

# A work in progress

Insights into the views of Australian financial analysts  
in relation to AIFRS

AUDIT





# Contents

Foreword	2
Executive summary	3
A work in progress	5
Improved understanding	6
Distinguishing between performance and accounting related changes	7
Making sense of AIFRS results	9
AIFRS and analyst perceptions	12
Expected benefits and disadvantages	14
In for the long haul	15
Contact us	16

## Foreword

Depending on who you talk to, International Financial Reporting Standards (IFRS) represent either a revolution in how we report financial performance, or are little more than a time consuming and expensive distraction.

As is often the case, the truth probably lies somewhere between these two extremes.

However, we should be wary of making premature judgements about IFRS. As we suggest in the title of this white paper, IFRS remain a work in progress. Some standards are still being finalised. The pace and extent of US convergence with IFRS remains uncertain. Consistency of application across different jurisdictions will be an ongoing challenge.

At KPMG we believe IFRS will yield tangible benefits, and not just for investors and other users of financial statements. Australian companies can use the move to the Australian equivalents of IFRS (AIFRS) to improve the transparency and relevance of their financial reporting and to enhance the market's understanding of their business performance. Some are already doing so.

Part of that process involves educating the users of financial statements about the new and different ways in which AIFRS illuminate the realities of financial and operational performance. Our survey of financial analysts, on which this report is based, indicates many companies are doing a good job in this area. It also highlights that many are yet to respond to the market's call for quality briefings on the impact of AIFRS on their company's financial reporting.

The move to AIFRS is an ongoing rather than a one-off exercise, with challenges yet to come. Many companies and others involved in the financial reporting chain have made a substantial investment in the move to AIFRS. The challenge now is to extract real benefits from this investment.

We trust this report provides a useful insight into the views and experiences of Australian financial analysts for the benefit of companies preparing to report their first full year performance under AIFRS.



Geoff Wilson  
National Managing Partner  
Audit & Risk Advisory Services

## Executive summary

By all accounts the transition to AIFRS is proceeding more smoothly than many had expected. However, the journey has only just begun.

To date, the market appears to be relatively comfortable and accepting of the first financial reports produced under AIFRS for December year-end companies. The release of financial reports under AIFRS for the full year to 30 June 2006 will be a critical test of the transition.

In April 2006, KPMG commissioned a survey of Australian financial analysts to determine their familiarity with, and understanding of, AIFRS. It replicated our first survey conducted in late 2004 on the same subject. Based on the latest survey, this white paper examines the current state of play concerning the introduction of AIFRS following the market's first exposure to full year financial reports under the new standards.

The key findings include:

- There has been an encouraging uplift in analyst understanding and readiness for financial reports produced under AIFRS since our first survey in late 2004.
- Most analysts report a reasonable knowledge of AIFRS, but the depth and breadth of this understanding remains patchy. It seems that analysts now have a greater appreciation of the complexity of some areas of AIFRS, such as the impact on mergers and acquisitions and financial instruments, and rate their understanding of these areas more moderately than they did in 2004.
- In 2004, the most common source of information about AIFRS was professional advisers. In 2006 this has changed dramatically with analysts now obtaining most of their information about AIFRS from the companies they track.
- Many companies have responded to the call from analysts for briefings on AIFRS with nearly half of the surveyed analysts saying most or all of the companies they follow have provided a briefing. However, a significant number of analysts still report they have only received briefings from a small number of the companies they track.

- Over three quarters of analysts surveyed are confident they can distinguish between changes in reported numbers resulting from changes in underlying business performance versus changes in accounting methodology. This is a significant improvement since our first survey.
- In 2004, our survey identified that analysts expected there to be market volatility when results under AIFRS were released. To date, this anxiety appears to have been quelled. In 2004 a majority of analysts said they would mark down a company's shares if they didn't understand why its results looked different under AIFRS. In 2006, analysts appear to be less likely to mark down shares of companies showing volatility after switching to AIFRS.
- Analysts remain divided in their view on whether AIFRS will provide more or less insight into company performance.
- Nearly half of the surveyed analysts have revised their company assessments in response to the impact of AIFRS on reported financial results.
- Analysts respond positively to company briefings on AIFRS that are proactive, timely, detailed and transparent.
- KPMG strongly recommends that companies do not miss the opportunity to use the move to AIFRS to improve market understanding of their operations and performance.

