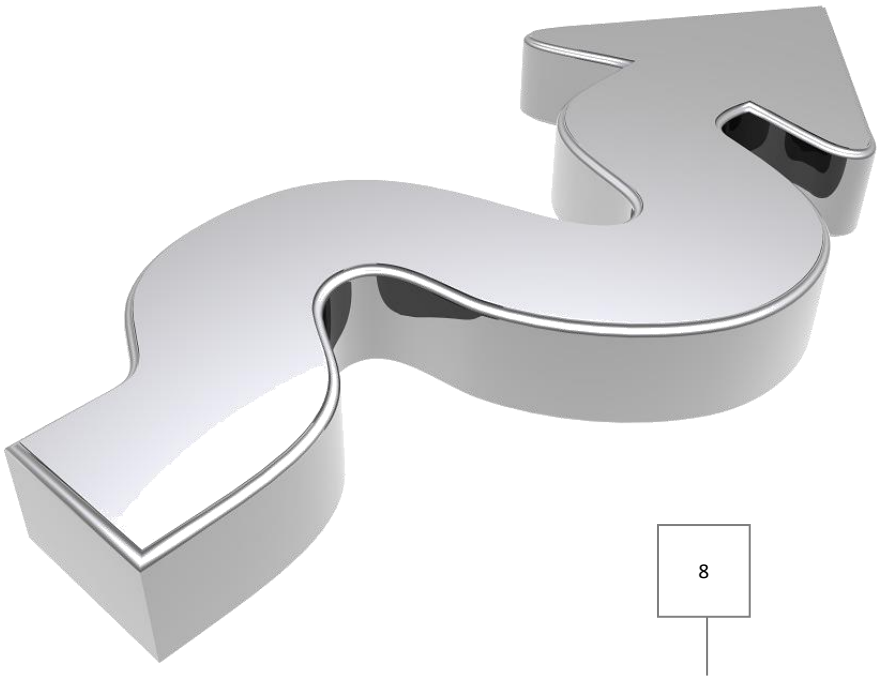
To transform corporate culture successfully, Deloitte recommends that organizations focus on three critical areas:

