BUSINESS REPORTING:
THE INEVITABLE CHANGE?

A Discussion Document by the Research Committee of The Institute of Chartered Accountants of Scotland

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FOREWORD

This discussion document is the result of a major research project undertaken by the Research Committee of The Institute of Chartered Accountants of Scotland. The Committee is grateful to the Scottish Chartered Accountants’ Trust for Education for funding the project.

It is in the interests of both the user and the preparer for the right amount of quality business information to be provided. The user benefits by being able to reach a better informed decision, so reducing risk. The preparer benefits by paying a reduced cost for capital.

Yet, in this drive towards relevant information, what are the constraints? There are concerns about information overload from some users and about commercial confidentiality from preparers, and the means of providing assurance as to the reliability of certain types of business information are, as yet, not well developed. Further, whatever is wanted, how can the substantial advances in information technology assist?

The question of what business information users want is not new but the answer, in today’s fast changing economic environment, may well be. The Research Committee has addressed this question in two stages. In the first stage we conducted in-depth interviews of fund managers and in-house analysts; brokers’ analysts; and bank lenders. The aims were to investigate the decision making processes of users and to identify the main concerns surrounding the current system of reporting and to identify the nature of business information needed in order to reach informed decisions. This work was guided by a working party and an Advisory Group.

Four themes emerged and the considerable detail obtained is published separately in a companion report, Corporate Communications: Views of Institutional Investors and Lenders. Included in the four themes was the controversial issue of one-to-one meetings between investment managers, or analysts, and the listed company and the extent to which these exchanges were seen as providing privileged access, with a concomitant complaint from those denied such access.
The second stage of the project used the four themes as a basis for further extensive survey research. The aims were to identify the needs of users and their attitudes to certain features of the current reporting system and to formulate proposals on how practices might be improved.

The research findings provide new insights and also provide systematic evidence to confirm existing anecdotal views. In particular, high on the list of needs is information which can help the user to assess the quality of management. The need for forward looking information is also a priority. Such information need not be financial in nature.

The consequent proposals which the Research Committee puts forward to change business reporting practices are, it is submitted, at times radical yet realistic. We propose measures to address the perceived inequity arising from the one-to-one meetings with the company. There are also proposals on how to provide assurance on the enhanced quality and quantity of information which is sought.

The advances in technology have been harnessed in our proposals. We have, for example, embraced the principle that any investor, large or small, should have access to a considerable amount of business information, to be provided by way of databases, so that each user may exercise an individual preference about the nature and extent of the information. We realise, however, that implementation of any of our proposals has to be evolutionary over the mid- to long-term and cannot simply be imposed.

There were also numerous issues raised which were beyond the scope of the project but which, nonetheless, require further investigation. These issues include how to report on the quality of management, the nature of the relationship between financial and non-financial indicators and the extent and nature of users' demands for independent assurance on the information to be provided.

We are grateful to all who took part in the project and would especially acknowledge the considerable help of those who responded to our research questions, either in person or by completion of questionnaires; and of the members of both the working party and the Advisory Group. These were all busy people who found the time actively to discuss and debate the issues, and thereby to assist the project.
We are also extremely grateful to Professor Pauline Weetman and Professor Vivien Beattie, the Institute’s successive Directors of Research during the term of this project and to Aileen Beattie, Director, Accounting and Auditing. Together they organised and took part in the research. They also evaluated the many disparate issues which arose with considerable skill and pulled together the main threads that emerged, not only from the research but from the numerous discussions on the subject by the Research Committee, the Working Party and the Advisory Group. This, together with the subsequent detailed drafting of the discussion document, was a substantial achievement. We are equally grateful to Ann Lamb, Assistant Director, Accounting and Auditing, and to Isobel Webber, Personal Secretary to the Director of Research, for the dedicated care and seemingly inexhaustible patience with which they prepared and edited successive drafts. We are also grateful to members of the Council of The Institute of Chartered Accountants of Scotland for allowing us to publish this document.

Professor John Baillie
Convener, Research Committee
The Institute of Chartered Accountants of Scotland

February 1999
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AND THE EDITOR

This discussion document was prepared by the Research Committee of
The Institute of Chartered Accountants of Scotland. As the Committee
rotates its membership the date in brackets relates to the date of joining
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The members of the Institute's working party for this project are:

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EXECUTIVE SUMMARY

Background

The nature of the economic environment is changing dramatically. The number of knowledge-based and service companies is increasing and short-term, strategic alliances between companies are becoming commonplace. Linked to changes in the economic environment, technological advances mean that vast amounts of data can now be made available reliably and cheaply. Software agents can search and analyse this data, as specified by the user, to produce useful information. The Internet provides a convenient way of allowing external users access to proprietary databases. Electronic dissemination, allied to sophisticated software agents, provides the flexible access and decision support demanded by users.

Traditional financial reporting, developed for manufacturing companies with mostly 'hard' assets, and rooted in the periodic reporting of aggregated, historical, financial information, no longer satisfies users. Because large volumes of data can now be filtered effectively, users are demanding more data. It is to be expected that business reporting will become user driven rather than producer driven, i.e., there will be a power shift from producers to consumers, as is occurring in many other parts of the economy.

The current wave of interest in the future of financial reporting dates from 1994, with the Jenkins Report in the US which proposed a customer focus (AICPA, 1994). Since then, a number of bodies and individuals around the world have published reports, articles and even illustrative web technology-based company reports that speculate on the future of financial reporting.

Recent ICAS research

Given the significance of these potential developments, the Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) has, over the last three years, funded a series of research projects into the
corporate communications process (Marston, 1996 and 1999; Holland, 1997). In particular, as stage one of the present study, the Research Committee set up a working party to investigate business information and user needs and conduct interview-based research into the decision making processes of investors and lenders. The full details of the findings are published in a separate research report (Weetman and Beattie, 1999). From stage one, four key themes relating to the corporate communications process were identified:

- the cyclical nature of corporate communications and users' decision making;
- the perception of differential user access to company information (an unlevel playing field);
- differing concerns regarding information overload; and
- the need to create and maintain confidence in the company and therefore to provide an appropriate level of assurance regarding the reliability and relevance of business information.

Survey findings

As stage two of our study, we report here the results of a large-scale survey of users, preparers and auditors, which investigates their views about current financial reporting, in particular their views regarding the four key themes above. Users were also asked to rate the importance to them of 29 key drivers of company performance. A total of 308 postal questionnaires were issued, yielding a 50% response rate, and 15 follow-up telephone interviews were conducted.

Main findings regarding the current system of financial reporting were as follows:

- **Cycle** There was dissatisfaction as to the timeliness of information flows. Regular, periodic flows were viewed as satisfactory for providing year-end information but not as a basis for assessing future performance.
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- **Differential access**  One-to-one meetings were seen to create the perception and reality of unfair advantage, but (with the exception of small shareholders) were viewed to be of general benefit. It was believed that they should be continued.

- **Information overload**  Generally, users did not suffer information overload and would welcome additional information. Users wished to retain control over the information search and selection process.

- **Confidence**  The prime source of confidence in business information is the subjective assessment of the ‘quality of management’, often obtained *via* interactions with management. External audit ranked only third.

- **Drivers of company performance**  ‘Quality of management’ was viewed as the key generic driver of company performance. Aspects of management quality, strategy and sources of risk were the main types of specific factor viewed as important.

A blueprint for business reporting

Our proposals for change in the reporting practices of listed companies map directly on to these survey findings. Our proposals are, therefore, aimed at: improving the timeliness of business information; levelling the playing field by improving access to disadvantaged groups; increasing the opportunities for users to interact with management; providing a wider range of relevant information while providing support for non-expert users; encouraging the dissemination of more information of a forward looking and/or non-financial nature that relates to the drivers of corporate performance; ensuring user control of the information search and selection stages of decision making; and ensuring adequate confidence in the information.

Our blueprint comprises proposals relating to seven broad features of the business reporting package:

- **The corporate database be made available to external users as an electronic library-type resource**: by making this resource available, the general desire for additional information on an as-demanded basis is met;
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- **Layering, linking and free search of information in the electronic library:** by exploiting technology to layer information, the information overload problem of non-expert users is reduced; links to non-company databases facilitate effective search strategies, while the free search principle satisfies users' desire to retain control over the information search and selection process;

- **Packaging the information using templates:** the provision of a range of pre-selected and pre-packaged information for each stakeholder group provides support to non-expert users and offers the relevant focus to suit different user perspectives;

- **Extending access to company meetings and to management:** by placing records and minutes of meetings in the electronic corporate library, unfair advantage is reduced while retaining the benefits of these meetings as a basis for assessing the quality of management; on-line questioning of management facilitates interaction;

- **Additional forward looking, non-financial and soft information:** by providing regular forward looking, prospectus type information relating to strategy and risk, and non-financial information relating to factors that drive forward looking profit and cash flow, users' ability to assess future performance is enhanced;

- **Frequency of library updating:** by retaining regular, periodic reporting, but increasing its frequency and speed of delivery the general desire for increased timeliness is satisfied without a shift to real-time reporting, for which there is currently no significant demand; and

- **Confidence: shift to assurance of processes rather than outputs and multiple levels and forms of assurance:** open access to a large part of the corporate database necessitates a shift towards the assurance of processes, not just outputs, while the expanded range
of information types available will create a demand for an appropriate corresponding range of assurance levels, relating to both the reliability and relevance of the information.

The way forward

We recognise that any attempt to mandate radical change, with the potential to destabilise the capital markets and provoke a litigation crisis, is too risky to be a viable option. Instead, we propose that the profession actively encourages and assists in bringing about change incrementally. This can be achieved by fostering discussion and debate among interested parties, by undertaking empirical and theoretical research and by encouraging companies to experiment with the form and content of their business reporting package.

Our blueprint sets an agenda for future research effort. We identify eleven key areas where research is urgently required. The first three are general, relating to the provision and use of business information and the underlying financial reporting model. The next five concern the additional information to be made available to external users, while the last three concern the provision of assurance regarding the expanded information set.

General

- Monitoring of corporate business reporting practices
- The use of business information by stakeholders
- Conceptual development of the financial reporting model to suit new business structures

Additional information

- Internal use of non-financial performance indicators
- Reporting of intangible assets
- Reporting on quality of management
- Relationship between financial and non-financial indicators
- Market value relevance of additional disclosures
Assurance

- Extent and nature of demand for related assurance services
- Development of relevant assurance procedures and reporting formats
- Skills base of professional accountancy firms
CHAPTER ONE

INTRODUCTION

In recent years, there have been significant changes in the business environment and in business practices. Financial reporting has been evolving gradually to accommodate these changes.

It has been clear for several years that developments in information technology would have a major impact upon the context and content of financial reporting. Technology permits more information to be provided in a user friendly way, since it can be targeted at the reader and supplied on an ‘as-demanded’ basis. The current wave of interest in the future of financial reporting dates from 1994, with the Jenkins Report in the US (AICPA, 1994). This report set out to improve business reporting by adopting a customer focus, ie meeting the information needs of investors and creditors. Since then, a number of bodies and individuals around the world have published reports, articles and even illustrative web technology-based company reports that speculate on the future of financial reporting.

Given the significance of these potential developments, the Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) has, over the last three years, funded a series of research projects into the corporate communications process (Marston, 1996 and 1999; Holland, 1997). In addition, as stage one of the present study, the Research Committee set up a working party to investigate business information and user needs and conduct interview-based research into the decision making processes of investors and lenders. The full details of the findings are published in a separate research report (Weetman and Beattie, 1999). From stage one, four themes relating to the corporate communications process were identified:
the cyclical nature of corporate communications and users’ decision making;
the perception of differential user access to company information (an unlevel playing field);
differing concerns regarding information overload; and
the need to create and maintain confidence in the company and therefore to provide an appropriate level of assurance regarding the reliability and relevance of business information.

In this discussion document, which represents stage two of our study, we report the results of a large-scale survey of the views of interested parties (ie users, preparers and auditors) regarding these themes. The questions asked were designed to establish respondents’ level of agreement, on a scale of one to five, with specific statements concerning the four themes. Users were asked additionally to rate the importance to them of 29 key drivers of company performance. An initial list of drivers was derived from the earlier interview research, of Holland (1997) and Weetman and Beattie (1999), and amended to include additional factors.

Based on this research evidence, we set out our own proposals for debate regarding the future development of financial reporting¹. These proposals are targeted primarily at public listed companies for the purposes of routine monitoring. They are intended to address the needs of both expert and non expert users. This discussion document is published in the spirit of stimulating debate on, and research and experimentation in, corporate communications. We would welcome comments on our proposals.

Structure of discussion document

Chapter two summarises the key changes which have occurred in recent years in the business environment, business practices, and financial reporting practice. This allows a preliminary assessment of the extent to which the traditional financial reporting model results in a ‘business reporting expectations gap’ in the modern business world. We then review recent proposals regarding the future of financial reporting.
Chapter three summarises the relevant academic and professional research on user needs, financial reporting and the structure and process of financial communication between companies and external stakeholders, viewed from the perspective of both users and preparers. Chapter four reports the results of our own survey of the views of various interested parties regarding four themes of current financial reporting (the cyclical process; differential access; information overload; and confidence and assurance). The attitudes of users, preparers and auditors (collected by means of a postal questionnaire) are summarised, along with the results of a smaller number of follow-up telephone interviews that explore the underlying logic for respondents' answers. We also summarise the importance to users of a number of potential drivers of company performance.