Many companies and others involved in the financial reporting chain have made a substantial investment in the adoption of AIFRS. The challenge now is to extract real benefits from this investment.

## A work in progress

The IFRS or their local equivalents, have now been adopted in more than 100 countries.

Several key players on the world economic stage - notably the United States, China, Japan, India and Canada - intend to bring their accounting standards into line with IFRS. By 2009, the US Securities and Exchange Commission hope to remove the requirement for foreign companies issuing securities in the US to reconcile their IFRS financial statements with US Generally Accepted Accounting Principles (GAAP). Full convergence of IFRS and US GAAP is likely to take longer.

For Australian companies and other reporting entities, AIFRS are now a reality. Companies have been required to produce financial statements under AIFRS for annual reporting periods starting on or after 1 January 2005. The market and others have now had the opportunity to respond to the first full year financial reports under AIFRS from companies with 31 December balance dates. They will shortly receive reports from the much larger number of June balancers.

Of course, the new standards do not change the underlying reality of a company's financial position and performance. However, financial statements prepared under AIFRS can look considerably different from those compiled under the former accounting standards. There may be significant differences in the treatment of intangibles, goodwill, the impairment testing of assets, share-based remuneration, defined benefit superannuation, acquisitions, financial instruments (including the reclassification of some instruments as equity rather than debt) and in the presentation of financial statements. In many instances, AIFRS will inject more volatility into reported earnings.

Preliminary indications here and abroad suggest that the transition to IFRS has been smoother than many expected. However, it is early days. The promised benefits of IFRS - essentially the adoption of a common, worldwide accounting language - have yet to be realised.

It is against this background that KPMG sought to examine the Australian experience in the transition to AIFRS. We did this by commissioning a survey of the views on AIFRS of 50 financial analysts during April 2006. This survey replicated an earlier analysts' survey conducted in December 2004, allowing us to track changes in attitudes to, and perceptions of, AIFRS over the intervening period. Collectively, the analysts surveyed covered all major industry sectors. They were drawn from 14 leading investment banks and broking houses.

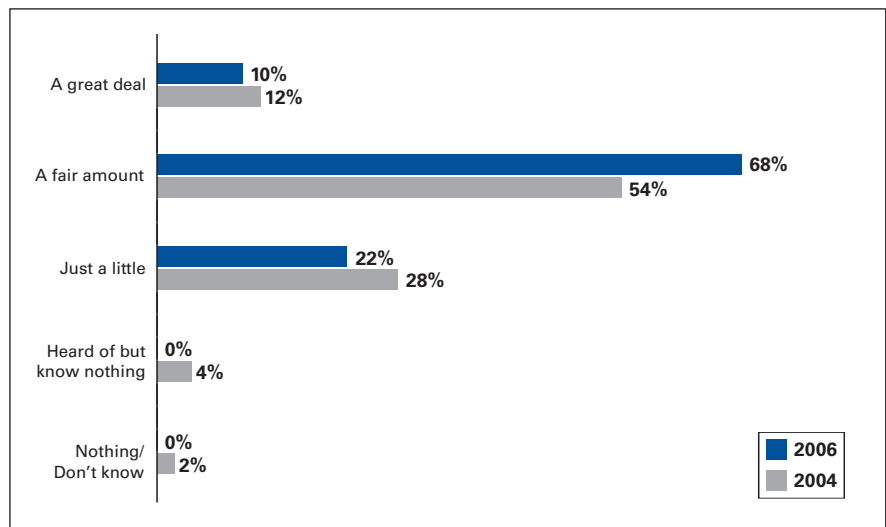
This white paper presents and discusses the current state of play concerning AIFRS in Australia and how things have changed since late 2004.

We consider professional analysts an acceptable proxy for the wider investment community. Their reports and recommendations influence many investment decisions; their valuation models and analytical techniques are mimicked by institutions and individual investors.

## Improved understanding

Two thirds of respondent analysts report they have a “fair amount” of knowledge about AIFRS. This is a modest improvement on the 2004 results.

Only 10 percent say they know a “great deal” about the new standards (Figure 1), a slight decline since 2004. KPMG suspects this reflects a greater awareness of the complexity of some areas of AIFRS causing some analysts to rate their level of knowledge more moderately.