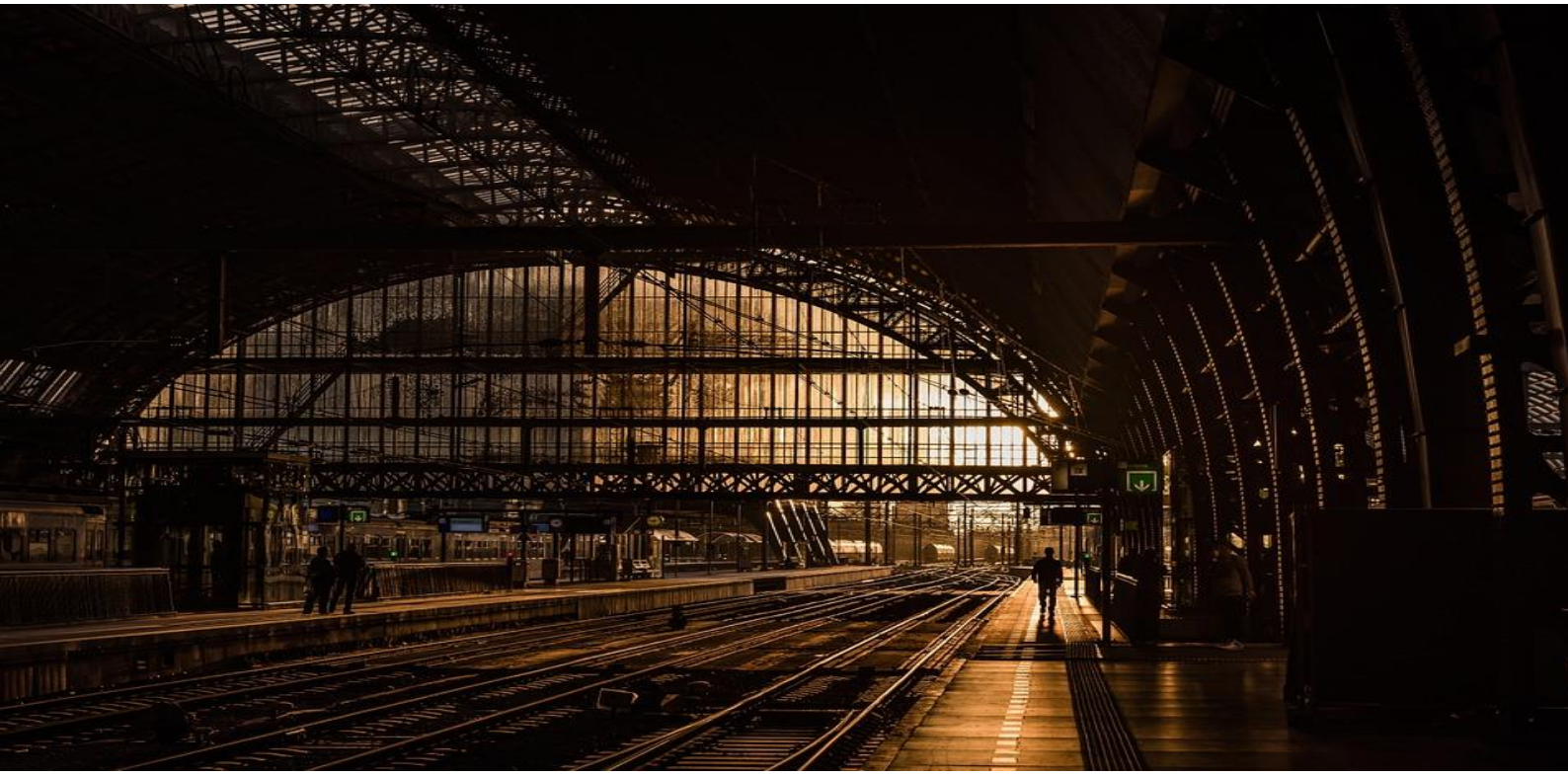
- **Align culture with business strategy.** Today, culture is an enabler of strategy. This means companies should define the behaviors that align to achieving their business strategy.
- **Make emotional connections with employees.** Companies need to take a page from consumer marketing and create emotional connections between the strategy and the workforce to create engaged, productive, and loyal employees. Research has found that "mission-driven" companies have 30 percent higher levels of innovation and 40 percent higher retention. (See ***Becoming irresistible: A new model for employee engagement***)
- **Take your culture off cruise control.** A company must actively manage its culture and adjust desired behaviors and processes as business strategies evolve over time to have an enduring effect on business performance and the bottom line.

"To make a significant and lasting impact on culture change, the levers that drive performance and behaviors need to be adjusted over time because the business strategy, work, and employees continually change," says Marc Kaplan, principal, Deloitte Consulting LLP, and national leader of the organization transformation and talent service line. "While culture can sometimes seem amorphous, it is possible to measure and develop required cultural attributes. Still, there needs to be an ongoing commitment to monitoring, measuring, and actively shaping the culture organizations need to drive the organizational strategy."

The solution is cloud-based and mobile-accessible, enabling business leaders to visualize, explore, and compare key data using an intuitive dashboard. Coupling this technology with deep experience in consumer behavior and organizational change, Deloitte delivers a precise plan with actionable insights for cultural transformation.

*For more information about **CulturePath** and where you can download an infographic on corporate culture, read Deloitte's recent perspective, Take your corporate culture off cruise control.*





Dynamic Discounting – 6 Opinions

Dynamic discounting continues to be an exciting space in payables. Here are 6 opinions related to dynamic discounting from Mark Thomas, Director Client Operations at C2FO.

1. "You tend to find a champion within an organization who sees the value of dynamic discounting." This single champion is typically from AP. He or she will be the one who promotes the benefits of dynamic discounting internally to get buy-in from everyone and ensure the different functions (I.e. IT, Procurement, Treasury, and Finance) collaborate.

2. "When alignment doesn't exist or you're dealing with a single stakeholder, you reach a stage of a process where you realize you're not as far along as you'd thought." Having a single stakeholder banging the dynamic discounting drum won't necessarily de-rail your project, but it could slow it down. It's good to get multi-stakeholder buy-in early – at the stage where, as a company, you have conceptually decided that dynamic discounting is a 'good thing'.

3. "It's something you can dial up or dial down based on cash position and business objectives at that time." Dynamic discounting isn't all or nothing. You don't need a consistent amount of cash that you pay out every day, week, etc. Dynamic discounting allows Treasury to release or retain as much cash as they want according to wider business objectives.