Our proposals for the future development of business reporting are presented in chapter five. These proposals are grounded in our survey responses, the findings of recent ICAS research studies into corporate communications and other relevant literature. The final chapter suggests directions for future research.

\textit{Endnote}

1 This discussion document reflects the Research Committee's ongoing interest in corporate reporting. In 1988, the ICAS Research Committee published its discussion document \textit{Making Corporate Reports Valuable (MCRV)} which examined the principles of corporate reporting and proposed a blueprint for meeting the information needs of various user groups. Subsequently, several of \textit{MCRV}'s proposals relating to the annual report and accounts have been developed by the UK standard setters to form part of today's corporate reporting practice.
CHAPTER TWO

RECENT CHANGES
AND VIEWS OF THE FUTURE

This chapter sets the scene by first describing recent changes in the environment in which business is conducted and outlining general trends in business practice. We then review the recent trends in financial reporting practice. On this basis, a 'business reporting expectations gap' is tentatively identified. The focus then shifts to the future, with a review of recent proposals emerging around the world relating to the future of financial reporting.

Changes in the business environment and business practices

There has been a marked change in recent years in the environment in which business is conducted, resulting in an increase in the complexity and diversity of business practices. The so-called information technology 'revolution' has resulted in the increased globalisation of capital markets and facilitated new electronic ways of conducting business with customers. Service companies have become a major, and rapidly expanding, sector of the economy. For such companies, human capital and intellectual property are key 'assets'. Product life cycles have shortened. Companies must be increasingly flexible and adaptable to survive and be successful.

There has been substantial growth in the 1990s in the use of derivative instruments (whether financial or commodity based). These instruments are sensitive to changes in market rates and prices and, therefore, increase a company's risk exposure. Worldwide many companies have experienced significant losses. The organisational form through which business is being conducted is also changing as strategic alliances, sometimes transient,
are created to undertake specific projects. These changes have been described by economists as a transformation of the world economic infrastructure.

Internally, management are increasingly recognising the inherent limitations of financial measures and are turning to a broader range of non-financial performance indicators. Kaplan and Norton (1992, 1993, 1996a and 1996b) were perhaps the first to develop an explicit framework within which to think about corporate value generally. Their ‘balanced scorecard’ approach encompassed factors such as customer satisfaction and staff morale alongside traditional financial measures as drivers of long term economic value. The four dimensions of the balanced scorecard cover financial, customer, innovation and efficiency factors. Their ideas have, however, gained widespread favour due to developments in information technology which facilitate the identification and measurement of key drivers.

Changes in financial reporting practice

During the 1990s, there have been several significant changes in the form and content of public financial reporting documents, in particular, the corporate annual report. There have been new financial reporting standards (FRSs), the introduction of the narrative Operating and Financial Review and summary financial statements. More timely reporting is being encouraged actively by standard setters, with the recent voluntary Statement on Preliminary Announcements encouraging issuance within 60 days of the year end (ASB, 1998a). In addition, companies are starting to explore the Internet as a medium for the dissemination of financial information.

New financial reporting standards

The Accounting Standards Board (ASB) has issued a series of reporting standards which attempt to improve the usefulness of financial statements. FRS 3 Reporting Financial Performance introduced a multi-column layout to the profit and loss account which distinguishes between
 Recent changes and views of the future

continuing and discontinued operations (ASB, 1992, amended 1993). It also introduced a secondary performance statement, the statement of total recognised gains and losses. FRS 1 Cash Flow Statements introduced, for the first time, a requirement for this statement to be provided (ASB, 1991, revised 1996). FRS 4 Capital Instruments and FRS 5 Substance of Transactions addressed some of the recognition and measurement problems which have plagued the balance sheet (ASB, 1993a and 1994). FRS 13 Derivatives and other Financial Instruments: Disclosures allows users to understand the significant aspects of the entity's risk profile and how this risk is being managed (ASB, 1998b). Narrative disclosures are to be included in the Operating and Financial Review and numerical disclosures are to be included as notes to the accounts.

Operating and Financial Review (OFR)

The Statement Operating and Financial Review (ASB, 1993b) has persuasive rather than mandatory force and no format is prescribed. The stated intention of the OFR, which lies outside the core financial statements and related notes, is to provide a framework for the company management to discuss and analyse, qualitatively and quantitatively, the factors underlying the performance and position of the business 'to assist users to assess for themselves the future potential of the business'. Unfortunately, research shows that compliance with the spirit of the ASB's guidance is disappointing (Weetman et al, 1995; Weetman and Collins, 1996; Arthur Andersen, 1996). Few companies were found to use ratios and there was a general lack of specific, forward looking information due to fears about confidentiality and litigation. Preparers were found to wish to remain very much in control of its style and content. Amongst the largest companies, however, the quality of the OFR was improving, especially where a strong managerial team exists (Weetman and Collins, 1996).
Summary Financial Statements (SFS)

Permission for fully listed companies to issue summary financial statements (SFS) was introduced by the 1989 Companies Act. The intention was to both reduce information overload on private shareholders and cut the costs of reporting for companies. Uptake of this reporting option has been slow, even since a relaxation of the regulations in 1995. In a survey, only 57% of UK private shareholders chose SFS over the full annual report (Bartlett and Chandler, 1997, p60). Few major companies have adopted this reporting option. In a survey of preparers, the main disadvantage was cited as the net cost increase in information production and dissemination (Gray and Roberts, 1993). In a survey of users, the financial statements were the sections of the SFS found to be most difficult to understand (Hansford et al, 1996). SFS are not, therefore, used widely and appear to be unsuccessful in making financial information more accessible to private shareholders, although it was never intended to simplify financial statements.

The Internet and other IT developments

In this section we first discuss the Internet and then consider other IT developments.

Internet

Companies are increasingly exploiting the business opportunities offered by the World Wide Web and the Internet. This new communication medium can be used for marketing, selling and general corporate communications purposes. Navigating successfully through the mass of data on the Internet is a great challenge. Technology has already moved on from browsers (the navigational tools which provide access to the Internet) to more value added products such as so-called ‘mining software’ (which is capable of sifting through data to present meaningful information) and to software ‘agent technology’ (which can acquire knowledge through learning and is helpful, for instance, in handling
information overload). We are now seeing the spread of Internet technologies having an effect on the market for the provision of financial information. The established information intermediary companies have traditionally delivered financial information via dedicated cabling and terminals. New entrants to the market, however, are now using the Internet.

Many public companies now maintain their own web site and several choose to include financial information. This electronic medium offers a number of advantages:

- the ability to continuously update information;
- the ability to make available unlimited amounts of information;
- the low cost of dissemination relative to printed formats;
- ease of access for users; and
- the facility for interactive communication.

In 1996, 30 listed companies (including 25 FTSE-100 companies) had established sites for publishing financial and related information (Company Reporting, 1996). Of these, nine published their annual report and accounts in full, and three published summary financial statements (in one case in addition to the full version). The mix of information provided by the other companies varied: eleven provided narrative comments on results; seven the full profit and loss account; three the balance sheet; and only one the cash flow statement. Twenty companies provided their press releases, seven provided environmental reports and a few provided their interim statements. Within a year or so, 52 of the FTSE-100 companies were making some form of financial disclosure on the Internet (Hussey and Gulliford, 1998). This rapid growth is mirrored worldwide.

The use of the Internet will continue to grow rapidly, bringing both opportunities and threats to the accountability profession. This new technology could support a radical shift to a real-time, events approach to financial reporting. The currently unregulated nature of this medium, however, brings a serious threat, as the attestation normally associated with published financial information is missing. The auditors' responsibility for financial statements displayed on the web sites and for other
information which is ‘linked’ to those statements via ‘hot keys’ is being considered urgently by several national standard setting bodies eg in the US and Canada.

Other IT developments

There have also been developments in data warehousing, a data processing application that integrates the data needed by executives for analysis and reporting into one source. Traditional decision support systems extract data from operational, transactional systems for users with little or no restructuring. Due to technological advances in query and business intelligence software tools and the falling cost of data storage, it is now viable to develop data warehouses which underpin decision support systems designed to achieve sustainable competitive advantage. Data warehouses can be defined as:

*a single, enterprise-wide repository of data at a detailed level. It is a subject-oriented, integrated, time-variant, and non-volatile collection of data, separate from operational systems, organised in an integrated generic format, independent of how the data may be viewed by various groups within an organisation* (SMAC, 1998b).

It is a relational database which draws information from internal operational systems and external sources including the Internet. Associated with the data warehouse is ‘metadata’ which is ‘the information about the contents and uses of the data warehouse, including definitional, historical, transformational, and usage information’ 3. Metadata helps the user to understand what is available, how to access it, what it means, etc. Business definitions, data quality alerts and business assumptions are included. This is critical to end user empowerment.

Data warehousing has, however, been criticised for providing only huge amounts of untargeted data which is difficult to go through and which fails to meet many users’ needs. The concept of data marts is, therefore, more interesting, in that databases of information are targeted
to meet the needs of specific users. A ‘data mart’ typically contains a
subset of the data from the data warehouse, with specialised content and
structure having specific relevance to a particular user group.

A business reporting expectations gap

There has been widespread agreement for some time that the
objective of financial reporting is to satisfy the information needs of users
with respect to decision making and accountability. In its draft Statement
of Principles, the ASB (1995) echoed many previous statements of
objectives:

The objective of financial statements is to provide information about the
financial position, performance and financial adaptability of an enterprise
that is useful to a wide range of users for assessing the stewardship of
management and for making economic decisions (para 1.1).

The traditional financial reporting model dates from the Industrial
Revolution, when companies largely represented a relatively stable
grouping of hard assets (land, buildings, plant and machinery) and people
engaged in manufacturing a product. All of the hard assets were recognised
in the balance sheet and, periodically, transactions were aggregated into a
set of financial statements.

The recent changes in financial reporting practice discussed in the
previous section represent a somewhat piecemeal attempt to maintain
the relevance of financial reporting to users. New FRSs have improved
the content of financial statements, the OFR has attempted to introduce
non-financial and forward looking information while summary financial
statements can be viewed as addressing the information overload
experienced by some users.

In today's business environment, however, the very concept of the
reporting entity is becoming undermined by loose, short-term strategic
alliances. This has led to the concept of the ‘virtual firm’. For many
companies, moreover, their most significant assets ie ‘soft’ assets such as
intellectual property and brands, are not reported in any way. Neither is
the exposure of companies to general business risks captured to any
significant extent. Stakeholders are aware that the fortunes of a company can change rapidly and dramatically and want to know about key events when they happen. The current reporting model, grounded in the entity concept, periodicity and strict recognition criteria, appears to be partial and problematic. A 'business reporting expectations gap' appears to exist. Evolutionary change within the confines of the traditional financial reporting model may be unable to satisfy the legitimate business information needs of users and more fundamental, revolutionary change may be necessary. It is critical that accountants, as business information professionals, address this issue.

Proposals regarding the future of financial reporting

The principal stakeholders in a company are its shareholders, lenders, employees, customers, suppliers and the public. Each group has distinct, if overlapping, information needs. The common denominator is their interest in the factors which 'drive' corporate success, ie the intrinsic value of a company which reflects the quality of a range of corporate relationships and the company's overall contribution to society. This broad concept of corporate performance is not new. It merely extends to external stakeholders the balanced scorecard type approach.

Several bodies and individuals around the world have speculated on how stakeholders' information needs will be addressed in the future. Their views are outlined in the remainder of this section, considering first the views that emanate from the US and then UK proposals.

United States

In this section we outline the Jenkins Report, the American Accounting Association's (AAA) response to that report, initiatives of the Financial Accounting Standards Board (FASB), and the personal proposals of a Commissioner of the Securities and Exchange Commission (SEC).
The Jenkins Report

In the US, the Jenkins Report (AICPA, 1994) set out to improve business reporting by adopting a customer focus, ie by meeting the information needs of investors and creditors. This detailed study proposed a ‘comprehensive model of business reporting’ which would ‘help focus attention on a broader, integrated range of information’ (p131). The model included five broad categories of information, encompassing ten elements, as follows:

- **financial and non-financial data**
  - financial statements and related disclosures
  - high level operating data and performance measurements that management uses to manage the business

- **management’s analysis of financial and non-financial data**
  - reasons for changes in the financial, operating, and performance related data and the identity and past effect of key trends

- **forward looking information**
  - opportunities and risks, including those resulting from key trends
  - management’s plans, including critical success factors
  - comparison of actual business performance to previously disclosed opportunities, risks, and management’s plans

- **information about management and shareholders**
  - directors, management, compensation, major shareholders, and transactions and relationships among related parties

- **background about the company**
  - broad objectives and strategies
  - scope and description of business and properties
  - impact of industry structure on the company
There is, therefore, a move towards more disaggregated information at the segment level (AICPA, 1994, p136) and the provision of non-financial information and forward looking information. The proposed changes are, however, not radical as the research has shown that:

*A lot is right with today's business reporting in the United States. It generally provides users with essential information that heavily influences their decisions. In particular, financial statements are viewed as an excellent framework for capturing and organizing financial information. Users have welcomed improvements in business reporting, but few suggest the current framework should be scrapped and a new one developed (p5).*

It is recognised, however, that 'an important limitation of the study is that it focused on immediate rather than longer term information needs' (p15).

