Digital financial reporting helps reduce risk where investors aren’t relying on disclosure by professional judgement alone

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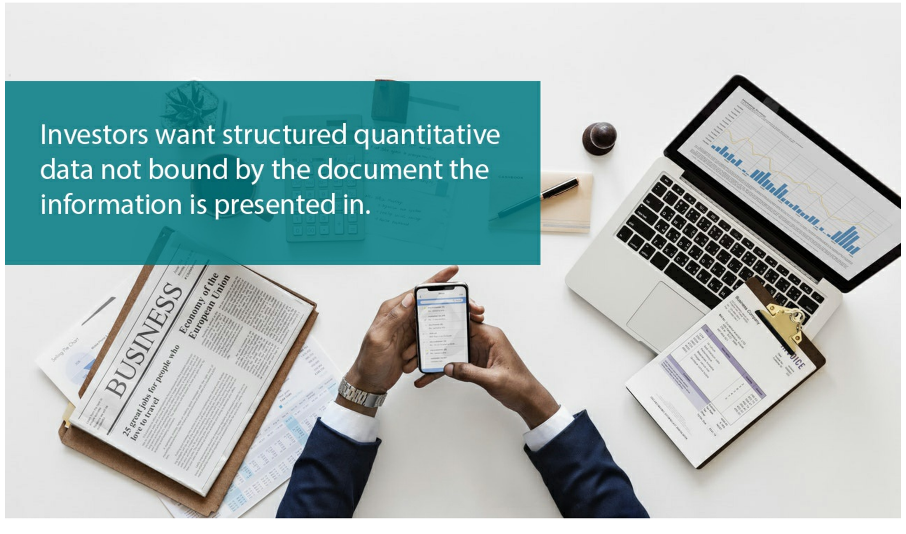
By Adv. Rory Voller

The Chartered Financial Analyst (CFA) Institute, a global association of investment professionals, recently found that investors can perform faster and better analysis investment decisions with digitised financial reporting tools. The CFA research, which is also one of the most respected institutions for ethical conduct, also found that the use of data and technology “not only research more companies but also take a closer look at the companies they already follow”. This is an important insight for South Africa especially in the advent of the fourth industrial revolution. These developments mean that all local industries must be at the forefront of the digital revolution or risk being left behind.

Local investors are part of the CFA through the CFA Society South Africa. In order to align with international best practices and ensure effective implementation of their mandate as prescribed in Regulation 30 (5), the Companies and Intellectual Property Commission (CIPC) will soon be launching the eXtensible Business Reporting Language (XBRL) electronic reporting mechanism.

XBRL is not only aimed at reducing risk for investors when analysing companies but it brings CIPC, which is currently receiving Annual Financial Statements in a PDF Format, into the digital age. In a recent article, Mohini Singh director of financial reporting policy at CFA Institute, says the use of data and technology in financial reporting can result in a more effective and efficient overall financial reporting process in which investors and analysts receive more transparent, better-quality information on a timely basis.

In her view, backed by CFA research, Sign highlights that “investors want structured quantitative data not bound by the document the information is presented in, along with management’s explanation of the results, which tends to be both quantitative and qualitative”. While this research strengthens the investment case for the CIPC’s introduction of XBRL, it is Singh’s observations that digital financial reporting not only improves productivity, financial statement accuracy, and opportunities for higher returns, but also allows for “better risk management”.



In February this year the CIPC started a pilot phase for testing filings via XBRL. More than 100 large JSE listed companies were invited to be part of the pilot test phase and trial the functionality of the CIPC’s portal for uploading of AFSs via XBRL. Of these more than 50 companies participated by successfully submitting close to 100 different sets of test filings.

After the completion of the pilot project, it will become compulsory for qualifying reporting entities to have XBRL-capable software to compile Annual Financial Statements data in XBRL format and according to the CIPCs published taxonomy from 1 July. All qualifying entities operating in South Africa will be required to submit their latest available approved and audited financial statements on the first date of submission applicable to them. This structured data is aimed at making it easier and cost effective for investment firms to cover small to mid-cap companies.

Given the complexities of the financial reporting environment, digital financial reporting not only helps reduce risk where disclosure no longer relies on professional judgement alone, it also helps to manage risk. The role of auditors has also come to light in South Africa pertaining to their professional judgment in the course of their work. Auditors – where XBRL is concerned – prepare the financial statements to be filed for their companies. It is no surprise that the Independent Regulatory Board for Auditors has introduced mandatory audit firm rotation to enhance auditor independence in order to improve their professional judgment. As the professionals who prepare these statements – auditors apply professional judgement to interpret ethical requirements and International Standards on Auditing for them to be able to make informed decisions.

XBRL could not have come at a better time where recent gaps in financial reporting standards have been exposed in one of the country’s major companies, Steinhoff International. A 2016 study titled at the Bucharest Academy of Economic Studies titled: The importance of professional judgement applied in the context of the International Financial Reporting Standards, found that “judgments made by accounting professionals might be challenged because of the nature of their professional responsibilities and the flexibility of the existing regulatory environment.”

“The current concern in the field of accounting regulations is to avoid the subjectivism as much as possible, in order to reflect and provide reliable and transparent information, by making appropriate use of the professional judgement. Regulation can improve the fundamental principles of the accounting theory, by pointing out what the accounting should be”, the paper found. The study highlighted the role “trust in a principles-based accounting framework.”

“The quality and integrity of the judgements made give rise to correct numbers being reflected in the financial statements and, therefore the trust in the operation of principles-based accounting standards increases once more if the suitable methods of valuation and classification are applied consistently”.
But as Pranav Ghai and Alex Rapp co-founders of Calcbench, a financial data and research firm that relies on XBRL, wrote in *Accounting Today*, “XBRL gives financial analysts the power to understand how exchange rates might affect various sectors and companies more precisely.”

Ghai and Rapp – based in New York - gave an example of how XBRL helps manage risk by taking a look at some of the risk factors associated with China and how investors can work around them in their analysis of companies based in China. “A crucial issue for analysts evaluating risks and opportunities related to China is to understand both the magnitude of a company’s investment in China, and how it is changing over time. Now that companies tag their segment-level disclosures in XBRL, finding that answer becomes an instantaneous exercise”, the two wrote. For South Africa, XBRL not only improves regulatory effectiveness it will replace the limitations of manual sample analysis on individual statements and enable improved high-level understanding of business in the country. By revolutionising the way reporting entities submit Annual Financial Statements the CIPC is bringing the country’s entities into the digital revolution.

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