4. "In dynamic discounting, there is no need to change or update contracts." You don't need to constantly renegotiate contracts, add addendums, or sign new contracts. Dynamic discounting works off of existing contracts with suppliers and then a set of Ts & Cs that buyers and suppliers sign up to, usually through the provider.

5. "Dynamic discounting can give P2P a very clear ROI for improving process/systems." Mark explains: "Say you want to invest in a new system to improve average approval time by 2 days. If you can then put a value on the dynamic discounting benefit generated by the additional 2 days, this will give you a very clear business case to purchase a system or change your process to achieve that."

6. "Measure regularly, to inform the actions you need to take to improve the market for yourself and suppliers." You want to look at the potential spend put through the platform and assess:

- The amount that is actually accelerated
- How many days it's accelerated by
- The rate received on accelerated payments

When you are starting a program, you might want to measure key metrics on a daily or weekly basis. Once you reach a steady state with suppliers and understand your relationship, you might not need to look at these metrics so regularly. But it's still a good idea to review quarterly and half-yearly so you can look back over the period and strategize what you can do to optimize the market going forward.

Do M&As Add Value?

M&A activities tend to follow cyclical waves. However the recent drop in the oil price triggered a new wave of activity. But whether businesses can be acquired "cheaply" remains to be seen. It is also uncertain whether M&As can add value for stakeholders.

Strategic mergers and acquisitions will strongly re-position a business during an economic downturn. For example Shell has sought to reposition itself as a leader in LNG and to potentially reduce E&P costs with the takeover of BG. Shell's goal is to maximise synergies and thus cost savings. But this is true in any acquisition – how do you ensure value is achieved and what can IT do to help? More than 50% of acquisitions actually reduce shareholder value, so it's no wonder boards are now demanding better M&A outcomes.

Synergies and Benefits

In any integration the roles of IT include: guarantee regular business operations; enable business side synergies; and realize IT synergies. But there are some severe challenges to realizing IT synergies. There may be duplicated applications and infrastructure as each entity is likely to bring its own platform. So a new landscape needs to be defined; two distinct IT organizations with their own processes, policies, and practices – the ability to manage/operate as one organization is thus essential to maintain service quality and control costs; and divergence of IT and business objectives – IT focusing on operational stability – business aspiring immediate revenue and profitability synergies.

In every acquisition, benefits are identified prior to the sale…but these may be difficult to realize post-sale. So understanding the pre-sale benefits should provide the focus and strategy for the post-sale integration.

A benefit is a financial benefit that can be realized when an enterprise is created from two or more separate entities. Therefore, synergies are a key driver for profit growth for the resulting enterprise emerging from the transaction. In this context two main types of benefits can be identified:

- **Revenue Enhancing** (soft synergies), where the strategic opportunity of a combined corporate entity to generate more revenue than its two predecessor standalone companies would be able to generate. Opportunities include: Cross-selling; New markets, and Product enhancements.

- **Cost Savings & Cost Avoidance** (hard synergies) where the opportunity of a combined enterprise is to reduce operating costs. Opportunities

include: Process changes; Organizational changes; and Technology changes – thus IT cost savings are a critical part of all integration programmes and provide a substantial part of the realizing pre-sale benefits.

The Value Gap

In most industries, transactions are becoming more complex but a well-executed transaction may increase value by attaining expected benefits, identifying additional sources of value and mitigating risk. But as most acquisitions don't achieve the expected value, the key challenge is to reduce the so-called value gap: the difference between the Targeted Transaction Value and the Actual Value Achieved.

This means paying particular attention to three things: capturing all the costs and savings, and calculating estimates consistently; not losing sight of pre-sale benefits when there is considerable change in progress and when these benefits are not planned and measured; and realizing benefits when other cost fluctuations are masked in a business.

The value of pre-sale benefits will reduce if they are delayed. This might happen due to momentum loss or failing to take advantage of the currency of the acquisition or any slow-down in the integration programme. Lost value can also occur because of poor change management, which is why it is so important to anticipate and mitigate for resistance to change from key stakeholders, organizational confusion and culture clashes.

The Solution

There's a solution to ensuring M&As add value. From an IT perspective, the solution lies in three possible integration approaches: standardisation, best-of-breed or co-existence. Each approach has variations, and the right choice is determined according to the integration needs of the business and the potential for the IT organisation to leverage synergies.