**AAA's response to the Jenkins Report**

In its response to the FASB invitation to comment on the Jenkins Report, the AAA Financial Accounting Standards Committee reviewed recent research into the value relevance of financial (ie earnings and balance sheet data) and non-financial measures. This research examined the association of these measures with capital market values (Linsmeier, 1997). It concluded that there is evidence that 'earnings' on its own has lost some of its ability to serve as a summary statistic for market valuation, but that the association becomes stronger when the range of financial statement information is broadened to include the balance sheet. Research also supports, however, the usefulness of certain non-financial measures such as potential market size, market penetration and customer satisfaction (eg Amir and Lev, 1996). These findings complement those obtained from surveys of users.

It should also be noted that the use of non-financial measures in performance evaluation is increasing, especially among companies adopting an innovation-oriented or quality-oriented strategy and in industries under regulatory pressure to improve non-financial performance dimensions (Ittner et al, 1997).
FASB

In 1998 FASB set up a business reporting research project to consider the types of information that companies are providing, such as operating data, performance measures, forward looking information, background information and information on intangible assets, and the means for delivering it. The Committee is expected to report in the year 2000. At the same time, FASB is also exploring how the Internet can be used to present business information, having launched a sample package on its web site called FauxCom®.

Wallman

In a series of articles published between 1995 and 1997, Steven Wallman, an SEC Commissioner, set out his own personal comprehensive vision of the future. Wallman (1995) noted that advances in information technology mean that it is now practical to distribute and analyse large amounts of data, hence the need for aggregation in financial reporting is gone. He identified four broad accounting and disclosure issues of critical importance to the future of financial reporting: recognition and measurement issues; timeliness; the concept of the firm; and the distribution channel and medium. Taken individually, Wallman cited potential, yet partial, solutions to these issues:

- the reporting of measures of soft assets outside of the traditional financial statements;
- additional reporting of business risks and more frequent reporting (eg monthly);
- a fundamental re-examination of financial reporting at the conceptual level; and
- disaggregated reporting via direct on-line access to sections of the company’s management information system.
In his next article, Wallman (1996) proposed an integrated, comprehensive solution, which he called the 'colorized approach'. This approach is offered as an alternative to the current accounting paradigm which Wallman characterises as 'black and white'. The 'colorized approach' defines a spectrum of disclosure based on the extent to which items meet existing recognition criteria. Recognition concepts concern whether an item: meets the definition of the element; is measurable with reliability; and is relevant. The core would broadly correspond to current financial statements. Immediately outside this core would be disclosures regarding items which meet most recognition criteria except reliability, such as research and development and forward looking information. The next layer would include items which perhaps do not satisfy the current definition of an element and also raise reliability concerns, such as customer satisfaction. The fourth layer would include items which do not satisfy definitional criteria such as risk measures. The fifth and final layer would include items which raise definitional, reliability and measurement concerns, such as intellectual capital. It is recognised that as one moves to the outer layers, a lesser degree of attestation would apply. Within the core, it would be possible to attest to the value of elements, while at the outer layers it may only be possible to attest to the procedures used to develop measures.

Finally, Wallman (1997) examined the impact of information technology on accounting and financial reporting, in particular the compilation, use and attestation functions. He noted that the 'colorized' model does not fully exploit emerging technologies. He proposed a disaggregated, user controlled 'access' model, which would include forward looking and soft information and predicts a move towards the attestation of procedures and processes. Wallman recognised the radical nature of his proposals, suggesting that, as an interim measure, this model should supplement rather than replace traditional financial statements, and acknowledging that, to reduce competitiveness concerns, tiering of user access be applied.
United Kingdom

In this section we outline the proposals of the Royal Society for the Encouragement of Arts, Manufactures and Commerce (RSA), Price Waterhouse and the Institute of Chartered Accountants in England and Wales (ICAEW).

RSA

In the UK, the RSA Inquiry *Tomorrow's Company* (1995) envisioned a more inclusive approach to both business and financial reporting. The RSA Inquiry was set up to consider the need for UK companies to compete in a global economy and as a result of a deepening concern over the way in which business conducted aspects of its affairs. Its overall vision was that only an inclusive, non-adversarial, approach to business relationships would provide a route to sustainable success. Underlying this approach was the concept of the *licence to operate*. Tomorrow's company would recognise that its long term future is enhanced by a supportive operating environment and would act, with others where necessary, to strengthen its licence to operate. It was recognised that the language of success used by companies would need to reflect this more inclusive approach. Tomorrow's company, therefore, must describe success inclusively and ensure that its measures, its reward systems and its reporting are in harmony with that description. Consequently, tomorrow's company would require a framework of measurement that reflects the success model and which is consistent with the purpose and values of the business.

This approach means going beyond the limitations of traditional financial reporting which was criticised for an over reliance on financial performance measures:

*By itself, financial performance does not gauge the overall health of the business. It neither defines competitive performance, nor measures the broader value created through product quality, speed of response and service. Companies which rely solely on financial measures of success are exposing their shareholders to unnecessary risk.* (RSA Inquiry, 1995, Press Release).
RSA (1998) is a follow-up to the 1995 report on *Tomorrow's Company* which focuses explicitly on the future of the annual report. It argues that the traditional annual report will survive the information age because it fulfils a deep-seated human need to have a document which 'freezes' the vast amount of information continuously becoming available at a point in time. This allows a line to be drawn and a review to be made of what has been achieved before moving on.

Nevertheless, RSA believe that the annual report is in need of a major overhaul to keep it relevant. It is proposed that the annual report be split into a single core document, published and available on the Internet, targeted directly at stakeholders. This would be supplemented by detailed reports covering *inter alia* statutory and obligatory disclosures. Suggested topics for the supplementary reports are: financial report; value chain report; people document; and sustainability document.

The core document would build on the OFR, setting out the company's purposes and values and reporting on a range of financial and non-financial performance measures, including targets, recent achievements and future prospects. It would aim to summarise 'the story' for all audiences in a compelling and accessible way. The core document would be published with the preliminary announcement and provide links to the supporting reports.

The importance of dialogue between the company and its stakeholders is emphasised. This could occur in the context of the core document or at the AGM or 'roadshows'. It is acknowledged that each user will be able to specify the information required and its format using 'push technology'. The annual report, therefore, viewed as forming only part, albeit a key part, of the total communications package. The proposals are presented as a challenge to all companies to improve their reporting voluntarily.

*Price Waterhouse*

The Price Waterhouse proposals relate only to the content of financial reporting. It is proposed that companies pursue *ValueReporting*, a financial reporting model focusing on the dynamics of shareholder value creation
(Wright and Keegan, 1997). In this model, companies would provide future oriented information on a range of financial and non-financial variables relevant to performance.

Two hundred expert users (financial analysts and fund managers) were surveyed to establish the value placed on 21 financial and non-financial performance measures (Coleman and Eccles, 1997). It was found that the analyst community generally placed greater value on all measures. Moreover, the specific measures wanted depended upon the industry which the analyst followed. Seven measures were identified which were viewed by analysts as valuable, but not adequately reported: market share; employee productivity; new product development; customer retention; product quality; research and development productivity; and intellectual property.

The authors of the report acknowledge that ValueReporting will have to be customised to each company (and perhaps each business unit) as the critical non-financial variables are business specific. They advocate additional reporting on a voluntary basis.

ICA EW

The ICAEW has produced various reports on specific aspects of financial reporting which have implications for its long term nature. In 1997, the Financial Reporting Committee addressed the financial reporting of risk (ICAEW, 1997). It proposed that a ‘statement of business risk’ be included in the financial reporting package, which brings together, within a coherent framework, all information relating to risk, some of which is currently available eg segmental reporting, OFR. It is argued that risk reporting will provide forward looking information to help users assess the amount and certainty of future cash flows, to reduce the cost of capital, and to encourage better risk management.

The impact of digital technology on financial reporting is the subject of a research report by Spaul (1997). Spaul argued that users need online, real-time access via company web sites to a broad range of internally generated corporate information, and informal material such as annual
reports. He predicted that there would be greater disclosure of forward looking information and, due to electronic monitoring devices, non-financial factors.

ICAEW (1998a) reported on the presentations made at a conference on the theme of performance measurement in the digital age. The consensus view was of a move to real-time reporting. Myners supported this view and also argued for the greater use of non-financial information as leading indicators of value, while Hodgkinson argued that continuous real-time assurance would be needed to underpin real-time reporting.

In September 1998, the ICAEW held a conference calling for a major review of financial reporting. It focused on the delivery mechanism for financial information, and developed an interactive prototype annual report, similar to the FASB’s on-line Fauxcom project. Using the core and supplementary reports of a fictitious company called Prototype plc (Benjamin, 1998), the reports were presented as a company website accessible to the stakeholders.

**Summary**

Changes in the business environment and business practices, many of which have arisen from the information technology revolution, have precipitated a major shift in the information demands of external stakeholders. This has led different organisations and individuals around the world to make proposals concerning the future of financial reporting. There are many points of similarity between the views expressed. In particular, there is widespread agreement that non-financial measures of performance and forward looking information will feature increasingly in the external reporting package. Since this will rank alongside traditional, historical financial measures, the absolute size of the business information pool will increase significantly. In addition, the importance of the Internet as a means of information dissemination is no longer in doubt. There are, however, differences of opinion (or silence) regarding the extent to which external reporting is integrated with internal management information systems, the need for company defined reports in addition to user controlled access and the desirability of real-time reporting.
In general, these proposals are based on thoughtful and informed reflection by individuals with a great deal of experience of financial reporting\(^6\). When the Research Committee embarked upon the present series of research projects into the corporate communications process it was keen to undertake relevant empirical research and ground its proposals explicitly in that evidence. The primary contribution of this discussion document is, therefore, to develop proposals based directly on empirical evidence relating to users' views of the current system of financial reporting.

**Endnotes**

1. For example, the SAS Institute (perhaps the least well known of the top five software companies in the world) launched its Balanced Scorecard software product in 1998, encompassing data warehousing, data mining, web integration and OLAP (on-line analytical processing) (SAS, 1998, p24).

2. In addition, the new Stock Exchange paperless dealing system means that all shareholders no longer automatically receive the company's annual report and accounts.

3. Metadata may be stored in a database, in a software package, or as system documentation.

4. FauxCom is a fictitious computer company developed by the Jenkins Committee to illustrate their vision of a business reporting package. This vision has now been developed to exploit web technology. All financial information on the site can be downloaded as Excel™ spreadsheet files, a simple search engine is provided and an audit opinion is provided that relates to the entire business reporting package.

5. Price Waterhouse merged with Coopers & Lybrand on 1 July 1998 and are now known as PricewaterhouseCoopers.

6. The claim in the Jenkins Report that its recommendations are supported by research has been challenged. Seidler (1995, pp119-120) argues that there are 'many voids and more than a few inconsistencies', the supporting database consisting of 'a totally unorganized collection of endless interview notes, papers done for the Committee, articles, staff summaries and a bibliography'.
CHAPTER THREE

USER NEEDS AND CORPORATE COMMUNICATIONS

Users seek the information they require from a broad range of sources, both inside and outside the company. Each user’s decision making process is unique, in terms of their information search tactics, selection criteria and analytical frameworks/models. Information about the economy and the industry comes largely from outside the company. Corporate communications of a financial nature comprise publicly disclosed information, the annual report and accounts, interim reports and preliminary announcements, and privately disclosed information revealed in analysts’ meetings and informal one-to-one meetings with analysts, shareholders or banks. Both types are important in the UK institutional setting.

This chapter reviews recent UK research into information sources and preferences of users and financial reporting incentives of companies. The findings of recent research projects which examine company meetings and users’ decision making processes are then summarised. The chapter then sets out a view of the structure and process of corporate financial communications by public listed companies in the UK based on this research.

Information sources and preferences of users

There is a range of distinct groups with a legitimate interest in the performance and financial position of a company. These user groups have different, though overlapping, information needs. Shareholders remain, however, the acknowledged primary user group, on the basis that
the satisfaction of their needs will also satisfy most of the needs of other stakeholder groups. Of course, shareholders are themselves a very heterogeneous group. To address this, a broad dichotomy is drawn between private shareholders, who generally are not financially sophisticated, and institutional shareholders, who generally are financially sophisticated.

Private shareholders

A recent UK study of private shareholders has shown that the full annual report is read thoroughly by only 10%, read briefly by 63% and not read at all by 27% (Bartlett and Chandler, 1997). Financial press reports were the most thoroughly read of eight different sources including summary financial statements, interim financial statements, preliminary announcements, stockbrokers’ reports, teletext or other TV media, and Datastream or other computer software. Generally, the annual report is found to be an important source of information, but its usefulness is limited by shareholders’ difficulties in understanding.

