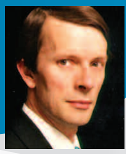
An international perspective

CRISPIN SOUTHGATE REPORTS ON THE WORK OF THE CORPORATE REPORTING USER FORUM.



Executive summary

- Engaging with the ACT, other representatives of corporate preparers and the standard setters, the Corporate Reporting User Forum is determined to ensure the views of users are heard. In particular, it has strong opinions on fair value, the conceptual framework and financial statements presentation.

The Corporate Reporting User Forum (CRUF) was formed in 2005, initially by a group of investment analysts consulted by PricewaterhouseCoopers for their views on corporate reporting. CRUF members have an international investor perspective, reflecting the global buy- and sell-side institutions where most of us have our day jobs.

As analysts, we welcomed the widespread adoption of international financial reporting standards (IFRS). But we were concerned that insufficient attention was being paid to the views of investors in the development of those standards and in the convergence project with the US Financial Accounting Standards Board (FASB).

CRUF supports the common goal of the International Accounting Standards Board (IASB) and the FASB for standards to be more principle-based and shorter. Our own guiding principles (see *Box 2*) will not strain the postman recovering from delivery of the latest 450-page HSBC annual report.

MUCH OF CONCERN Although a period of relative stability in IFRS, with no new major standards becoming effective before 2009, there is still much going on of concern to investors at the IASB (www.iasb.org). The Active Agenda covers convergence projects under the memorandum of understanding with the FASB, including major work on business combinations, fair value measurement, financial statement presentation (previously called performance reporting), revenue recognition, post-retirement benefits and leases. A separate joint project revisits the conceptual framework. Projects on the research agenda include liabilities and equity, derecognition, intangible assets and replacement of existing standards for financial instruments. CRUF comment letters on many of these subjects can be found on www.cruf.com.

IASB Chairman Sir David Tweedie and his colleagues have listened to our concerns that investors are often consulted too late. They have welcomed our willingness to engage as early as possible in the process of forming standards. In addition to many informal contacts, the IASB held the first open public meeting with CRUF members in January 2007.

The CRUF also engages with corporate, or preparer, groups – in the UK, that's the ACT, the Hundred Group and the CBI – to discuss areas of common concern.

CRUF members contributed to the report leadership project, sharing the aim of more accessible, effective and practical reporting. Look, for example, at 'generico' pension disclosures and the use of non-GAAP measures such as expected rather than contractual maturity dates of borrowings in www.reportleadership.com.

Set against the background of our guiding principles, here are some of the issues that concern us in relation to three major IASB agenda items.

FAIR VALUE Many of us are closer to the views of preparers on the limitations of 'fair value', particularly in relation to operating activities, than to the published views of the CFA Institute on the matter.

The mixed fair value/historic model currently in use gives rise to considerable difficulties. But the solution does not involve the exclusive use of fair values in primary statements. The purpose of the balance sheet is to reflect the capital invested in the business – where it came from and where it has been deployed. It is not to provide a 'fair value' of the entity as a whole.

CONCEPTUAL FRAMEWORK We strongly support a revised conceptual framework with authoritative status. It will be a vital foundation for developing shorter, more principle-based standards and moving away from lengthy rule-based horrors such as IAS 39 and FAS 133.

Box 1. The Corporate Reporting User Forum

The Corporate Reporting User Forum was formed in 2005. CRUF participants include individuals from both buy- and sell-side institutions, and both equity and fixed income markets. The forum includes individuals with global or regional responsibilities and from around the world. CRUF meets on a regular basis in both London and Frankfurt, and has facilities for remote participation.

CRUF is a discussion forum that aims to help its participants approach the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of the International Accounting Standards Board.

CRUF participants take part in discussions and joint representations as individuals, not as representatives of their employer organisations. It does not seek to achieve consensus views, though at times its participants will agree to make joint representations to standard setters or to the media. The chairmanship of CRUF rotates at each meeting and different individuals take leadership in discussions on different topics and in the initial drafting of representations.

For more information, visit www.cruf.com

However, the flaws in the current parent company approach are not so serious as to warrant moving towards an entity approach: this would put theoretical elegance ahead of commercial reality and analytical practice. The perspective of current shareholders should remain primary; the requirements of other users, including creditors, lenders and bondholders, can still be dealt with effectively in this model.

Similarly, the stewardship concept should be retained as a separate objective of financial reporting. Linked to this, we believe that history matters. We want to see evidence of the achieved accrued returns on various elements of historic capital as well as information that is useful in assessing the future prospects for cashflow.

FINANCIAL STATEMENT PRESENTATION Revised presentation of the primary financial statements is necessary and overdue. For example, investors often need to dig into notes to identify material revaluation items that have moved net worth. An appropriate statement of earnings and comprehensive income would bring most of this information to the front, where it belongs.

We like earnings and some of the ideas being debated by the IASB/FASB suggest they do not. There is a tendency to overemphasise the balance sheet and the number at the bottom of the comprehensive income statement. But investors have been using earnings and earnings per share measures for decades. Whether they should have been is an interesting theoretical question, but the actual practice of investment analysis and valuation in a historical context will require such a metric for the foreseeable future.

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Box 2. The guiding principles of CRUF

Accounting standards that govern the preparation of corporate reports should be principles-based and comprehensible to the financially literate. These standards should not result in outputs that are at odds with economic reality.
Such standards should be based on the presumption that the stated principles are faithfully applied. Therefore, standards should avoid unnecessary detailed prescription and not unduly restrict companies in presenting meaningful results that are in accordance with those principles.

Corporate reports should report economic reality.
Accounting standards should require compliance with their spirit rather than their letter, so that preparers are required to disclose economic 'substance' rather than accounting or legal 'form'.

Users want transparent and comprehensive disclosures.
Corporate reports should be prepared with the objective of providing a fundamental source of information for investors and creditors on which to base their decisions.

Corporate reports should provide information that is clear, understandable, consistent and relevant.
No single primary statement should take precedence.

Not all information that is relevant for users of corporate reports has to be reflected in the primary financial statements. Some information, such as contextual and non-financial information, may best be presented outside the primary financial statements.

Accounting standards should not discourage companies from presenting additional information that is useful to users.

The purpose of the cashflow statement should be to identify and explain cash inflows and outflows over the period. Further, the cashflow and accompanying notes should provide insights into the drivers of maintainable cashflows as well as the trends over time of these drivers.
The cashflow should be capable of comparison and reconciliation with the profit and loss and balance sheet. The impact of acquisitions and disposals on these cashflows should also be clear.

The purpose of the balance sheet should be to reflect the capital invested in the business along with capital adequacy, compliance with legal covenants and stewardship.
The purpose should not be to determine the entity's fair value. Further information regarding the values of individual assets and liabilities (including assumptions and sensitivities) should be provided in the notes.

The purpose of the profit and loss statement should be to identify the returns generated from the capital invested in the business.
The profit and loss and the accompanying notes should clearly differentiate and analyse relevant information, such as:

- operating performance from financing activities;
- recurring from non-recurring activities; and
- value changes from trading activities.