A Revolution in Indonesian Financial Reporting

Globalisation of Capital Markets

As the forces of globalisation reshape so many aspects of our lives, the importance of effective international communication has never been greater. An event the opposite side of the world may be known of and have repercussions in Indonesia within hours or minutes. During the current turmoil in global capital markets, bad news overnight from New York would be mirrored in Asia as soon as the local markets opened the following morning. It wasn't so long ago, that during another large downward correction of major markets, the then Jakarta composite index bucked the global trend by rising while others overseas all fell. Such immunity from world events is unlikely ever to be repeated in the current era. If global capital and financial markets are not yet fully integrated, their interdependence is plain to see. The reliability of communication is critical to enable market operators to make rapid and informed decisions. The adoption of the English language as the international language of business has certainly facilitated effective global communication.

Inconsistency of Accounting Standards between Markets Increasing the Cost of Capital

But in the area of financial reporting, the use of a common language alone is not enough to ensure that international investors can correctly interpret the financial reports they rely on to make sound investment decisions. As capital becomes increasingly mobile and international investors are attracted to new markets, they have to be able to evaluate investment opportunities on a common platform with alternative opportunities elsewhere. Historically, accounting principles have been developed at the national level and may reflect the narrow needs of individual markets. In such a limited context they may be adequate. However, if key terms used in financial reports are defined differently across borders, it makes the interpretation and comparability of companies' financial reports additionally complex.

The problems of inconsistency are typically brought into focus when companies have multiple listings in different markets. Major companies have sometimes reported dramatically inconsistent results for the same financial reporting period when applying different national accounting principles. Such inconsistencies devalue the credibility of both the accounting profession and the regulators. They also increase the complexity of cross border investment, slowing decision making and inflating costs. For an international investor in a new market, this also means higher risk and the need for compensatory higher returns.

Convergence with IFRSs and International Harmonisation

To address this challenge, Indonesia over recent years has been gradually "converging" its accounting principles to make them consistent with International Financial Reporting Standards (IFRSs). Indonesia is thereby playing its part in the international harmonisation of financial reporting so that Indonesia's financial reports will be more readily comparable with those from most other major markets. The process of convergence will significantly accelerate in 2011 and 2012 at a speed that some refer to now as a "gradual big bang". The adoption of the new reporting requirements is mandatory for public listed companies, companies that receive and manage funds from the public and state owned enterprises.

IFRSs are set by the International Financial Standards Board (IASB) that was established in its present form in 2001, superseding the predecessor International Financial Standards Committee (IASC). The IASB's primary mission is "to set high quality globally accepted standards" for general purpose reporting. As an agency of the G20, the IASB is placed at the centre of global public policy. Since its creation, the IASB has introduced a number of original IFRSs as well as amending many of the existing International Financial Standards (IASs) produced by the IASC.

A New Era Bringing Fundamental Change

What is the significance of these changes for those who prepare and use financial reports in Indonesia? For 2011 reporting, nine amended standards will be applied for the first time, followed in 2012 by a further four newly amended standards plus two new standards. That will mean that by 2012, Indonesian generally accepted accounting principles will be in alignment with all IFRSs applicable for 2009. Further changes may thus be anticipated in ensuing years. The comparative 2010 results of companies will have to be restated to be consistent with amended standards. The 2011 results of companies will need to restate for 2012 reporting. Interim financial reports for 2011 should also adopt the new requirements.

The new approach will require not just knowledge but judgement based on sound interpretation. Whereas the rules based approach seeks to provide guidance for every eventuality, it fails when unable to anticipate new and creative transaction types. Thus when there is no rule, preparers have the freedom to do as they please. Such gaps can be the harbingers of disaster. A principle based standard states the qualitative characteristics of transaction types and/or assets and liabilities to determine their nature and classification avoiding quantitative criteria that may fail to be fully inclusive. The challenge will be to achieve consistent interpretation of standards between companies.

The implementation of the changes will be very demanding for not only for those preparing financial statements, but also others responsible for the approval and use of financial reports including CFOs, CEOs and other directors and commissioners of companies, audit committee members and auditors, market analysts etc. The implementation is not simply a question of learning and applying new rules. IFRSs marks an arguably revolutionary change away from primarily rules based reporting, closer to US Generally Accepted Accounting Principles, to a principles based approach. Successful implementation will be dependent on effective change management.

Those groups significantly impacted by the coming changes have much new to learn. The accounting staff of organisations will need to work hard in the coming months to become familiar with the pending changes and achieve the confidence necessary to interpret and apply them correctly. Participation in training workshops and obtaining certification of competence in IFRSs from reputable accounting institutes will facilitate the process. Companies face a significant challenge to manage and implement the changes. The arduous task of amending accounting procedures and records cannot be delayed. Though no doubt burdensome for companies, the prize for success is considerable. The changes introduce a new era in financial reporting in Indonesia, something that can only increase the attractiveness of Indonesia as a place to invest and to do business.