Institutional shareholders and other investment analysts

Not surprisingly, expert users rank the financial statements in particular, and the annual report generally, higher than private shareholders. Survey evidence showed that 25-30% find companies’ financial reports ‘very useful’ for communicating true value, 60% find them ‘useful’, while 10-15% find them ‘not very useful/not at all useful’ (Coleman and Eccles, 1997). The information preferences of buy-side and sell-side analysts differ significantly. It has been found that institutional investors’ top three ranked sources are the annual report and accounts, personal interviews and company presentations, whereas investment analysts’ top ranking sources are preliminary announcements, personal interviews and interim statements (Bence et al, 1995). The analysts seem to have a generally higher need for information, rating the importance of nearly all information sources higher than the investors. It is likely that this is because analysts generally follow only a few companies, and hence their analysis tends to be more detailed.
Financial reporting incentives of companies

It has been observed that, prior to regulations mandating corporate disclosure of financial information, many companies provided voluntarily a range of information to investors. Companies believed that such disclosure was in their self interest, ie the benefits outweighed the costs. Today, many companies choose to provide financial and related information in excess of that required by regulation. The principal financial benefit of disclosure is a lower cost of capital, due to a reduction in uncertainty and, therefore, the information risk premium. Research studies have consistently shown that increased segmental disclosures correlate with a lower cost of capital. Disclosure can also have public relations benefits.

The main costs of disclosure are information costs ie the costs of collection, processing, auditing and dissemination; litigation costs ie costs associated with allegations of incomplete, inaccurate information; and competitive disadvantage eg via disclosure of technological and managerial innovation strategies and tactics, and operational information. Following a general analysis of these costs and benefits, Elliott and Jacobson (1994, p94) concluded that:

for public companies, unless competitors develop the capability to impose significantly greater competitive disadvantages through use of the information or litigation costs become more perverse, the most likely result is that the optimal level of disclosure will increase in the future.

Company meetings

Company meetings are a key aspect of a company's investor relations programme. These meetings are of two principal types:

- general meetings, for individuals from different organisations; and
- one-to-one meetings, for individuals or small groups from the same organisation.
These meetings have been the subject of a series of recent research reports published by ICAS (Marston, 1996 and 1999; Holland, 1997).

Views of companies

Marston (1996), *Investor Relations: Meeting the Analysts*, gathered descriptive data from 337 of the top UK companies about the nature, content and value of such meetings. Concern that these meetings give analysts access to unpublished price sensitive information had resulted in a raft of legal and regulatory pronouncements *via* statute law, the Stock Exchange and professional bodies. This survey confirmed the importance to companies of these types of meetings as a valuable means of communication (especially with buy-side analysts).

The relative importance of seven information types relating to past performance and twenty information types relating to future performance was assessed. The top ranked item in each category was, respectively, an explanation of recent results in the context of the general economic environment and long term corporate strategy. Marston concluded that analysts' meetings should continue to be permitted but that the inequality of access to such meetings must be addressed. She recommended that detailed records of all meetings be kept and made public *via* the Stock Exchange's Regulatory News Service on the Internet.

The study by Holland (1997), *Corporate Communications with Institutional Shareholders: Private Disclosures and Financial Reporting*, focused on the entire communication process, both public and private disclosures, although only institutional shareholders were considered. Holland interviewed the finance directors and senior personnel of 33 large, listed UK companies about the disclosure process. It was found that the primary reasons for disclosure, both public and private, were to improve corporate financing capability, defend against takeover bids, refine the corporate image and enhance share prices. These aims were constrained by regulations on insider dealing and the release of price sensitive information.
It was found that the main corporate message, which was revealed in the OFR section of the annual report, formed the 'common root' from which message variants were tailored to the needs of each channel and each institutional shareholder. This main message was expanded in private meetings, generating new information.

The top companies recognised that they operated in a competitive market for reputation and credibility in corporate communications and had to engage, therefore, in expensive corporate communication programmes. By focusing on core institutional shareholders (ie effectively restricting access) they sought to achieve efficiency gains².

Companies developed sharp strategic views in time for the external communication cycle following the earnings announcement. It was perceived that interactions with institutional shareholders created a 'dual knowledge advantage', with the company gaining insights into broader market expectations.

Importantly, the content and timing of the annual report was viewed as critical in facilitating private disclosure, creating a 'minimum disclosure baseline' and setting the timetable for private meetings. For these reasons, the annual report was regarded as providing a fundamental structure to corporate communications, despite its limitations.

Views of users

In a follow up study, *Investor Relations Meetings: Views of Companies, Institutional Investors and Analysts*, Marston (1999) conducts 22 interviews with finance directors, buy-side analysts and sell-side analysts. This study was conducted after the Criminal Justice Act 1993 and new Stock Exchange guidance on the dissemination of price sensitive information was introduced in 1994. All three groups agreed on the importance of investor relations meetings and, following a period of reflection, had come to a consensus that these meetings could continue very much as before, despite the new regulations.

Analysts saw the meetings as an opportunity to assess the calibre of management and gauge whether their mood was upbeat or downbeat. Companies saw the meetings as an opportunity to market their capital
and receive valuable feedback. The flow of information, therefore, was
two way. The major concern identified by Marston is the extent to
which non-participants in these meetings are disadvantaged and how
these meetings can be made more transparent. She recommends that, in
addition to making presentation packs, slides and minutes publicly available,
the dates of meetings and the availability and method of access to the
additional information revealed at them, be published in shareholder
reports. It is also suggested that some of the additional information could
be included in the OFR.

The dynamic decision making process of users

Research undertaken on behalf of the Research Committee for the
present study (stage one) has investigated the dynamic decision making
process of users, to overcome the focus of existing research on static user
needs. The full details of the findings are published in a separate research
report, Corporate Communications: Views of Institutional Investors and Lenders
(Weetman and Beattie, 1999). Discussions were held with fund managers
and in-house analysts employed by institutional investors representing
five leading holders of funds, with brokers' analysts employed in four
leading broking firms and with bankers employed in five institutions in
commercial lending banks and merchant banks. The researchers also met
with experts in benchmarking, credit rating and corporate
communications advice.

In looking at the decision making process, a distinction was drawn
between the initial decision to invest or lend, which was based on a very
thorough historical analysis and investigation of the factors that drove the
business and profit, and subsequent monitoring to maintain confidence.
Monitoring was a cyclical process, starting each year with the preliminary
announcement of annual results. The bankers relied on published
information less than analysts, because of their enhanced access to internal
information. All three groups dealt with information overload through
the selective use of key measures and all experts preferred to carry out
their own process of distillation and interpretation rather than relying on
others.
The interview agenda focused on two areas: the identification of broad categories of information items desired by users; and the evaluation of risks and uncertainties. These areas are considered in the next two sub-sections.

**Desired information items: drivers of cash flow and profit**

As the information needs of users have been widely researched, stage one focused on identifying broad categories, rather than detailed lists, of information items. The starting point for all users was the 'drivers of cash flow and profit'. As drivers are frequently not reported explicitly, proxy performance indicators are sought. Six key categories are identified:

- the national economy within which the company operates;
- the product market within which the company operates;
- the industry within which the company operates;
- the company quality of management;
- the company strategy; and
- the quality of company assets.

The first three of these categories are not normally found in any great detail in UK annual reports. Other sources were used to gain this understanding. The value of company meetings in assessing the quality of management and company strategy was clear from many interviewees. It was also clear that additional understanding, if not additional information, was imparted at one-to-one meetings.

**Evaluation: use of templates**

The evaluation of risks and uncertainties in the decision making process was explored explicitly with interviewees. All three user groups indicated that they used their own model or 'template' to capture the key business 'drivers'. The term 'template' is used with respect to physical phenomena to refer to a pattern used to shape or give structure to something. The term is also used in the area of cognitive psychology to
indicate a structured decision/judgment guide which reflects an individual's underlying knowledge structure. It is, therefore, an abstract simplification of, often complex, inter-relationships in the real world. A template both identifies the elements related to a decision and specifies the nature of that relationship. In complex decision making, templates can overcome problems of information overload. Weetman and Beattie (1999) found in some cases, users' templates were implicit and informal, while in others it was an explicit, quantitative spreadsheet. These templates facilitated what-if analysis and sensitivity analysis. Users were sceptical about whether companies could produce forward looking information impartially.

Various

Assurance was considered important by many users, whether obtained via formal audit or via face-to-face meetings with management. The annual report was widely acknowledged as the core source of information. Users were asked to describe their ideal information set unconstrained by the existing financial reporting framework. None of these expert users complained of information overload, perhaps because they used their own template to filter the information set available. More market, industry and segmental information was desired by many, as was more timely information.

Four themes

Based on the interview evidence, four key themes of the decision making process were identified:

- the cyclical nature of corporate information flows;
- the desirability and value of one-to-one meetings (i.e. differential access);
- the existence of information overload and strategies to overcome it; and
- the creation and maintenance of confidence in business information.
Corporate financial communications

Based on the combined research evidence presented in this chapter, we formulated an overall view of the structure and process of corporate financial communications. This is summarised in Figure 3.1. The top half of this figure relates to the disclosure choices of preparers whereas the bottom half concerns the decision making process of users.

The company has two types of information available. The first is hard, largely quantitative financial and operating data that is captured formally by management information systems. The second is soft, often qualitative strategic and other tacit management knowledge that is not formally captured in a database. Management selects from both types when making disclosure choices. External disclosures are also of two types: formal; and informal. Formal disclosures are those made publicly, *ie* annual report and accounts, interim statements, preliminary announcements, press releases, profit warnings. They are formally attested to by an independent auditor. They comprise mandatory and voluntary components. Informal disclosures are those made privately to specific users, *ie* general company meetings with analysts and institutional/major investors, site visits, one-to-one meetings, telephone conversations, conference calls.

The total pool of business information available to the end user also includes information sources outside the company, *eg* industry and economic information. End users search this information pool, in either a structured or casual way, and select from it (*ie* filter out) information relevant to their decision. They do this using an implicit or explicit template. This template is also used in the analysis stage of decision making, where knowledge of the relationship between information items and the decision variable is utilised.

There is a feedback loop from the information user to the company, the principal information provider. This feedback is most common during private communications.
Figure 3.1 The corporate communications process: information providers and users

- Corporate database of financial and operational information
- Strategic and other tacit management knowledge
- Selection by company of information subsets for communication to external stakeholders
- Public financial communications (mandatory and voluntary components)
- Private financial communications with specific users
- Other sources
- Auditor
  - assurance
- Pool of business information available to (selected) external stakeholders
- Search, selection and analysis by end user of drivers of cash flow and profit
  - le filtering and use of template
- User
  - feedback
- Decision

Key: □ = Information set
○ = Activity
→ = Information flow
Another way of looking at the preparers' disclosure choices is provided in Figure 3.2. This figure emphasises the content of, and access to, the corporate information database. Four 'tiers' of corporate information are identified. Tier one comprises mandatory public disclosure. The boundary is defined by regulation and there is open access to external users. Tier two comprises voluntary public disclosure, where the content is now defined by the company and there is again open access to external users. Tier three comprises selected private disclosure, where the company chooses to make additional information available to certain groups or individuals. Finally, there is a residual pool of undisclosed private information, that resides either in the company's information system or is held tacitly by management.

Figure 3.2 The tiered corporate information pyramid: content and access
Summary

This chapter has summarised recent relevant research conducted by ICAS and others into the corporate communications by listed UK companies. The variety of user needs, based on their differing abilities and decision making objectives, is outlined. The aims and constraints of the other key party in the reporting process, the preparer company management, is also reviewed. It is noted that company meetings, both general and one-to-one, are a vital part of the financial reporting process in the UK.

Research undertaken on behalf of the Research Committee into the decision making processes of expert users reveals the widespread use of templates to assist in the search, selection and analysis of business information. These templates focus on the drivers of cash flow and profit (or proxies thereof). This research identified four key themes for further analysis: cyclical nature of corporate information flows; differential access to corporate information afforded by analysts' meetings; information overload; and confidence.

Finally, an overall view of the structure and process of corporate financial communications is presented. Four tiers of corporate information, offering different levels of external user access, are identified in the context of these communications.

Endnotes

1 See, for example, Conover and Wallace (1994).
2 Meetings with analysts, who act as information intermediaries, can be expected to yield similar efficiency gains.
3 'Forward looking' information relates to current issues relevant to an assessment of future prospects and is distinct from 'forecasts'.
CHAPTER FOUR

SURVEY OF USER, PREPARER AND AUDITOR VIEWS

This chapter reports the results of the Research Committee’s survey of the views of interested parties regarding financial reporting. Four themes arise from the combined research evidence presented in chapter three, particularly the interview evidence of Holland (1997) and Weetman and Beattie (1999).

The chapter outlines the themes: cyclical nature of corporate communications and decision making; differential access; information overload; and confidence. Next it describes the survey approach used and gives details of the respondents. The findings with respect to each of the four themes are then presented, using selected quotations from the interviews to explain the reasons why particular views are held. Significant differences between the views of users, preparers and auditors are highlighted, as are significant differences among the various user groups. Finally, the importance to user groups of 29 drivers of company performance is reported.