**Figure 1. How much, if anything, do you know about the Australian equivalents of the International Financial Reporting Standards?**

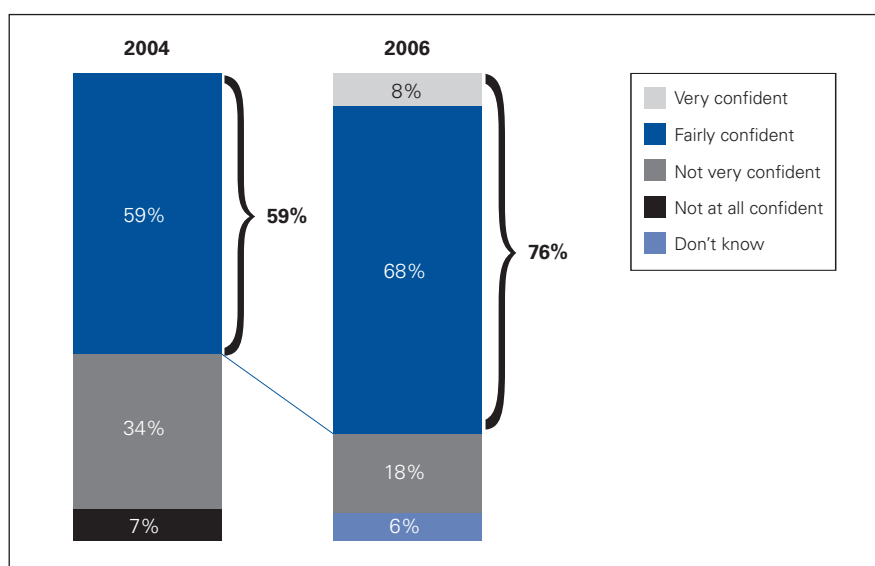
In this context, it is interesting to note that analysts rely heavily on the companies they track for their knowledge of AIFRS, with 64 percent of respondents citing companies as a prime source of information. This is up from 43 percent in 2004. Professional advisers are cited by 44 percent of analysts as important information sources while 22 percent regard word of mouth as a prime source.

Analysts' own employers are regarded as an important source of AIFRS information by only 22 percent of respondents, although 72 percent say they have received AIFRS-related training provided by, or sponsored by, their employers. This training is felt to be “adequate” by three quarters of analysts, but only 22 percent regard it as being “thorough”.

## Distinguishing between performance and accounting related changes

In our 2004 survey, 59 percent of analysts thought they would be able to distinguish between changes in financial statements that reflected changes in underlying business performance against those attributable to accounting changes. In 2006, more than three quarters of analysts are “very confident” or “fairly confident” that they can make this distinction. Of some concern is that nearly one in five respondents were not at all confident about their ability to separate performance-related changes in the figures from accounting-related ones, or simply did not know if they could. (Figure 2)

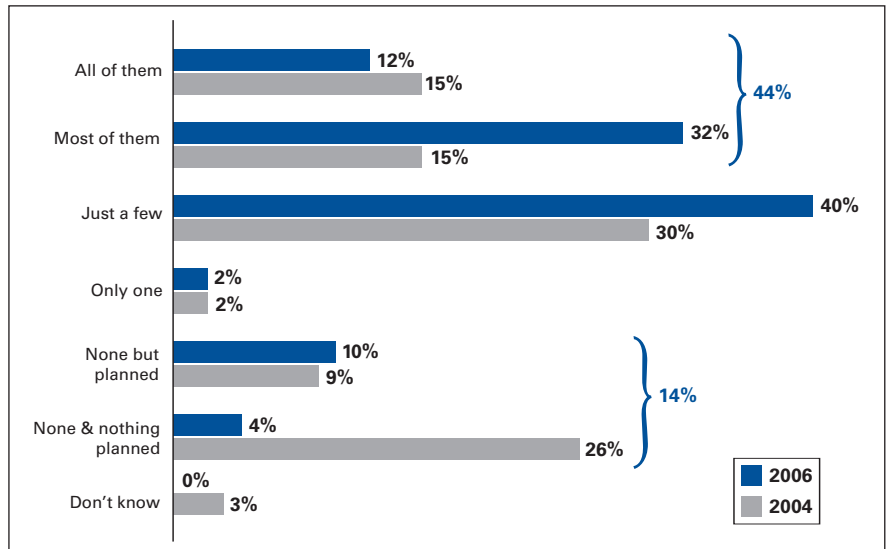
Generally, most analysts feel that 31 December 2005 reports prepared under AIFRS succeeded in explaining how AIFRS have affected the disclosed results. More than four out of five believe the key differences in accounting policies resulting from the adoption of AIFRS were explained “very well” or “fairly well”.