The IT post-merger integration team will focus on the following hard synergy benefits. In the IT organisation itself, savings of 10-20% can be made in terms of personnel and transaction costs. In IT systems and data, savings of 25-45% can be made in terms of personnel and operational costs. In the IT infrastructure, savings of 10-20% can be made in terms of operational and maintenance savings. With licences, SLAs and sourcing, savings of 10-25% can be made in terms of hardware and software costs. And – if this is not a step too far in the initial integration programme – the IT post-merger integration team may consider moving to the cloud to make further substantial savings.

It's clear that integration synergies may not be leveraged all at once. Instead, they are likely to be realized step by step following a business-driven transformation path. The message here is that, no matter the path, companies will only to achieve full M&A benefits by completing every aspect of this integration work.

Many organisations never truly complete an integration and, as a result, they begin to question the actual value obtained from the merger or acquisition.

Once an integration journey has started, it must be completed. Problems typically arise because of low prioritisation of the IT integration, or an underestimation of the required IT integration effort. So more often than not, integration plans are rarely completed. This leaves the organisation to deal with running duplicate processes, applications and services, and never realizing the true added value of the merger or acquisition. Worse still, an incomplete integration increases the complexity and cost of the IT landscape.

So make sure to follow the plan and guarantee completion. Another hard fact is that merging companies often increases IT expenditure by up to 15% in the first few post-merger years. But after that, the IT budget can be reduced to 60% or even 80% of the combined pre-merger costs. It's well worth completing the integration to make sure M&As add value!

About the Author:

Phil Robinson advises clients on business strategy alignment and securing rapid business value from IT transformation. He works collaboratively with senior leaders in a trusted-adviser role to understand issues, shape solutions, build business cases and deliver benefits. He has held senior management positions in the USA, SE Asia and Europe and is excited that we are living in the biggest time of change where everything about how technology is bought, consumed, paid for, is changing and client's need to respond. The increasing challenges facing clients needing to re-position in the digitally-enabled world means a new style of IT.

Spat Over True and Fair View with EU Mulling Endorsement of IFRS 9

If company directors want to pay a dividend out of corporate profits, do they rely on the words in the *Companies Act 2006*, or do they rely on the Financial Reporting Council's guidance?

This spat between the UK's accounting watchdog and long-term investors such as pension funds and insurers has acquired added piquancy with the European Union mulling a request from the International Accounting Standards Board to endorse IFRS 9, Financial Instruments, for use across the EU.

The IASB finished its work on a replacement for its existing financial instruments literature, IAS 39, in July 2014. If endorsed, preparers must apply it from 1 January 2018. But for the IASB to put the project to bed, it must first satisfy the three endorsement criteria in the IAS Regulation 1606/2002.

These say, first, that a standard must fulfil the "true and fair view" criteria set out in the accounting directives. Second, it must satisfy the so-called qualitative criteria. This broadly means that the application of an IFRS must result in numbers that are understandable, relevant, reliable and comparable.

The qualitative requirements are intended to assist users of financial statements to reach economic decisions and to assess management's stewardship. And third, an IFRS must be conducive to the "European public good".

High stakes

The stakes are high because at no point since the EU began using IFRS in 2005 have these criteria been under such intense scrutiny. The reason is quite simply that IFRS 9 and its new forward-looking impairment model are supposed to right some of the accounting wrongs that helped to plunge global markets into meltdown almost a decade ago.

This stems largely from the fact that impairment of financial assets held at amortised cost, as well as the use of fair value – especially mark-to-model fair values – have both figured widely in the post-Lehmans post mortem. Moreover, IFRS's detractors in the UK argue that long-term investors were poorly served by the IFRS accounting model.

Proof of that dissatisfaction emerged in November 2013, when a letter from the Association of British Insurers, the Investment Management Association and the National Association of Pension Funds to the FRC was leaked to the press. In that letter, the investors underscored the importance that they attach to the true and fair view override and prudence in accounting. Collectively, the three organisations manage in the region of £7tn of assets.

In tandem with this development, the Local Authority Pension Fund Forum obtained an opinion from commercial silk George Bompas QC. He aired the notion that IFRS financial statements might well have played a much bigger role in fuelling the financial crisis than had previously been thought.