Themes underlying current financial reporting and corporate communications

The four themes which emerge from the ICAS-funded research into the corporate communications process are outlined in this section.
Cyclical nature of corporate communications and decision making

The idea of a cycle of decision making linking into the annual cycle of reporting was particularly clear from the users' descriptions of decision making and the preparers' descriptions of the process of communication with shareholders. The cycle was dictated partly by the frequency of information being made available by companies and partly by the users' processes for selecting and assimilating information.

Differential access

Weetman and Beattie's (1999) research into the decision making process showed that, despite the care taken not to breach the regulations on price sensitive information, there is an appearance of privileged access being available to certain users, producing an unlevel playing field. Holland's (1997) research showed that one-to-one meetings gave clear benefits to both participant parties and also that the market as a whole benefited. We conclude that the meetings indicate the existence of a further layer of access to information which companies are willing to provide in principle but that they are cautious about general dissemination of the information because of concerns over loss of competitive advantage.

Information overload

Concerns regarding information overload did not feature as a complaint by Weetman and Beattie's (1999) interview respondents because they, as experts, had developed methods of filtering the information relevant to their needs. For instance, they stressed the importance of receiving information in a regular and digestible manner, made selective use of key measures and fitted these measures into templates which they had devised. They expressed no desire to see present levels of disclosure reduced.
Confidence

Weetman and Beattie's (1999) interviews show that the monitoring process of users was essential to the maintenance of the users’ confidence and, therefore, ensuring the continuance of the financial licence to operate. The maintenance of confidence was, however, influenced by quite subtle factors indicating that overall confidence was the result of complex interactions.

Key to the maintenance of confidence was the reputation of company management for providing reliable information. Forward looking information, as a measure of the dynamics of the business, was also essential to the users. The one-to-one meetings provided certain users with the opportunity to obtain such information on an ongoing basis.

The survey

The survey was undertaken in two stages. Stage one used postal questionnaires and stage two used follow-up interviews.

Postal questionnaire

To establish rigorously the accuracy and validity of the four themes derived from face-to-face interviews, the Research Committee undertook a large scale postal questionnaire of interested parties in 1998. The questions asked were designed to establish respondents’ level of agreement, on a scale of one to five, with specific statements concerning the four themes.

Two versions of the questionnaire were created and piloted: one for users; and one for preparers and auditors. Generally only minor changes to the wording of questions were required to reflect each party’s role in the communication process. Users were asked additionally to rate the importance to them of 29 key drivers of company performance. An initial list of drivers was derived from the earlier interview research, of
Holland (1997) and Weetman and Beattie (1999), and amended to include additional factors. Each section offered the opportunity for respondents to comment.

A total of 308 questionnaires were issued in April 1998, together with a covering letter from the ICAS President. After two follow-up requests, a total of 154 responses were received (ie 50%). The sample groups and response rates are shown in Table 4.1.

<table>
<thead>
<tr>
<th>Table 4.1 Sample groups and response rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>User groups:</td>
</tr>
<tr>
<td>corporate lenders (banks)</td>
</tr>
<tr>
<td>fund managers</td>
</tr>
<tr>
<td>investment analysts</td>
</tr>
<tr>
<td>small shareholders</td>
</tr>
<tr>
<td>Sub-total</td>
</tr>
<tr>
<td>Preparers: finance directors</td>
</tr>
<tr>
<td>auditors</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

To ensure that both expert and non expert user groups were represented, we enlisted the cooperation of the UK Shareholders Association for private investors. In the case of all groups except finance directors our strategy was to identify the major organisations involved in each area of activity and seek the help of a senior individual within it to distribute the questionnaire to a small number of suitable colleagues. For example, six banks each distributed six questionnaires to appropriate staff. The senior audit partners of major accountancy firms were asked to distribute to the audit engagement partners of listed UK companies. We identified the names of finance directors of the top 350 pls listed in the FT 500, selected a systematic sample of 60, and wrote directly to them. Questionnaires were serially numbered to permit follow up².
Aggregate responses are shown in Tables 4.2 to 4.6, where: 1 = strongly agree; 2 = agree; 3 = neutral; 4 = disagree; and 5 = strongly disagree. Percentages may not total 100% as the ‘don’t know’ category is not shown. The average score is shown in the second last column and the dispersion of responses is categorised in the last column as high, medium or low based on the standard deviation of responses. This classification indicates the degree of consensus among respondents. To illustrate, if all respondents are neutral with respect to a given question, the average score is 3.0 and the dispersion is classed as low (in fact it is zero). By contrast, if respondents are divided equally across the five response categories, the average score is still 3.0, but the dispersion is classed as high.

In the commentary on these tables that follows, sometimes the ‘strongly agree’ and ‘agree’ categories are combined and described as a ‘positive response’ group, while the ‘disagree’ and ‘strongly disagree’ categories are combined and described as a ‘negative response’ group.

Follow-up interviews

Postal questionnaires are an effective way of finding out ‘what’ a large number of people do or think, but are less useful at eliciting ‘why’ they do or think as they do. We believed that this additional understanding was essential to serve as a firm foundation for our recommendations and conducted fifteen follow-up telephone interviews. Potential interviewees were selected to give a range of views on key issues. Following a successful approach to request a telephone interview, all interviews were carried out by a chartered accountant following the guidelines set out in Appendix A. These interviews were recorded and transcribed. Of the fifteen interviews, one was with a corporate lender (CL), four with fund managers (FM), three with investment analysts (IA), one with a small shareholder (SS), three with finance directors (P), and three with auditors (A).
Cyclical nature of corporate information flows

This section of the questionnaire concerned the timing, rather than the underlying content or quality of business information flows. It stated that:

There appears to be a cycle in the timing of formal business information flows from companies to users: preliminary announcement, analysts meeting, annual report, annual general meeting, interim results, interim results meeting. Informal, private one-to-one meetings with major shareholders also form part of this cycle.

Aggregate responses are shown in Table 4.2.
<table>
<thead>
<tr>
<th>Question asked</th>
<th>Response category</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1  2  3  4  5</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Percentage of respondents</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>This description reflects accurately my experience of business information</td>
<td>33  63  2  1  -</td>
<td>1.7</td>
<td>Low</td>
</tr>
<tr>
<td>flows</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The cycle of business information flows provides timely information</td>
<td>3  44  35  17  -</td>
<td>2.7</td>
<td>Medium</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The cyclical nature of business information flows assists in the ready</td>
<td>4  53  30  12  -</td>
<td>2.5</td>
<td>Medium</td>
</tr>
<tr>
<td>assimilation of the information</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The cyclical nature of business information flows is effective in providing</td>
<td>10  67  13  9  -</td>
<td>2.2</td>
<td>Medium</td>
</tr>
<tr>
<td>information about the financial year recently ended</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The cyclical nature of business information flows provides a good basis for</td>
<td>-  24  39  31  5</td>
<td>3.2</td>
<td>Medium</td>
</tr>
<tr>
<td>assessing future performance</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 Response categories are: 1 = strongly agree; 2 = agree; 3 = neutral; 4 = disagree; and 5 = strongly disagree.

2 The dispersion is based on the standard deviation (s.d.) of responses, classified as follows: s.d. ≤ 0.7 (low); 0.7 < s.d. ≤ 0.99 (medium); and 0.99 < s.d. (high).

Ninety-six percent of respondents either agreed or strongly agreed with the above statement regarding the information cycle. Seventy-seven percent responded positively that the cycle provided year-end information effectively (the remainder disagreeing or being neutral) and 57% responded positively that the cycle assisted in assimilation. Only 47%, however,
responded positively that the cycle provided timely information and only 24% responded positively that the cycle provided a good basis for assessing future performance.

There is clearly significant dissatisfaction regarding the ability of current information flows to provide timely information flows which serve as a good basis for assessing future performance.

Comments made in this section frequently criticised the long gap between the publication of the preliminary announcement and the full, audited annual report and accounts:

... the two should be closer together.

... the timing of elements of the cycle need to be condensed: preliminary and analysts and annual report should be simultaneous and earlier.

... preliminary announcements can too often be made too far in advance of the annual report being posted.

In the follow-up interviews, respondents expanded on their questionnaire responses. They highlighted the limitations of accounts for forecasting purposes, the problems and disadvantages associated with more frequent reporting, and the advantages of a regular, periodic information flow.

... it is always difficult to use the companies' accounts and figures to actually forecast the future ... (FM)

... the report and accounts ... will not give you a clue as to where you're going to be twelve months ahead. (FM)

Two of mine do report quarterly but to be perfectly frank, one needs industry figures on a quarterly basis in order to make fair comparisons. (IA)

Well, [quarterly meetings are] two extra meetings effectively a year and it does mean that you spend a lot of your time on maintenance research rather than thinking about the bigger issues. (IA)
You have an expectation as to when you will have information and when there are likely to be periods when it is going to be quieter so I think it enables you to structure your work round that. (IA)

Timely in the sense that it can be anticipated. (SS)

... analysts' ... diaries are very much fixed by the flow of information ... (P)

Summary

Four main findings emerge from this evidence:

• There was dissatisfaction regarding the ability of the information cycle to provide timely information.
• There was extreme dissatisfaction regarding the ability of the information cycle to provide a good basis for assessing future performance.
• It was suggested that the gap between the preliminary announcement and the full, audited report and accounts should be reduced.
• Certain disadvantages of more frequent reporting, and advantages of regular, periodic information flows, were identified.

Differential access

This section of the questionnaire investigated attitudes to the private, informal, one-to-one meetings which take place between company management and certain users of business information. During these meetings, additional non-price sensitive disclosures can occur. Aggregate responses are shown in Table 4.3.
### Table 4.3 Interested parties' views of differential access

<table>
<thead>
<tr>
<th>Question asked</th>
<th>Response category</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General attitude:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>one-to-one meetings create the perception of unfair advantage for some members of the investment community</td>
<td>16 58 12 12 1</td>
<td>2.2</td>
<td>Medium</td>
</tr>
<tr>
<td>one-to-one meetings do create an unfair advantage for some members of the investment community</td>
<td>11 37 24 21 4</td>
<td>2.7</td>
<td>High</td>
</tr>
<tr>
<td>one-to-one meetings are beneficial to the investment community as a whole</td>
<td>6 43 28 15 5</td>
<td>2.7</td>
<td>Medium</td>
</tr>
<tr>
<td>one-to-one meetings are disbeneficial to the investment community as a whole</td>
<td>5 9 21 48 14</td>
<td>3.6</td>
<td>High</td>
</tr>
<tr>
<td><strong>Specific views:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>managers of companies value such meetings because they learn about the market's perception of the company</td>
<td>12 64 13 7 1</td>
<td>2.2</td>
<td>Medium</td>
</tr>
<tr>
<td>the users attending the meetings gain additional understanding and insight about the key drivers of company performance</td>
<td>23 69 6 1 -</td>
<td>1.8</td>
<td>Low</td>
</tr>
<tr>
<td>the market as a whole gains as financially sophisticated users (eg financial analysts) have a better understanding of the company which is reflected in the share price</td>
<td>6 61 21 9 2</td>
<td>2.4</td>
<td>Medium</td>
</tr>
</tbody>
</table>
Table 4.3  Interested parties' overall views of differential access (continued)

<table>
<thead>
<tr>
<th>Question asked</th>
<th>Response category</th>
<th>Percentage of respondents</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td>One-to-one meetings should be:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>allowed to continue at the present level (typically a series of meetings with</td>
<td>14 62 13 8 3</td>
<td></td>
<td>2.2</td>
<td>Medium</td>
</tr>
<tr>
<td>core institutional shareholders)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>extended (within the boundary of the law), either in content or to additional</td>
<td>5 29 39 23 3</td>
<td></td>
<td>2.9</td>
<td>Medium</td>
</tr>
<tr>
<td>user participants, because of the benefits to the investment community as a</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>whole</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>extended for some other reason (Please specify)</td>
<td>1 3 46 30 4</td>
<td></td>
<td>3.4</td>
<td>Medium</td>
</tr>
<tr>
<td>prohibited</td>
<td>6 2 12 32 48</td>
<td></td>
<td>4.1</td>
<td>High</td>
</tr>
<tr>
<td>Commercial confidentiality considerations prevent management from conveying</td>
<td>15 57 10 15 1</td>
<td></td>
<td>2.3</td>
<td>Medium</td>
</tr>
<tr>
<td>certain information regarding the key drivers of company performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

There was a majority view (74%) that such meetings create the *perception* of unfair advantage, yet only 48% believed that they *actually* did so. In terms of benefiting the investment community as a whole, over twice as many responded positively to this (49%) as negatively (20%).

As for the nature and recipients of benefits arising from one-to-one meetings, 76% agreed that managers of companies benefit by learning about the market's perception of the company, 92% agreed that users at the meetings gain additional understanding and insight about the key
drivers of company performance, and 67% agreed that the market as a whole gains from this better understanding being reflected in the share price.

Alternative proposals for change in these meetings ranged from prohibition (only 8% agreement), to retaining the status quo (76% agreement), to extension of content or user access (34% agreement). The overall consensus, therefore, was for the same or slightly enhanced meetings of this form. It is notable that 72% believed that commercial confidentiality considerations prevent management from disclosing certain information about key performance drivers, yet a significant minority (16%) disagreed.

