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Financial reporting – what do investors want?

The accounting profession is continuing to wrestle with the dilemma of fair value accounting. Valuing a corporate's financial assets and liabilities at market value may undermine the balance sheet's historical validity. Movements in those values, taken through the profit and loss account, will obscure the sustainable earnings trend.

If financial instruments are fair value accounted why not apply the same approach to all assets and liabilities? If so, the net assets reported in the balance sheet will tend to reflect the enterprise value derived from discounting the future expected cash flows – isn't enterprise value the investment analysts' province rather than the accountants'?

Fundamental shift

It is easy to see why this issue is shaking the foundations of the traditional accountant's training. When combined with the risk disclosure and management issues arising from the continuing debate on corporate governance matters, and similar pressures from the Accounting Standards Board, the leading bodies in the accounting profession are having to think deeply about the role of accountants in financial reporting and the direction of future reporting standards.

The Institute of Chartered Accountants in England and Wales (ICAEW) have taken a lead in this by publishing *The 21st Century Annual Report* at www.icaew.co.uk which discusses some of the shortcomings evident in current annual reports and how these might be overcome.

Investors' needs

But what do investors want? It seems reasonably clear that investors want, among other things, reliable information that can lead them to an assessment of the enterprise value of a corporate. This can be achieved through an understanding of the size, and probable volatility, of the future sustainable earnings of the corporate and a view of its historical performance.

Why don't we accept that shareholders deserve a report which meets all their expectations, even those which go some way towards requiring an enterprise value for the company and hence a view of the future of the share price?

Achieving this insight means investors must understand the nature of the risks run by the business, the quality of management who assess and manage those risks, the present and future competitive environment for the business' output and much else besides.

Against these subjective and obdurately unquantifiable parameters the accountants' concerns for the maintenance of historic cost accounting seem almost irrelevant. But somehow financial reporting must resolve itself into a clearly defined process.

Why don't we accept that shareholders deserve a report which meets all their expectations, even those which go some way towards requiring an enterprise value for the company and hence a view of the future of the share price? Why do we allow some institutional investors and investment analysts to have an inside track in their contacts with, and data from, a company?

Radical approach

A radically new approach would be to require a company to commission an independently audited investment analyst's report, based on data supplied by the company and from elsewhere. All the data used would be made available publicly, in electronic form at the time of the report's publication. The report would be given to shareholders semi-annually. No data, other than those used to generate these semi-annual reports, would be made available preferentially to analysts or others. The authenticity of the data used, but not the conclusions, would be affirmed by the corporate's auditor.

This seemingly revolutionary approach mirrors the recent change in the provision of house surveys that are now to be given by sellers rather than commissioned by buyers.

If such an audited analyst's view were to be incorporated alongside the company accounts it would serve to re-focus shareholders' and others' views away from the historic to the future performance of the company. It may also help to resolve the dilemma of how to construct popularist short form annual reports and accounts. These will be more balanced if they contain a brief analyst's report since that report will be based on all the available company data.

Using the internet

The full set of information in a company's annual report and accounts, and any additional data supporting the analyst's report, might then be made available publicly only in electronic form on the internet website maintained by the company. This should also include an immediate verbatim record of all questions and answers given at analysts' meetings and the company's AGM.

The subject of how companies should use the internet, and maintain the disclosure disciplines that apply to all company reports and investor relations communications, is discussed in a recent report, available on the web from Online Investor Relations at www.newsdirections.com/survey98.html

No compromise needed

By accepting that there are two audiences needing to understand a company's performance – the non professional individual investor and the professional institutional investor – and catering for them in very different ways, no compromises need be made since both groups would, if they wanted, always have full recourse to the same information at the same time.

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These issues have been discussed in the two yearly international study of corporate disclosure *Full Disclosure 1998* (www.infofarm.com).

Shelley Taylor, its publisher, has said "It is the voluntary disclosure of qualitative information that creates share price premium and therefore this should be seen as a fundamental component of corporate disclosure".

The Department of Trade and Industry is undertaking a comprehensive review of company law which will include statutory reporting requirements.

Perhaps now is a good time to suggest that the approach to company reporting is put on a modern footing by better use of the internet and making available an expert opinion on future performance. ■

David Creed is director general of The Association of Corporate Treasurers.