Forward-looking financial reporting

Prof. Arnold Schilder
Chairman BCBS ATF
Member IASB SAC

Personal comments

De Nederlandsche Bank

Introduction

- I agree with Mary Barth that the question is not whether, but how financial reporting should reflect estimates of the future

- I see defining the how is the challenge
  - Uncertainty
  - Time horizon

De Nederlandsche Bank

How should financial reporting reflect uncertainty?

- Reflect past risk experience which can be projected into the future, adjusted for revised expectations
  - Expected losses: statistics
  - Behaviour across market cycle: experience
- Uncertainty is not an absolute concept; there is room for learning from lessons from the past
- Forward-looking estimates, based on economic substance, facilitate economic decision-making

De Nederlandsche Bank

How far into the future should financial reporting reach?

- Economic decision-making takes places within a continuum. Financial reporting should allow an assessment of an entity's performance over time by considering both short-term and long(er)-term inputs into the estimation process
  - Short-term, micro inputs, i.e. information arising from quarterly, (semi-)annual reporting cycle, adjusted for expectations at reporting date
  - Long(er)-term, macro inputs, i.e. information arising from business cycle and economic cycle, adjusted for expectations at reporting date

De Nederlandsche Bank

In summary: projecting information from multiple-period inputs

	Short-term, micro inputs[1]	Long(er)-term, macro inputs[2]
Risk measurement	Expected loss	Expected loss
Risk measurement error	Unexpected loss	Unexpected loss

1 For instance, counterparty information gathered in current and past reporting cycles, projected into the next reporting cycle
2 For instance, business sector information gathered in current and past business cycles, projected into the next reporting cycle

De Nederlandsche Bank

Is there a tension with the IFRS Framework?

- Past transaction or event
  - Statistics and experience relate to the past, not to the future; but can be projected into the future
  - Risk measurement models are becoming increasingly sophisticated, backed by multiple-period statistics, recognised in IAS 39

- Control
  - Considering realistic expectations is part and parcel of management decision-making, management operates in the context of those expectations
  - For instance, goodwill management and measurement, explicitly recognised in IFRS framework

De Nederlandsche Bank

Conclusion

- Expected losses and market cycle behaviour are concepts which are not necessarily in contradiction with the IFRS framework concepts of past transaction or event, coupled with control

- Rather, it is a question of interpretation of those concepts
- In this context, reliability criteria need to be considered
- Disclosure of the related risk management framework is the accompanying ingredient

De Nederlandsche Bank

Next steps

- Explore further the synergies between the asset/liability framework and future risks and the estimation of those risks

- The objective is to permit financial statement users to obtain a deeper understanding of the entity's expectations of the future and to relate the entity's estimates to other available benchmarks

De Nederlandsche Bank