Typical comments made regarding this theme were:

... their unfairness is blatant.

... there should not be a two-tier system of business information, private shareholders invariably lose out.

... should be replaced by open meetings with shareholders as a whole.

... perhaps some information should be published, eg order book, more frequently to enable everybody to have the information.

... knowledge from such meetings is generally made available in due course from analyst publications.

... the investment community is increasingly ‘hungry’ for information, making the need for more openness and timely information necessitating one-to-one meetings.

... one-to-one meetings have become more important and financial statements less so.

... one-to-one meetings are an important means by which shareholders, or their representatives, communicate their views or concerns.
The benefits of such meetings are, therefore, generally seen to outweigh the costs. That is, there is some disquiet about the 'two-tier system of business information', but also an acknowledgment of users' increasing 'hunger' for information and the value of meetings as a corporate governance mechanism.

In the follow-up interviews, respondents expanded on their questionnaire responses. They highlighted the advantages of one-to-one meetings in terms of management accountability, a forum for shareholders to evaluate management and for management to obtain feedback.

*I think if you had a situation where a company could shelter behind the idea that once every year it just had to stand up and make a formal statement, sit down and have a couple of questions and walk away again you wouldn't have much accountability.* (FM)

... extended is better than stopped because ... . It also keeps the company on its toes. (SS)

... the fact that management have to go through these meetings actually sharpens them up to do the right thing and so ego trips and all those sorts of things are much less likely to occur because you have to face the music every quarter. (P)

... they are extremely careful not to ask questions which if answered would prejudice their positions as holders of the shares, so it's more a matter I think of assessing the confidence of the management really ... (FM)

... the advantage they get is that they are able to make a better assessment potentially of the management's likelihood of achieving its strategic objectives. (FM)

... the only thing one-to-one meetings provide is for them to go through the softer issues, how committed is management, and the ideas, you know the body language and so forth and how credible are management and also some amplification of points to some extent an educating of the analyst and what's actually happening in the business ... (P)
... see the analysts' presentations that my clients give out and they are far more forward looking than the public information and sets of accounts and far more numeric as well. (A)

... we also get a flavour of what the institutions think about the way we are running the business. (P)

The creation of an unlevel playing field was viewed in the following terms:

... at the end of the day you have two sets of investors, you have experts like the institutions and then you have the man on the street and I don't think it is possible to take the lowest common denominator approach and there are safeguards in there for the man on the street ... (IA)

... some organisations just ask better questions so that they end up getting better information because they just ask the right questions. (P)

Those interviewed generally did not perceive commercial confidentiality considerations to be significant.

I don't think there are many situations where commercial confidentiality prevents companies describing to us the most profitable parts of the business ... they are not going to keep their jewels hidden. (FM)

... the amount of information they're not willing to give simply because it is commercially sensitive is enormous, but you know as well as I do that the information flows between groups of companies where there is a competitive element is found out by fair means or foul and the fact that companies tend to use that as an excuse to confiscate their business I think is a bit childish. (FM)

... we certainly do come across instances where companies refuse to tell us things on the grounds that it would disadvantage them in competition ... (FM)
... confidentiality does prevent you from doing certain things ... . If you have competitors you don't want to put it on the public record. (P)

I'm rather cynical about confidentiality being used as a shield for avoiding clear disclosure ... if I were speculating about why people don't do it, it is that a lot of that additional reporting really creates benchmarks against which management teams could well be measured ... (A)

Summary

Four main findings emerge from this evidence:

- There was a general belief that one-to-one meetings create both the perception of unfair advantage and actual unfair advantage.
- There was a belief that one-to-one meetings benefit the investment community as a whole and should be allowed to continue.
- The perceived advantages of one-to-one meetings related to management accountability, the creation of a forum both for shareholders to evaluate management and for management to obtain feedback.
- Commercial confidentiality considerations were not generally perceived to be of overwhelming significance.

Information overload

This section of the questionnaire established the extent to which information overload is seen as a problem and, if so, views regarding various strategies for overcoming it. Table 4.4 summarises whether a problem is, or is not, perceived to exist.
In relation to other members of the investment community, there is a wide variety of views ranging across the entire spectrum of agreement. Nearly twice as many perceive a problem as do not (47% cf. 25%). User groups only were asked if they personally had a problem: only 19% responded positively that they did, compared to 60% who did not. This may reflect the bias towards expert user groups in our sampling. In fact, 74% of users said that they would welcome additional business information, while only 10% would not.

Those respondents who agreed that information overload was a problem, for either themselves personally or for other groups, were asked to consider ways in which the detail and complexity of the total pool of business information could be reduced. In particular, the value of ‘filtering’, i.e. the communication of only a prescribed sub-set of the information pool was investigated. Six various options were explored to reflect the possible parties who might be in control of the information selection and filtering process.

Findings are shown in Table 4.5, in rank order of preference.
Table 4.5 Interested parties' views on strategies to reduce information overload

<table>
<thead>
<tr>
<th>Question asked</th>
<th>Response category</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>1. company filtering based on my/users' specification of my/their needs</td>
<td>7</td>
<td>51</td>
<td>7</td>
</tr>
<tr>
<td>2. company using filters devised by standard setters</td>
<td>7</td>
<td>33</td>
<td>19</td>
</tr>
<tr>
<td>3. third party filtering based on my/users' specification of my/their needs</td>
<td>7</td>
<td>24</td>
<td>17</td>
</tr>
<tr>
<td>4. reducing amount of information</td>
<td>-</td>
<td>35</td>
<td>7</td>
</tr>
<tr>
<td>5. the company filtering according to its perceptions of my/users' needs</td>
<td>2</td>
<td>30</td>
<td>12</td>
</tr>
<tr>
<td>6. third party filtering according to their perceptions of my/users' needs</td>
<td>2</td>
<td>12</td>
<td>16</td>
</tr>
</tbody>
</table>

The most preferred option is for the company to filter the information based on users' specification of their needs (58% support). There is also fairly broad support for standard setters to devise the filters. There is little support for third parties or the company to undertake the filtering role. It is clear that users generally wish to retain control over the information search and selection stages of decision making. It should be noted, however, that the level of consensus over these options is low (ie dispersion is high).

Typical comments made regarding this theme were:
Investors' demand for increased information is growing strongly.

Information is only useful to those who know how to use it. Depriving those who do on the grounds of confusing those who don't is a lowest common denominator approach.

Information should be available on an as-demanded basis. Information systems, computing and the Internet are excellent forms of interactive information request and supply.

Information overload characterises all forms of activities these days and is not confined to business information.

Information flows are trying to be all things to all men. More targeted flows are needed.

Small private investors do not want the summary financial statements to be an attempt to cram as much detail as possible into a smaller space, they want a different and usually much more accessible people orientated story.

I would prefer to see far more information of a prospective nature.

Additional information on expectations of future performance would be useful.

More emphasis to be given to management discussion of the results.

It is inappropriate for the company to determine the level of information the users require in assessing performance, trends, etc.

Summary

Four main findings emerge from this evidence:
- There was a variety of views on whether information overload is a problem for certain sections of the investment community.
- Only a minority of users expressed a personal problem with information overload, with the majority welcoming additional business information.
- The most favoured way to reduce information overload was to have the company filter the available information set based on users’ specification of their needs.
- There was a desire for targeted information on an as-demanded basis.

**Confidence**

This section of the questionnaire dealt with users’ confidence in the business information made available by companies. Not surprisingly, only three respondents did not agree that the creation and maintenance of confidence in business information was important (two of these were neutral). The sources of this confidence are shown in Table 4.6, in rank order.

<table>
<thead>
<tr>
<th>Question asked (abbreviated)</th>
<th>Response category</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. assessment of quality of management</td>
<td>39 53 8 - -</td>
<td>1.7</td>
<td>Low</td>
</tr>
<tr>
<td>2. one-to-one meetings with management</td>
<td>23 53 8 5 1</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>3. external audit</td>
<td>15 52 22 10 1</td>
<td>2.3</td>
<td>Medium</td>
</tr>
<tr>
<td>4. brokers’ reports</td>
<td>2 44 31 17 5</td>
<td>2.8</td>
<td>Medium</td>
</tr>
</tbody>
</table>
There is widespread agreement that the most important source is seen to arise from the individual’s personal, subjective assessment of the quality of management. This is followed by one-to-one meetings with management. Interestingly, external audit ranks only third.

The main ‘other means’ identified by respondents were:

- comparison with the company’s competitors/talking to competitors (eight mentions);
- press articles (six mentions);
- data published by company in annual or interim accounts (three mentions);
- analysts’ meetings (two mentions); and
- credit rating agencies (two mentions).

Comments made regarding this theme frequently concerned the independence of external auditors. For example:

*Always check who is auditing the accounts, some firms are less independent than others.*

*I believe the very largest firms compromise the independence of their audits by accepting other assignments.*

*Some companies exert too much influence over the audit process.*

*I should be able to have more confidence in the external audit.*

Other issues cited were:

*The main builder of confidence is the company and managements’ track record on telling the truth.*

*Track records tend to speak for themselves.*

*I wish chairmen would write and speak as honest men, within the limitations of ‘acceptable’ business confidentiality, rather than as spin doctors.*

*One is often frustrated by not being able to drill down during analysis.*
In the follow-up interviews, respondents expanded on their questionnaire responses. The limitations of the external audit in creating confidence were expressed as follows:

*There is a slight concern ... that on occasion one comes across situations where one has a worry about the company's accounts but they have still been audited and passed ...* (FM)

*The external audit is important to some degree but we've all been let down by auditors before ...* (P)

*... external audit that's what I do for a living but my feeling is that the investment community just relies on a sort of check the box 'yes we've had an audit, it's a well known audit firm - the opinion is clean let's move on' so I think its a hurdle if you like. Once the hurdle is made then other things are more important.* (A)

*If one was cautious about management one might feel greater reliance on external audit. If one was confident of management one might also feel that the external audit would not add too much to it.* (IA)

The relatively greater reliance placed on a personal, direct evaluation of management was justified in the following terms:

*[At one-to-one meetings] you can stare into the whites of their eyes ... you can tailor it to what you are looking for so you can concentrate on areas you are particularly interested ...* (IA)

*... ultimately the confidence in information, if you like, is bolstered out by the one-to-one meetings with the management team and a good part of this is can management actually deliver future success ...* (P)

*... when we give our presentations and so forth I think to come across confidently and be able to answer the questions etc gives the investment community a lot more confidence in the company.* (P)

*If I were an individual investor ... there is no substitute for staring into the whites of their eyes* (A)
If I were an individual investor ... there is no substitute for staring into the whites of their eyes (A)

... every company ... depends so heavily on the chief executive to drive the company and to create ideas ... (FM)

Summary

Three main findings emerge from this evidence:

• Relative to the other sources of confidence in business information, a low rating was given to external audit, due partly to independence concerns.
• Critical importance was placed upon the subjective assessment of management as a source of confidence.
• The external audit was regarded as a 'hurdle', ie a necessary but not sufficient condition for confidence to exist.

Differences between the views of interested parties

This section focuses on the similarities and differences between the views of the various groups surveyed. This analysis is conducted at two levels. First, we look at the three primary groups (Pr): users (U); preparers (P); and auditors (A). Second, we examine the four user sub-groups (Users): corporate lenders (CL); fund managers (FM); investment analysts (IA); and small shareholders (SS). A simple statistical test is used to determine whether the observed variation in responses across groups is statistically significant, ie unlikely to arise through mere chance and hence indicative of a systematic difference.5

Each of the four themes is considered in turn, and the significant differences are highlighted. Summary data for the four themes is provided in Appendix B, Tables A to D. These tables report the average group score and the dispersion (classified as low (L), medium (M) or high (H)). The final two columns indicate (with a tick (✓)) the presence of significant inter-group differences (significant differences) between the three primary groups (Pr) and the four user sub-groups (U).
The views of individual groups regarding the cyclical nature of corporate information flows are shown in Appendix B, Table A. It is notable that preparers agree more strongly than users and auditors that the current cycle provides timely information, while auditors are least convinced about the value of the cycle as a basis for assessing future performance.

Across the four user sub-groups, it is small shareholders who are most satisfied with the timeliness and effectiveness of information flows, while corporate lenders are the least satisfied group with respect to these two issues.

Summary data for the questions on one-to-one meetings are presented in Appendix B, Table B. There are significant differences with respect to the groups’ general attitude to one-to-one meetings. Auditors believe strongly that the perception of unfair advantage is created; and an unfair advantage is created, while preparers are more neutral. Preparers believe strongly that such meetings benefit the investment community as a whole, while users and auditors are more neutral. It follows that preparers are most in favour of allowing these meetings to continue at their present level and most opposed to their prohibition.

Across the four user sub-groups, it is small shareholders’ views that are, not surprisingly, distinctly different from the other, more expert groups. Small shareholders have strong beliefs that one-to-one meetings, to which they have no access, create both the perception and reality of unfair advantage. In contrast to all other groups, they agree, on average, that such meetings are disbeneficial to the investment community as a whole and should be prohibited.