Many long-term investors broadly argue that IFRS accounts provide insufficient protection for shareholders and creditors. By investor protection they mean the notion that financial statements should give sufficient support to lawful profit distributions. At the same time, the accounts should confirm that a company's net assets do not fall below the amount of its share capital. Put bluntly, a company should be solvent when it pays out a dividend.

Academics' opinions sought

Meanwhile, in a bid to clarify the conflicting views around the suitability of IFRS 9 for endorsement across the EU, the European Commission engaged two academics from the University of Mannheim Business School – Jannis Bischof and Holger Daske – to assess the standard against the EU legal framework.

Perhaps unsurprisingly given the high stakes, the academics conclude that IFRS 9 does indeed satisfy the endorsement criteria. But equally noteworthy is their analysis of prudence in accounting, not least because it lays bare the cultural and expectation gulf between the UK investors and supporters of IFRS 9.

Bischof and Daske bluntly dismiss the view that IFRS 9's use of fair value is inherently imprudent. "There are extremely restrictive interpretations of the prudence principle in the academic literature that seem to suggest that fair value accounting *per se* is an imprudent reporting practice," they write.

They continue: "Not only are these interpretations purely theoretical, but they are also inconsistent with the general consensus in the accounting literature of what meaningfully constitutes a prudent ('conservative') accounting system."

Their conclusion is damning for investors such as the ABI and their argument that prudence is a state of mind that runs through the process of preparing accounts. They write: "Overall, we are not convinced that current EU legislation or available ECJ jurisprudence require annual accounts to comply with the prudence principle to achieve a TFV."

Friends in high places

In any event, IFRS 9 has friends in high places. Alongside the support of the academics at the University of Mannheim Business School, both the EBA and the ECB

– which is responsible for banking supervision in the EU – have come out in favour of endorsing IFRS 9.

Notwithstanding this, the row over IFRS 9, and IFRS more generally, has now spilled over into the UK – leaving the FRC at loggerheads with many of the UK's biggest investor interests.

Their private misgivings became decidedly public on 20 November when the Local Authority Pension Fund Forum released a letter sent to the chairman of FTSE 350 companies warning them to ignore the FRC's 2014 accounting guidance on distributable profits and the true and fair view. That guidance, LAPFF argued, could mean "UK listed company accounts are at risk of being contrary to the requirements of the law".

Prompting the move was a further opinion from George Bompas QC. He concluded that accounts which do not refer specifically to "what is or is not available for distribution by reference to amounts stated in them" cannot give a true and fair view of a company's "assets and liabilities, financial position and profits or losses".

A true and fair view

Central to this claim – indeed, the whole dispute between the FRC and LAPFF – is section 393 of the *Companies Act 2006*, which requires a company's accounts to give a true and fair view of "the assets, liabilities, financial position and profit or loss".

LAPFF argues that the FRC's latest guidance on true and fair view relies on a wrong-headed reading of section 393. The LAPFF argues that the words in the FRC's guidance do not reflect the specific words found in s393(1) of the *Companies Act 2006*.

Cllr Keiran Quinn told *Financial Director*: "Both EU and UK law is clear on the object to which the true and fair view of S393 attaches, which is specific basic numbers in the accounts 'assets, liabilities, financial position and profit or loss'. It is not 'the accounts as a whole' more generally, nor 'the state of affairs'.

"The law is also clear on the statutory purpose for that standard, which is member and creditor protection. Standard setters have got the purpose of the law wrong, and have got the object of the standard for that purpose wrong, when in law it's a true and fair view of the specified numbers."

The FRC, meanwhile, slammed the LAPFF move. In a statement, the FRC said in December: "[We are] aware that the LAPFF has written to company chairmen. Their letter deals with a very narrow point of company law in terms which we cannot support and raises uncertainty unnecessarily. The FRC and the government have confirmed that the *Companies Act 2006* does not require the separate disclosure of a figure for distributable profits."

The Bischof and Daske paper is yet another hint that the EU will ultimately endorse IFRS 9. If it indeed does, FDs might well be calling their lawyer. After all, as LAPFF wrote to company chairman last November, the issue has "significant implications going forwards for you and your colleagues".