**Figure 2. How confident are you that you have been given sufficient information to distinguish between changes in financial reports that result from business performance from those due to accounting changes under AIFRS?**

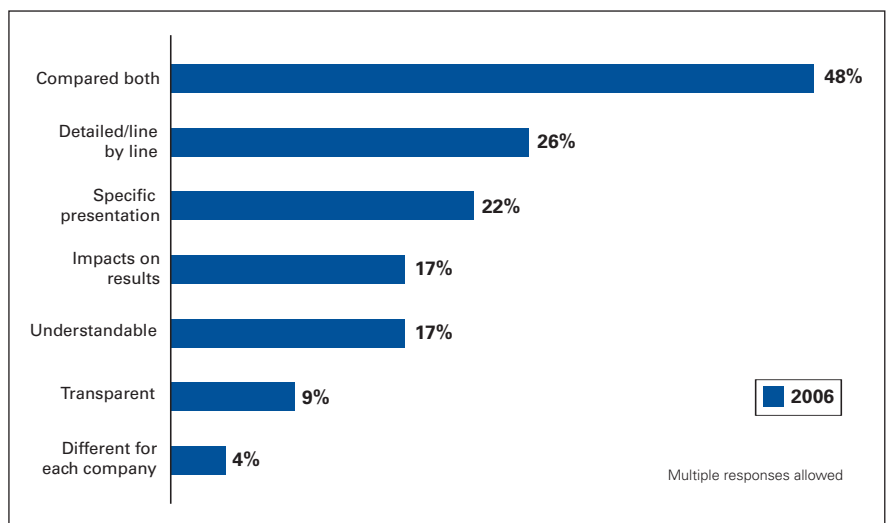
Nearly half the analysts report that all or most of the companies they follow have undertaken analyst briefings or supplied additional information explaining how AIFRS are affecting the financial information they are reporting. (Figure 3)

While this is a significant improvement since our first survey, more than half of analysts (56 percent), still report they have received a briefing from just a few, one, or none of the companies they track.



**Figure 3. How many of the companies you follow have held briefings or undertaken other communications to explain how AIFRS will affect the financial information they report?**

When briefings have been provided they have been rated high quality. Seventy-seven percent believe the quality of this information is “very good” or “fairly good”. Asked why they regard this information as good, nearly half mention the quality of the comparisons and explanations comparing performance under AIFRS and Australian Generally Accepted Accounting Policies (GAAP). (Figure 4)



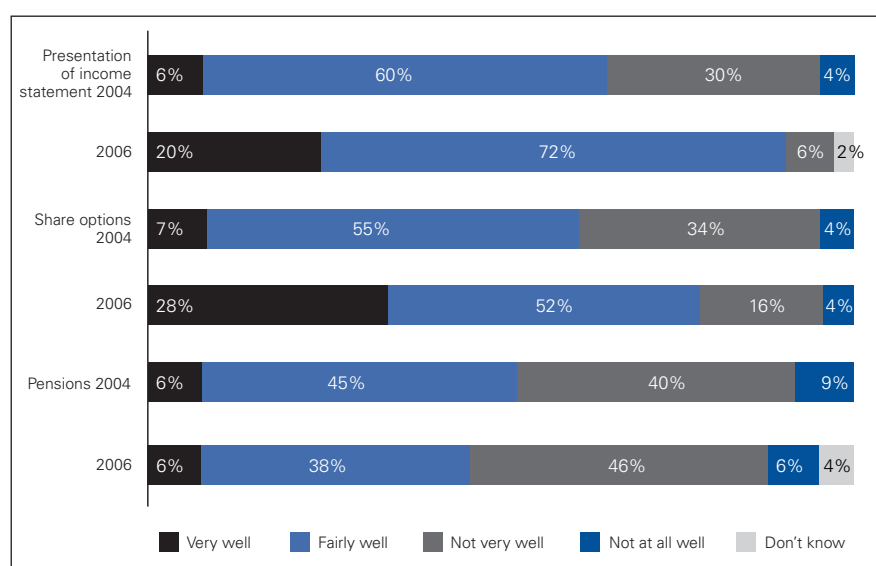
**Figure 4. Why do you consider the information provided to be very good/good?**