Summary data for the question on information overload are shown in Appendix B, Tables C(a) and C(b). Interestingly, the group least opposed to a third party filtering the information based on user defined needs was users; users were, however, most opposed to a reduction in the amount of information and the company filtering the information. It was preparers who were most in favour of companies taking on the filtering role, ranking it as their preferred option.

Across the four user sub-groups, investment analysts are the expert group which is least concerned about information overload and would welcome additional information. There is low dispersion on these points
among the group. As would be expected, small shareholders are the user group at the opposite end of the spectrum on these points. It is notable, however, that their views are, as a group, broadly neutral and dispersion is high.

Sources of user confidence are dealt with in Appendix B, Table D. There were no significant between group differences, at either level, regarding the importance of user confidence. Out of the three primary groups, auditors, not surprisingly, rate the external audit most highly, while users place the least emphasis on brokers’ reports. Across the four sub-groups, small shareholders rate one-to-one meetings least highly, which is to be expected as they do not have an opportunity to attend them. Brokers’ reports are rated most highly by this group, however, they are still ranked only third, while investment analysts, as would be expected, rate them lowest.

Summary

The main findings to emerge, under each of the four themes, are listed below.

Cyclical nature of information flows

• Users and auditors were most dissatisfied regarding the timeliness of the information cycle.
• Auditors were most dissatisfied regarding the value of the information cycle as a basis for assessing future performance.
• Greater satisfaction among the small shareholder user group regarding the timeliness and the effectiveness of year-end information flows.

Differential access

• Auditors believe most strongly that one-to-one meetings create the perception of unfair advantage and actual unfair advantage.
• Preparers believe most strongly that one-to-one meetings benefit the investment community as a whole and should be allowed to continue.
• Small shareholders hold opposing views to all other groups, believing that one-to-one meetings are disbeneficial and should be prohibited.

**Information overload**

• Investment analysts are the expert user group which is least concerned about information overload and would welcome additional information.
• Small shareholders are the user group which is most concerned about information overload and least welcoming of additional information. On average, however, their views are broadly neutral and dispersion is high.

**Confidence**

• Across all groups, critical importance was placed upon the subjective assessment of management as a source of confidence.
• There were no significant between group differences for this theme.

**Drivers of company performance**

This section of the questionnaire was given only to the user groups. Previous research had shown that, in their decision making process, the starting point for all expert users was the key ‘drivers’ of company performance, *ie* factors believed to have a significant influence (Weetman and Beattie, 1999). Users were asked to indicate the importance of each of five generic factors and 29 specific factors in a typical company evaluation. The scale used is: 1 = very important; 2 = important; 3 = fairly important; 4 = of little importance; and 5 = not important at all. Overall results are shown in Table 4.7, in descending rank order, and the detailed distribution of responses is shown in Appendix C.
<table>
<thead>
<tr>
<th>Rank</th>
<th>Generic factor*</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>quality of management</td>
<td>1.4</td>
<td>Low</td>
</tr>
<tr>
<td>2</td>
<td>company strategy</td>
<td>1.6</td>
<td>Low</td>
</tr>
<tr>
<td>3</td>
<td>industry within which company operates</td>
<td>1.7</td>
<td>Low</td>
</tr>
<tr>
<td>4</td>
<td>quality of assets</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>5</td>
<td>national economy within which company operates</td>
<td>2.4</td>
<td>Medium</td>
</tr>
<tr>
<td>Rank</td>
<td>Specific factor**</td>
<td>Average score</td>
<td>Dispersion</td>
</tr>
<tr>
<td>------</td>
<td>-----------------</td>
<td>---------------</td>
<td>------------</td>
</tr>
<tr>
<td>1</td>
<td>integrity of management</td>
<td>1.4</td>
<td>Low</td>
</tr>
<tr>
<td>2</td>
<td>vulnerability of company to competition</td>
<td>1.5</td>
<td>Low</td>
</tr>
<tr>
<td>3</td>
<td>ability of management to achieve targets</td>
<td>1.6</td>
<td>Low</td>
</tr>
<tr>
<td>4</td>
<td>acquisition strategy (past performance and future plans)</td>
<td>1.7</td>
<td>Low</td>
</tr>
<tr>
<td>5</td>
<td>recent changes in quality of management, corporate succession and management style</td>
<td>1.8</td>
<td>Medium</td>
</tr>
<tr>
<td>6</td>
<td>experience of management</td>
<td>1.8</td>
<td>Medium</td>
</tr>
<tr>
<td>7</td>
<td>corporate strategy re the development of existing operations</td>
<td>1.8</td>
<td>Low</td>
</tr>
<tr>
<td>8</td>
<td>distribution of company's activities by business segment</td>
<td>1.9</td>
<td>Medium</td>
</tr>
<tr>
<td>9</td>
<td>impression of management on face-to-face meeting</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>10</td>
<td>customer and supplier dependencies of company</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>11</td>
<td>disposal strategy (past performance and future plans)</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>11</td>
<td>flexibility of company to technological change</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>11</td>
<td>capital expenditure plans</td>
<td>2.0</td>
<td>Medium</td>
</tr>
<tr>
<td>14</td>
<td>understanding of dividend policy and financing strategy</td>
<td>2.1</td>
<td>Medium</td>
</tr>
<tr>
<td>15</td>
<td>vulnerability of company to exchange rate changes</td>
<td>2.2</td>
<td>Medium</td>
</tr>
<tr>
<td>15</td>
<td>distribution of company's activities by geographic sector</td>
<td>2.2</td>
<td>Medium</td>
</tr>
<tr>
<td>17</td>
<td>vulnerability of company to interest rate changes</td>
<td>2.3</td>
<td>Medium</td>
</tr>
<tr>
<td>18</td>
<td>vulnerability of company to changes in government policy</td>
<td>2.5</td>
<td>Medium</td>
</tr>
<tr>
<td>19</td>
<td>corporate innovation</td>
<td>2.5</td>
<td>Medium</td>
</tr>
</tbody>
</table>
Table 4.7 Users' overall ranking of drivers of company performance (continued)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Specific factor (continued)</th>
<th>Average score</th>
<th>Dispersion</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>understanding the mechanics of new accounting policies</td>
<td>2.6</td>
<td>Medium</td>
</tr>
<tr>
<td>21</td>
<td>knowledge of current value of tangible assets</td>
<td>2.7</td>
<td>High</td>
</tr>
<tr>
<td>22</td>
<td>knowledge of value of intangible assets (eg intellectual capital)</td>
<td>2.7</td>
<td>Medium</td>
</tr>
<tr>
<td>23</td>
<td>other national economies affecting company</td>
<td>2.8</td>
<td>Low</td>
</tr>
<tr>
<td>24</td>
<td>plans for investment in human assets</td>
<td>2.9</td>
<td>Medium</td>
</tr>
<tr>
<td>25</td>
<td>fiscal policy of national economy</td>
<td>3.0</td>
<td>Medium</td>
</tr>
<tr>
<td>26</td>
<td>impact of environmental issues</td>
<td>3.2</td>
<td>Medium</td>
</tr>
<tr>
<td>27</td>
<td>nature of the presentation of the annual report</td>
<td>3.3</td>
<td>High</td>
</tr>
<tr>
<td>28</td>
<td>knowledge of historical cost of tangible asset</td>
<td>3.3</td>
<td>High</td>
</tr>
<tr>
<td>29</td>
<td>knowledge of identity of valuer</td>
<td>3.3</td>
<td>High</td>
</tr>
</tbody>
</table>

* The number responding varied between 81 and 83.
** The number responding varied between 80 and 82.

The most important generic factor is quality of management (66% rate as very important), followed by company strategy, industry, quality of assets and economy. There is a high level of consensus (ie low dispersion) as to the top three factors. Respondents were given the option of specifying factors other than those listed. The 'other' generic factor nominated most frequently by respondents was the quality/strength of cash flow (ten mentions). There were no significant differences between group's views.

As for specific factors, the three most important factors were: integrity of management; vulnerability of company to competition; and ability of management to achieve targets. The level of consensus was high for all three (ie low dispersion). Moreover, the top three factors were broadly comparable across the four user sub-groups. Several of the top ten factors relate to the inherent qualities of management (eg factors ranked 1, 3, 6 and 9). Others relate to things that might affect the company, but that are not apparent from the accounts (eg factors 2, 4 and 10). Respondents
were given the option of specifying factors other than those listed. The 'other' specific factors cited most frequently were cash flow (five mentions) and debt repayment schedules (three mentions).

Similarities and differences between the views of the four user groups are shown in Appendix D. There were significant differences (indicated by a tick (✓) in the final column) for eleven specific factors. These are listed below in order of overall importance to users. Among the higher ranking factors, and relative to the other groups, investment analysts stood out as viewing the integrity of management as least important; small shareholders rated vulnerability of company to competition as least important; corporate lenders rated experience of management as most important; and investment analysts rated flexibility of company to technological change as least important.

Among the lower ranking factors, and relative to the other groups, corporate lenders and small shareholders rated vulnerability of company to changes in government policy and knowledge of current value of tangible assets as most important. Investment analysts rated these two factors as least important; corporate lenders rated knowledge of value of intangible assets as most important and investment analysts rated this as least important; investment analysts rated plans for investment in human assets as least important; corporate lenders rated impact of environmental issues as most important and investment analysts rated this as least important; small shareholders rated the nature of the presentation of the annual report as most important; and corporate lenders rated knowledge of the identity of valuer (of tangible assets) as most important and investment analysts rated this as least important.

It would appear that investment analysts are not impressed by information, often soft and non-financial in nature, relating to human assets and environmental issues, presumably preferring to focus on the hard financial data.

Representative comments about this section of the questionnaire were:

*The key driver in a business is the quality of management and this can be adduced by their ability to achieve targets.*
Quality of management is paramount as evidenced by a clear and deliverable strategy.

Leadership is all, as in every walk of life.

We rarely see a thoughtful and comprehensive risk analysis presented by companies of the driver factors they consider important. Now that would be fun to see!

Summary

Six main findings emerge from this evidence:

- Critical importance was placed upon the 'quality of management' as a generic driver of company performance across user groups - it was the top factor for three of the four groups.
- Critical importance was placed upon management integrity, vulnerability of company to competition and ability to achieve targets as specific drivers of company performance across user groups.
- Aspects of management 'quality', strategy and sources of risk were the main categories of specific factors viewed as important.
- The integrity of management was considered less important by investment analysts than other user groups.
- The vulnerability of the company to competition was considered less important by small shareholders than other user groups.
- The experience of management was considered more important by corporate lenders than other user groups.

Overall summary and conclusions

The evidence presented in this chapter results in the following main findings regarding current financial communications:
• **Cyclical nature of corporate information flows** – There was dissatisfaction as to the timeliness of information flows; regular, periodic flows were viewed as satisfactory for providing year-end information but not as a basis for assessing future performance.

• **Differential access** – One-to-one meetings were seen to create the perception and reality of unfair advantage, but (with the exception of small shareholders) were viewed to be of general benefit. It was thought that they should be continued.

• **Information overload** – Generally, users did not suffer information overload and would welcome additional information; users wished to retain control over the information search and selection process.

• **Confidence** – The prime source of confidence in business information was the subjective assessment of the ‘quality of management’, often obtained via interactions with management; external audit ranked only third.

• **Drivers of company performance** – The ‘quality of management’ was viewed as the key generic driver of company performance; aspects of management quality, strategy and sources of risk were the main types of specific factor viewed as important.

Our proposals for change in financial reporting map directly on to these findings. Our proposals are, therefore, aimed at: improving the timeliness of business information; levelling the playing field by improving access to disadvantaged groups; increasing the opportunities for users to interact with management; providing a wider range of relevant information while providing support for non expert users; providing more information of a forward looking and/or non-financial nature that relates to the drivers of corporate performance; ensuring user control of the information search and selection stages of decision making; and ensuring adequate confidence in the information.

Naturally our proposals must recognise certain reporting constraints relating to commercial confidentiality, litigation risks and cost. We believe, however, that some of these constraints are not fixed in the long term. Our detailed long term proposals are presented in the next chapter.
Endnotes

1 This phrase is derived from the RSA’s concept of a ‘licence to operate’.
2 Responses were recorded in a spreadsheet (Excel) and subsequently analysed using the statistical package SAS.
3 The categories are based on the standard deviation of responses as follows: s.d. ≤ 0.70 (low); 0.70 < s.d. ≤ 0.99 (medium); and 0.99 < s.d. (high).
4 These concerns are consistent with the findings of studies that focus on the perceptions of auditor independence. In a recent UK study, however, Beattie et al (1999) find that regulatory changes introduced in the early 1990’s significantly enhance perceptions of auditor independence. In particular, the existence of an audit committee, the risk of referral to the Financial Reporting Review Panel and the risk to the audit firm of loss of Registered Auditor status were significant enhancement factors.
5 A one-way analysis of variance test is used, and a 5% level of significance is applied.
6 Given the reporting incentives of companies, this option has an inherent danger of bias.
CHAPTER FIVE

A BLUEPRINT FOR BUSINESS REPORTING

Based on the survey evidence presented in chapter four, the Research Committee offers its proposals for change in the business reporting practices of listed companies. These proposals seek to address the needs of expert and non expert users alike. The proposals also seek, where possible, to facilitate the assessment by users of the quality of management, since the survey showed this to be both the prime source of confidence in business information and the most important driver of company performance. Although many of our proposals are relevant to the public and voluntary sectors, we do not consider their particular needs here.