Regional Office News
Hong Kong News

CMA Australia 2016 New Year Cocktail Reception cum Celebration of Women Leadership, Macau Development and Editorial Committees' Establishment was held on on 27 January 2016 at Regal Hotel Hong Kong. Four visiting Australian Senators were honoured at the reception.

From the Left: Senator Sam Dastyari, Senator for New South Wales; Senator Alex Gallacher, Senator for South Australia; Senator Glenn Sterle, Senator for Western Australia; Senator Helen Polley, Senator for Tasmania; Prof. Allen Wong, Senior Vice President – Global; The Hon. Kenneth Leung, Hong Kong Legislative Councillor; Dr. Lee George Lam, CMA Australia Honorary Chairman – Asia; Dr. Dennis Tam, CMA Australia Vice President – Global Macau; Prof. Lin Zhi Jun, CMA Australia Vice President – Global China; Mr. Andy Li Wai Kwan, CMA Australia Executive Director – Hong Kong.

The picture shows Prof. Allen Wong, Senior Vice President – Global with Consul-General Mr. Paul Tighe at the Macau 'Australia Day' Cocktail on 29 January 2016 in Galaxy Macau.

PNG Regional Office

On January 24 2016, Professor Janek Ratnatunga, CEO of ICMA Australia, Dr Thaddeus Kambanei, PNG Regional Director of ICMA, met with Dr. Ken Nugan, Secretary Finance and the President of the Institute of Chartered Management Accountants of PNG, at the Holiday Inn in Port Moresby to discuss further issues regarding the existing strategic alliance between ICMA (Australia) and ICMA (PNG).

The ICMA (Australia)'s CMA examinations have been written into the Rules of the *Institute of Chartered Management Accountants (PNG)*, a professional body set up by statute (Management Accountants Act 2004) in the independent State of Papua New Guinea.

The Rules of the Institute specifies the level of training, examinations, period of service, experience and fitness for membership required relating to the admission or advancement of a person to membership of the Institute as a *Fellow of the Institute of Chartered Management Accountants (FCMA)* and *Associate Chartered Management Accountant of the Institute (ACMA)*.

ICMA (Australia)'s CMA preparatory program must be done by all aspiring to be FCMAs or ACMAs of ICMA (PNG).

For more information, see: http://www.cmawebline.org/about-icma/strategic-alliances.html

Sri Lanka Regional Office

The first CMA preparatory program was organized by the *Institute of Chartered Accountants of Sri Lanka* in 1999. In February 2016, the 25th program was conducted by Professor Janek Ratnatunga at the Kingsbury Hotel in Colombo Sri Lanka. The program is now offered exclusively by the *Academy of Finance*, in Sri Lanka. Over 60 senior managers including CEOs and CFOs from all sectors of the Sri Lankan economy attended this program held over 7-days.

Professor Janek Ratnatunga, CEO of ICMA Australia conducting the seminars. These seminars are reputed to not only impart 'World-Class' knowledge; but also enable participants to apply this knowledge immediately in practice.

Official photograph of the participants with Professor Janek Ratnatunga, CEO of ICMA, Australia; and Mr Kapila Dodamgoda, Regional Director of ICMA in Sri Lanka.

Some happy students celebrating the end of the program with Professor Janek Ratnatunga.

Cambodia Regional Office

In March 2016, the first Cambodian CMA Preparatory Program was held. The program was organised by Ruwan Hulugalle & Company (RHC) under the direction of Dr. Ruwan Hulugalle CMA, Regional Director for Cambodia. Over 20 senior managers including CEOs and CFOs attended this program held over 7-days in Phnom Penh.

Professor Janek Ratnatunga, greeted on arrival at the Phnom Penh airport.

Professor Janek Ratnatunga, CEO of ICMA Australia, conducting the Seminar at the Intercontinental Hotel in Phnom Penh.

Professor Janek Ratnatunga, CEO of ICMA Australia and Dr. Ruwan Hulugalle, Regional Director for ICMA in Cambodia with the first batch of participants.

Indonesia Surabaya Centre - MRA with Indonesian Institute of Management Accountants (IAMI)

Members of the ICMA Surabaya Centre in Indonesia held a meeting at the Surabaya Mall on March 5, 2016 to discuss strategies for the development of CMA Activities in the Region. There will be much activity in May with a CMA Preparatory Program at Gadjah Mada University in Yogyakarta (in Association with CMA Trainers of Airlangga University of Surabaya). The program is organised by the Centre for SMART, and Dr Intiyas Utami the Regional Director of Central Java and the Yogyakarta special region.