## Making sense of AIFRS results

Will traditional measures of financial performance such as EBITA and net profit before exceptional items be as relevant under AIFRS as they were under Australian GAAP? Nearly half the surveyed analysts believe they will be just as relevant in an AIFRS world. Only 14 percent think they will be less relevant. However, 38 percent of analysts agree that the lack of a clear definition of operating profit under AIFRS is a serious shortcoming that needs to be addressed.

Whatever performance measures are adopted under AIFRS, there is overwhelming agreement they should be calculated and presented on a consistent basis.

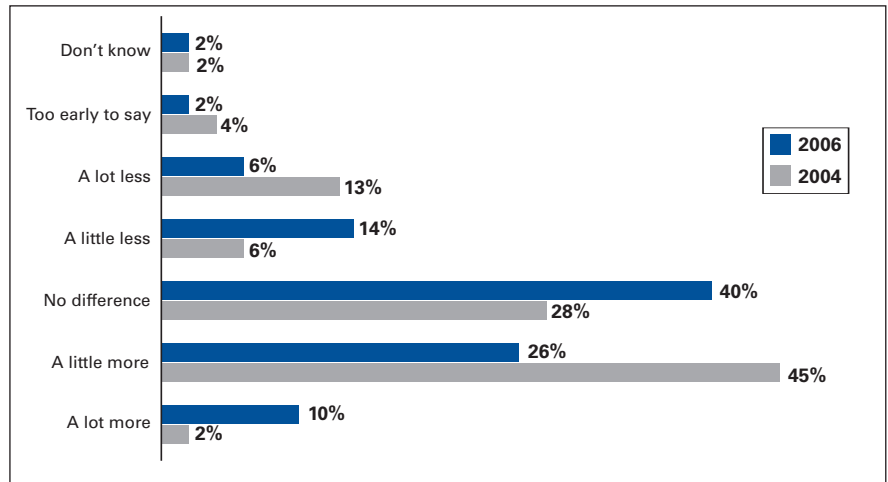
Compared with 2004, analysts also appear to possess a better understanding of how AIFRS affect the presentation of income statements and the treatment of share options. They are less certain about how AIFRS affect the treatment of pensions. (Figure 5)



**Figure 5. How well do you understand the affect of AIFRS on the presentation of income statements and the treatment of share options and pensions?**

On the treatment of mergers and acquisitions and financial instruments, analyst understanding has changed little since 2004. In the latest survey, less than half the analysts claim a good or fair understanding of how AIFRS affect merger and acquisition transactions.

Some argue that AIFRS represent a more rigorous and disciplined approach to financial reporting, and that statements prepared under AIFRS will provide a more accurate insight into the real financial performance of organisations. The analysts surveyed are sceptical about this proposition. Indeed, they are less convinced about it than in 2004. (Figure 6)



**Figure 6. Do you think the introduction of AIFRS will give you more or less insight into the true financial performance of the companies you follow?**

The 36 percent who believe AIFRS will provide enhanced financial and performance insights give several reasons for their position. (Figure 7)

2006	
Main reasons	%
More disclosure of financial instruments/share based payments/pensions/intangibles	22
More information/items on P&L	22
More disclosure/transparency	17
Records notes/off balance sheet	11
More insight into profit/true financial position/value/performance	6
Standard report – global comparison	5
Other – various	17

**Figure 7. Why do you think the introduction of AIFRS will give you more insight into the true financial position of the companies you follow?**

The largest group of respondents say AIFRS will make little or no difference to their understanding of company performance. They claim it has no affect on the actual operations of a business, or on the business’s cash flow.