Committee Members at hard at discussions over dinner.

Dr Basuki, the Surabaya Centre co-ordinator with his "Angels' including (from Left to right) Dr. Puji Handayati (Head of Research) and Dr. Sulis Rohayatun (Secretary) and Dr Ana Sopanah, the Regional Director of East Java for ICMA; at the dinner meeting on March 5, 2016.

Another initiative that affects ICMA Members in Indonesia is the Mutual Recognition Agreement between The *Indonesian Institute of Management Accountants (IAMI)* and the ICMA. The purpose of the MRA is to strengthen cooperation between the two Professional Institutions in professional development and the professional community in Indonesia.

For more information, see: http://www.cmawebline.org/about-icma/strategic-alliances.html

What's On in the World of the CMA?

- March 5-13, 2016: 1st CMA Preparatory Program, Ruwan Hulugalle and Company, Phnom Penh, Cambodia.
- April 15-23, 2016: CMA Preparatory Program, Wisdom Institute, Dubai, UAE.
- May 9-15, 2016: CMA Preparatory Program, IPMI, Jakarta, Indonesia.
- May 16-17, 2016: Certificate of Proficiency in Performance Management and Valuation, Centre for SMART & STIE PERBANAS, Surabaya Indonesia.
- May 19, 2016: CPD Program: Certified International Business Analyst (CIBA) program for CMAs, organised by the Academy of Finance and Management (AFMA) & the Centre for SMART; Yogyakarta, Indonesia.
- May 20-June 4: CMA Preparatory Program, Centre for SMART & Gadjah Mada University, Yogyakarta, Indonesia.
- May 22, 2016: CPD Program: Certified International Business Analyst (CIBA) program for CMAs, organised by the Academy of Finance and Management (AFMA) & the ICMA Indonesia Branch; Jakarta, Indonesia.
- May 23-29 2016: CMA Preparatory Program, TOP Academy, Kuala Lumpur, Malaysia.
- May, 2016: First CMA Preparatory Program in the Farsi Language, Segal Training Institute, Tehran, Iran.
- June 1-7, 2016: CGBA Preparatory Program, MMU Foundation (YUM), Melbourne, Australia.
- October 15-24, 2016: 2nd CMA Preparatory Program, Ruwan Hulugalle and Company, Phnom Penh, Cambodia.

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Navitas Workforce Solutions, Australia

Wharton Institute of Technology and Science (WITS), Australia

Academy of Professional Education, India

Academy of Finance, Sri Lanka

IPMI (Indonesian Institute for Management Development), Indonesia

Multimedia College (MMC), Malaysia

Business Sense, Inc. Philippines

HBS for Certification and Training, Lebanon

Wisdom Group of Institutions (UAE)

Institute of Professional and Executive Management, Hong Kong

AFA Research and Education, Vietnam

Institute of Finance and Management PNG

TOP Academy, Malaysia

Segal Training Institute, Iran

Centre for SMART, Salatiga, Indonesia

Ruwan Hulugalle & Company, Cambodia

AUSTRALIA

Global Head Office

ICMA Australia

CMA House
Monash Corporate Centre
Unit 5, 20 Duerdin Street
Clayton North, Victoria 3168
Australia
Tel: 61 3 85550358
Fax: 61 3 85550387
Email: info@cmawebline.org
Web: www.cmawebline.org

Australian Contacts

New South Wales
Professor Chris Patel , PhD, CMA
Branch President
Macquarie University

Northern Territory
Professor Lisa McManus, PhD, CMA
Branch President
Charles Darwin University

South Australia
Prof Carol Tilt, PhD, CMA
Branch President
Australian Institute of Business

Western Australia
Dr. Vincent Ken Keang Chong
Branch President
UWA Business School

Queensland
Dr. Gregory Laing, PhD CMA
Branch President
University of the Sunshine Coast

Published by:
The Institute of Certified
Management Accountants
Unit 5, 20 Duerdin Street
Clayton North 3168, Victoria, AUS

OVERSEAS REGIONAL OFFICES

CHINA (including Hong Kong and Macau)
Prof. Allen Wong, FCMA
Regional Director and Chief Executive - Greater China
12/F, Tai Yip Building, 141 Thomson Road,
Wanchai, Hong Kong Tel: (852) 2574 1555
Fax: (852) 2574 1455
Cell: (852) 9156 7561
Email: info@cmaaustralia.org
allen.wong@cmaaustralia.org

INDIA (Including India, Pakistan, Bangladesh, Nepal and African subcontinent)
Main Regional Office (Mumbai)
Dr. Chintan Bharwada, FCMA
Regional Director - India
148, Juhu Harshal,
8 Gulmohar Road, JVPD,
Juhu Mumbai 4000049, MAH, India
Tel +91 8108440817
Website: icmaindia.org
Email: info@cmaindia.co.in

INDONESIA
Special Capital Region (Jakarta) Regional Office
Ms. Arum Indriasari – Jakarta Centre

IPMI Business School
Jl. Rawajati Timur I/1
Kalibata, Jakarta, Indonesia
Tel +62 21 7970419
E-mail : arum.indriasari@ipmi.ac.id

West Java Regional Office
Ms. Paulina Permatasari, FCMA
Regional Director - West Java
Jl. Pagarsih # 156
Bandung, West Java, Indonesia
Email: paulinapssj@gmail.com

East Java Regional Office
Dr. Ana Sopanah, CMA
Regional Director - East Java
GRAHA Inspire
Jalan Cakalang Kavling AURI No 16
Malang, Indonesia
Email: anasopanah@gmail.com

Central Java Regional Office
Dr. Intiyas Utami, CMA
Regional Director - Central Java
Jl. Sinoman Tempel No. 256
Salatiga, Central Java, Indonesia
Email: intiyas@staff.uksw.edu

LEBANON
Mr. Fawaz Hamidi, CMA
Regional Director - Lebanon
Boulevard Centre-136
PO Box 171, Tripoli, Lebanon
Tel: 06-433761
Email: hbs@cmamena.com
www.cmamena.com

MALAYSIA
Dr Wan Fadzilah Wan Yosuff, CMA
Regional Director - East Malaysia
53 Jalan 9/9A, Seksyen 9
43650 Bandar Baru Bangi
Selangor, Malaysia
Email: wanfadzilah@live.com

PAPUA NEW GUINEA
Dr Thaddeus Kambanei, CMA
Regional Director - PNG
Malagan Haus, Suite 02, Level 2
Section 15, Lot 8, Reke street, Boroko
P.O.Box 1581, Vision City, Waigani
National Capital District, Papua New Guinea
Email: Thaddeus.Kambanei@yahoo.com
http://www.cmapng.com

PHILIPPINES
Mr. Henry Ong, FCMA
Regional Director - Philippines
2502B East Tower Tektite Building
Philippine Stock Exchange Center,
Exchange Road
Ortigas, Pasig City 1600, Philippines
Tel: (+63) 631-6241 or 634-6476
Email: hong@businesssense.com.ph
http://www.cmaphilippines.com

SRI LANKA
Mr Kapila Dodamgoda, CMA
Regional Director - Sri Lanka
No. 3, St Kilda's Lane, Colombo 3, Sri Lanka
Tel: +94 114 515253 or +94 112590113
Email: kapiladodamgoda@yahoo.com
http://www.cmasrilanka.com

UNITED ARAB EMIRATES
Mr. Shakeeb Ahmed, CMA
Regional Director - U.A.E.
Flat 101, Al Kazim Building
Khalid Bin Waleed Street
Bur Dubai, P.O. Box: 26791
Dubai, United Arab Emirates
Email: a hmed.shakeeb@gmail.com
Website: www.cmadubai.org

CYPRUS
Mr. Christos Ioannou BA (Hons), MBA (Finance), CMA
Regional Director-Cyprus
11A Dafnidos 6041, Larnaca, Cyprus
Email: chioanou@cytanet.com.cy

VIETNAM
Mr. Long Phan MBusAcc, CPA, CMA
Regional Director- Vietnam
Level 3, GP Invest Building, 170 La Thanh Street
Dong Da District, Hanoi, Vietnam
Email: longplt@afa.edu.vn

IRAN
Mr. Alireza Sarraf, CMA
Regional Director- Iran
Unit.4, No.3 Koozegar Alley (after Beheshti Str);
Vali-e-asar Str,
Tehran, Iran
Email: sarraf@experform.com