2006	
Main reasons	%
No impact – business/reporting/information still the same	45
Cash flow (and operations) unaffected/don't care about balance sheet	20
Very technical	10
Don't know/too soon/wait and see	5
Other – various	20

**Figure 8. Why do you think AIFRS will give you less insight into the true financial performance of the companies you follow?**

The transition to AIFRS has occurred within a strong economic environment with solid business performance and buoyant share market.

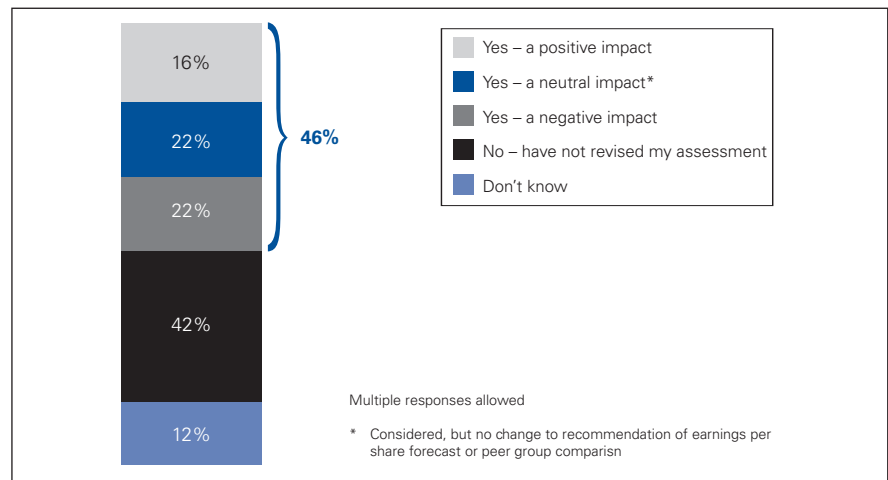
The true test of whether the market recognises the value and insight provided by reporting under AIFRS maybe yet to come.

A tighter economy may just provide the catalyst required for analysts to further develop their appreciation of the additional information provided by financial reporting under AIFRS.

## AIFRS and analyst perceptions

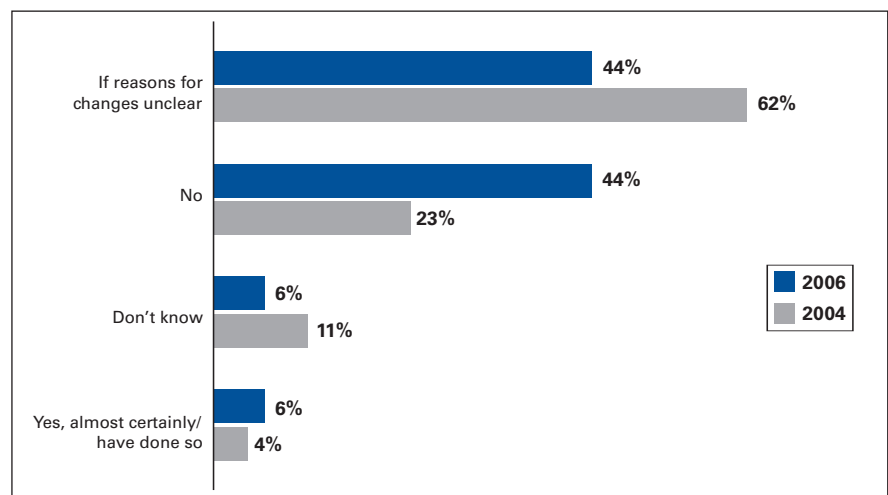
Will reporting under AIFRS affect analysts' assessments and recommendations?

To date nearly half the analysts surveyed say they have revised their assessments of companies in response to AIFRS. (Figure 9) Negative revisions outweigh positive ones, but not by a dramatic margin.



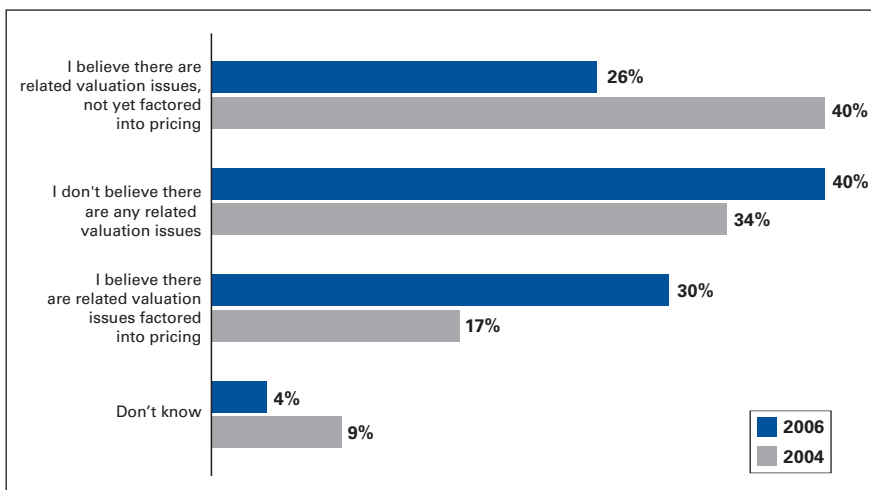
**Figure 9. Have you revised your assessment or recommendation for any of the companies you follow due to the impact of AIFRS in this first AIFRS reporting period?**

It is often mentioned that AIFRS will lead to increased volatility in reported financial performance. Only a small minority of analysts admit to having already marked down shares because of perceived increased performance volatility under AIFRS. Many more (44 percent) say they will mark down if the reasons for performance volatility are unclear. However, compared with 2004 analysts appear less likely to penalise performance volatility. (Figure 10)



**Figure 10. Would you mark down shares showing volatility after switching to AIFRS?**

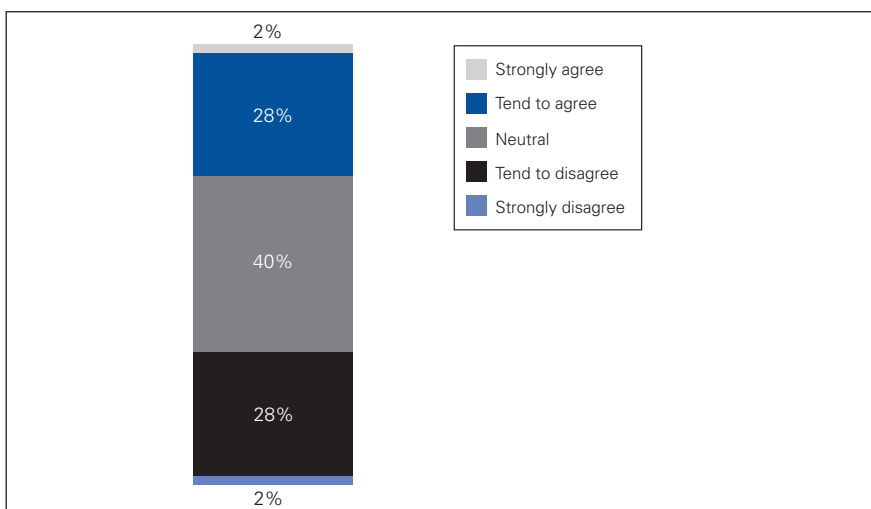
More than two thirds of analysts believe company valuations will be unaffected by AIFRS, or that AIFRS-related valuation issues have already been factored into share prices. This is a considerable change since 2004. (Figure 11)



**Figure 11. Your view on the impact on company valuations of introducing AIFRS?**

Only 26 percent of respondents agree with the proposition that AIFRS will lead to better decision-making in capital markets while 40 percent disagree. This is a distinct change from 2004 when the respective figures were 30 percent in agreement and 27 percent in disagreement.

Analysts appear divided and undecided over whether they feel AIFRS will strengthen Australian capital markets.



**Figure 12. The introduction of AIFRS will facilitate the strengthening of Australian capital markets.**

## Expected benefits and disadvantages

Analysts' views on the benefits and disadvantages of AIFRS have changed slightly since 2004.

Top 5 most commonly mentioned benefits	
2006	2004
Work for accountants	Global/allows comparisons
Greater transparency	Greater transparency
Enables more valid comparisons	None
Standardisation	Don't know
Greater consistency	Eliminates goodwill

Top 5 most commonly mentioned disadvantages	
2006	2004
Hassle to rework the numbers	Confusion potential for misinterpretation
General confusion	More analysis required – working backwards
Affects comparison with previous results	Inconsistency between markets/countries
Inconsistency	Volatility doesn't reflect business performance
Will take time to get used to	Potential to change the way a company does business

## In for the long haul

AIFRS represent a work in progress. The 30 June 2006 reporting season will tell us all a lot more about how Australian companies are adjusting to AIFRS. The new standards remain a challenge for all involved in the financial reporting chain: preparers, auditors, analysts, investors and regulators.

Many companies and others involved in the financial reporting chain have made a significant investment in the transition to AIFRS. Extracting maximum benefits from this transition is another matter. However, the transition is not complete. New and modified standards will emerge. AIFRS will be reshaped by a number of forces including the ongoing convergence project involving the International Accounting Standards Board and the US Financial Accounting Standards Board. Consistency of application and interpretation across more than 100 jurisdictions is a further challenge.

Some observers believe IFRS are producing more complex financial statements that make it harder to distil performance down to key metrics such as earnings per share. While this may seem to make financial statements more complex, this complexity simply mirrors the growing complexity of business operations and transactions. As Charles Grieve of the Hong Kong Securities and Futures Commission puts it, “Accounts are moving towards telling the truth and the whole truth, and the whole truth is complex. There will no longer be easy numbers for people to look at. But the figures will reward study.”<sup>1</sup> Certainly analysts and investors must learn how to extract useful information from financial statements prepared under IFRS.

For listed Australian companies all this underlines the importance of clearly communicating to markets about how AIFRS affect reported performance. Many companies have stepped up to the mark, offering high quality briefings on the impact of AIFRS. Our survey results confirm that analysts respond positively to briefings that are proactive, timely, detailed and transparent. Yet there are still a significant number of companies that have not yet briefed analysts about AIFRS. Our strong recommendation is that companies do not miss this opportunity to enhance market understanding of their performance.

Indeed, market communication around AIFRS should not be regarded as a one-off exercise, but an opportunity for ongoing improvement in market communication. The move to AIFRS provides an opportunity for companies to:

- Enhance the market’s understanding of business performance and prospects.
- Validate the accuracy and timeliness of the valuation models being used by stakeholders.
- Confirm that market communications are contributing to precise decision-making by key stakeholders.
- Better understand changes in competitive position.

1: ‘IFRS: Views on a Financial Reporting Revolution’, KPMG, April 2006

## Contact us

For more information about the survey or to discuss the implications for your company, please contact:

### Financial Services

**Andrea Waters**

National IFRS Leader

+61 3 9288 6127

[ajwaters@kpmg.com.au](mailto:ajwaters@kpmg.com.au)

**Adrian Fisk**

+61 2 9335 7923

[adrianfisk@kpmg.com.au](mailto:adrianfisk@kpmg.com.au)

### Consumer & Industrial Markets

**Nicola Davis**

+61 2 9335 7993

[nicoladavis@kpmg.com.au](mailto:nicoladavis@kpmg.com.au)

**Adrian King**

+ 61 3 9288 5738

[avking@kpmg.com.au](mailto:avking@kpmg.com.au)

### Information, Communications & Entertainment

**John Wigglesworth**

+ 61 2 9335 7670

[wigglesworth@kpmg.com.au](mailto:wigglesworth@kpmg.com.au)

### Energy & Natural Resources

**Alison Kitchen**

+ 61 3 9288 5345

[akitchen@kpmg.com.au](mailto:akitchen@kpmg.com.au)

### Government

**Nick Baker**

+ 61 2 6248 1205

[njbaker@kpmg.com.au](mailto:njbaker@kpmg.com.au)

### Adelaide

**Peter Robertson**

+ 61 8 8236 3236

[pdrobertson@kpmg.com.au](mailto:pdrobertson@kpmg.com.au)

### Brisbane

**Martin McGrath**

+61 7 3233 3225

[mmcgrath@kpmg.com.au](mailto:mmcgrath@kpmg.com.au)

### Perth

**Denise McComish**

+61 8 9263 7183

[dmccomish@kpmg.com.au](mailto:dmccomish@kpmg.com.au)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2006 KPMG, an Australian partnership, is part of the KPMG International network. KPMG International is a Swiss cooperative. All rights reserved. Printed in Australia. The KPMG logo and name are trademarks of KPMG. June 2006. VIC10153AAA.

Liability limited by a scheme approved under Professional Standards Legislation.