In this chapter, our proposals are presented initially as a description of a desirable (and, we will argue, feasible) state of business reporting as it might exist in, say, the medium to long term. This state is designed to reduce the business reporting expectations gap without serious cost to preparers and assurance providers. This, in turn, will reduce current iniquities, improve the allocation of capital in the economy and reduce companies' cost of capital. Seven proposals are made.

We then consider how this desirable state might be achieved, ie the process by which change is accomplished. We recognise that radical change in an established activity such as business reporting, where behavioural patterns are set largely through custom and practice, is potentially very dangerous, as uncertainty and confusion can seriously destabilise the capital markets. For this reason, we propose a series of short term measures combined with positive encouragement of experimentation by preparers, to be followed by incorporation of best practice into voluntary codes, and finally, in the long term, the possibility of mandatory regulation.
The concepts underpinning several of our proposals are not new. We are, however, reinterpreting existing concepts in the context of today’s reporting environment.

**The future state of business reporting**

Our blueprint comprises seven proposals regarding the form and content of corporate communications. In the following sub-sections we first state our proposal, we then say what we believe will be achieved by implementing the proposal, and we then provide supporting discussion.

**The corporate database as an electronic library-type resource**

<table>
<thead>
<tr>
<th>Proposal</th>
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<tbody>
<tr>
<td>We propose that an electronic library-type resource, based on the corporate database, be made available to external users.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>We believe that this addresses the general desire for additional information available on an as-demanded basis.</td>
</tr>
</tbody>
</table>

A cornerstone of our proposals lies in the transformation of the corporate database into a resource which is made available, at least partially, to external users. The corporate database would serve as an electronic library, in which users could search out specific information from a very large database and/or browse.

Currently in the corporate communications process, certain areas of the library (tier four in Figure 3.2: undisclosed private information) are closed to all external users whilst other parts (tier three: selected private disclosure) are available only to certain users. Tiers one and two are available to all. We propose that changes should be made to the demarcation lines to open up the library to a greater extent. In particular, some of the information currently in tier three would shift to tier two
(voluntary public disclosure) or tier one (mandatory public disclosure). More generally, we propose that, subject to legitimate constraints, some tier four information would also shift to tier two, partially breaking the traditional, yet arbitrary, schism between financial and management accounting. We do not recommend that all information available to management be made available externally. We recognise that certain information could easily be misinterpreted by the external user if taken out of context, for example, production and operating statistics, environmental issues and information arising from internal bargaining by management, such as budgets¹.

Although we acknowledge that some non expert users may not have the skill, time or inclination to search the library at first hand, the important principle is that there is equality of access, not necessarily equality of use, to more relevant and timely information. All users can potentially access the library, although effective rationing will occur due to differential skill and effort.

Layering, linking and free search of information in the electronic library

<table>
<thead>
<tr>
<th><strong>Proposal</strong></th>
</tr>
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<tbody>
<tr>
<td><em>We propose that existing technology be exploited to layer and link information, to provide direct links to non-company databases; and to maintain a facility for free search.</em></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Benefits</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>We believe that:</td>
</tr>
<tr>
<td>• the layering feature addresses the information overload concerns of non expert users, while providing for the additional information desired by many;</td>
</tr>
<tr>
<td>• layering and linking facilitate effective search strategies by users; and</td>
</tr>
<tr>
<td>• the free search principle satisfies the desire of users to retain control over the information search and selection process.</td>
</tr>
</tbody>
</table>
The mode of access to the electronic library would be through the use of information technology, in particular, it seems likely that the Internet will prove to be the most suitable mechanism for dissemination. We believe that the concept of 'layering', which was envisaged in MCRV (ICAS, 1988, p81), is worthy of further attention as a means of addressing the needs of the non expert users within the context of electronic access to data. By layering, MCRV meant that each financial statement would start with the simplest possible presentation of the main factors. As the reader worked through the information available, it could be called down in layers of increasing complexity and detail. This would allow the user to 'drill down' to the level of detail desired, subject to regulation setting the cut-off layer of information beyond which the detail need not be placed in the public domain². Of course, companies may choose to permit access to additional layers of information.

In keeping with the concept of layering, users could delve more deeply into various items by the use of 'hot keys', which provide powerful cross-referencing and search facilities. We note that some companies are already redesigning their web-based annual reports to allow users access to layers of information through the use of 'hot keys'. The hot key cross-referencing would be extended to databases other than that of the company. For instance, a user who wanted to find out more about a particular business reporting standard could use a hot key to transfer to a database holding the text of, and explanatory material on, such standards. Competitor, industry-wide, economic and external benchmark information could also be linked.

Sophisticated search software would allow users to access the library database to suit their particular needs, including defining their own questions about the company's performance ie the formulation of 'queries'. Thus, users, rather than being reactive, become proactive by defining their own needs and seeking the information to satisfy them. The software would be flexible, allowing the user to roam free through the database rather than be driven in the direction set by the company. Such a search facility would allow for the provision of additional information welcomed by expert users.
Packaging the information using templates

**Proposal**

*We propose that a range of pre-packaged information be provided, based on a standardised template for each stakeholder group.*

**Benefits**

We believe that this:

- addresses the needs of non expert users who can choose simply to access the relevant template, drilling down to whatever layer of detail they specify; and
- provides the relevant focus to suit various stakeholder perspectives.

Many non expert users rely heavily on 'pre-packaged' information, such as that found in corporate reports, and are reasonably satisfied with it. Most do not want more information, since many already experience information overload. To address their needs, we believe that the raw data should be repackaged into a range of standard templates. Because of its value in providing a familiar and fundamental structure to corporate communications, the traditional annual report and accounts would be a primary template, especially for shareholders. The financial statements and notes to the accounts would be in a prescribed format derived from the library database, to be accompanied by a commentary focused on explanation with a forward looking emphasis. Other standard templates could be developed for other stakeholder groups, eg loan capital providers, employers, customers\(^3\). These templates would include pre-selected variables and ratios relevant to the specific perspective of the user, together with suitable benchmarks. These templates could be periodically refined, eg based on monitoring of the most frequently accessed parts of the library.
Expert users, on the other hand, expressed a desire for more information and to retain control of the search and selection stages of decision making, to enable them to use their own analytical templates. These users would be free to search the library based on their individual specification.

Extending access to company meetings and to management

**Proposal**

We propose that:

- access to general company meetings be extended via live broadcast, with records being placed in the library;
- access to one-to-one meetings be extended via minutes being placed in the library; and
- a facility for on-line questioning of management via the electronic library be made available.

**Benefits**

We believe that:

- the extension of access reduces the unfair advantage aspect while retaining the benefits of company meetings;
- the extension of access facilitates the subjective assessment of 'quality of management'; and
- the on-line questioning facility allows interaction which, *inter alia*, enhances corporate governance structures.

Our research has shown that, with the exception of small shareholders who are disadvantaged, all interested parties believe that company meetings, general meetings with analysts and major shareholders and one-to-one
meetings benefit society as a whole by creating a dual knowledge advantage and should not be restricted or prohibited. It is, however, necessary to increase the transparency of private disclosures.

If users are to be active rather than passive in their corporate governance role, having access to relevant information to make their decisions is not enough. They must also have the ability to challenge management on their policies and notify them of their decisions. Moreover, our research has shown that the opportunity to assess the quality of management is both the key source of user confidence and is seen as the key driver of company performance. We, therefore, encourage the continuance of such meetings, subject to the introduction of changes to alleviate unfairness.

In considering general meetings, we recommend that the presentation packs and accompanying slides be made available publicly in the corporate database library. An audio visual record of the meeting could also be stored in the library. We also see potential for opening up the meetings between management and analysts to a much wider audience. The analysts' meetings with companies, which take place immediately after the earnings announcement and which provide a rich dialogue and much useful information, could be broadcast live via one of the many satellite television channels using existing technology.

With regard to one-to-one meetings, we propose that detailed minutes of each be placed in the library. We do not recommend that this disclosure should take the form of a verbatim record of the questions and answers in the meeting both because this would be likely to stultify the meetings and because the experts are likely to consider their line of questioning to result from their own research and be confidential.

It is important to recognise, however, that the types of information imparted are of two types: factual information; and perceptions about the quality of management. Presentation packs and minutes relate only to factual information, whereas audio-visual media facilitate perceptions about the quality of management to be formed.

These combined proposals fail, however, to give non expert users any interaction with management. The annual general meeting (AGM) is supposed to give all shareholders, whatever the size of their shareholding, direct and public access to their boards (Cadbury Report, 1992, p49), yet
the Myners Report has criticised it as being an expensive waste of time and money (Myners, 1995, pp14-15). Myners viewed the AGM as too important to leave as it is and favoured changing its format to make it a more rewarding experience for shareholders. We consider that the AGM has become outmoded, and that its only serious remaining function is as a voting mechanism.

Some companies are already trying to overcome such concerns by televising their AGMs and keeping the films in a company archive, while others produce live text broadcasts (Jackson, 1997). This improves access to timely information and allows users to monitor the reactions of management to the questions posed at the AGM, but it does not allow true interaction. The next stage of development in this area could be the teleconferencing of AGMs which would allow a shareholder in, say, Edinburgh to question the company representatives at the AGM in, say, Chicago. Developments along these lines would not impose undue time demands on the company's employees. An alternative approach, which we favour, would be to allow users to question company management on-line, via the corporate database library website. The questions could be submitted by users at any time and relate to any subject. To avoid taking up excessive amounts of senior management time, the company would have to put in place procedures to filter the questions, delegating the responsibility for responding to straightforward questions to junior management and employees. Voting is another activity which could be conducted on-line.
Additional forward looking, non-financial and soft information

Proposal

We propose that access to a wider range of information be available, where there is a clear external demand. In particular:

- at three to five yearly intervals, selected prospectus type information be provided;
- certain non-financial information currently captured by management information systems be provided eg performance indicators; and
- certain information not currently captured by management information systems be provided eg intellectual capital, biographical information on directors.

Benefits

We believe that this:

- addresses the desire of users for specific additional information types to assess future performance, the drivers of future profit, cash flow and other success indicators; and
- facilitates the objective assessment of the 'quality of management'.

Our research has shown that users see the main categories of specific drivers of company performance as, in descending order of importance:

- aspects of management quality eg integrity, ability to achieve targets, experience;
- company strategy eg acquisitions, existing operations, disposals; and
- risk sources eg vulnerability to competition, customer and supplier dependencies, flexibility to technological change, vulnerability to exchange rate and interest rate changes.
Many of these drivers relate to soft, qualitative and/or subjective issues, while others concern the future. Most are non-financial in nature. These types of information are not generally documented on a company’s database, because of the inherent difficulties of data capture (ie the difficulties of observation and measurement) and disclosure. If the business reporting expectations gap is to be reduced significantly, however, then a practical way must be found to disclose, to some extent, this type of information.

We note that, in special circumstances such as capital issues and takeover situations, companies become more ‘open’, issuing verified documents containing forward looking information eg prospectuses, defence documents. We also note that 26% of our survey respondents either did not agree that commercial confidentiality considerations prevented management from conveying information on key drivers or were neutral. We suspect, therefore, that confidentiality and litigation concerns have been overstated. We propose that, at three to five yearly intervals, selected prospectus type information be disclosed publicly. This would include, *inter alia*, information on significant new products and activities; the extent to which the company is dependent upon patents, contracts, *etc*; principal future investments; significant recent trends in production, sales, stocks, orders, costs and selling prices; and financial and trading prospects for the current financial year.

We also note that the OFR section of the annual report contains the main corporate message and has become the ‘common root’ of message variants. Yet public disclosure of strategy and risk factors is limited and it currently contains very little specific, forward looking information. We propose that the OFR be enhanced to include explicit discussion of the principal drivers of company performance. Where possible, there should be appropriate quantification, which need not necessarily be financial.

Given the importance which users place upon management quality, both as a source of confidence and as a driver of company performance, we suggest that detailed biographical information relating to members of the top management team be disclosed. This would permit the relevance and value of each individual’s qualifications and experience to be assessed, both of which are aspects of management quality. We also suggest that, to avoid bias, disclosure is also made of the following events in the directors’
recent past: court judgments; declaration of bankruptcy; and involvement with companies entering into insolvent liquidation. This information would assist users in their assessment of directors' attitudes towards fulfilling their obligations\(^{14}\).

Also, additional information relating to risk sources could be provided. In most cases, this could be quantified. Examples of this type of information include:

- information about the market, and the company's position within it, is already available from other sources eg trade organisations. There can be, therefore, no serious claim that disclosure will result in competitive disadvantage. The company could choose either to integrate selected relevant information into its own website, and perhaps expand on it, or provide a link to that of the trade organisation;
- information about major suppliers and customers, in particular, the proportion of business conducted with them and selected details regarding the relationship (again, there could be links to the websites of these other companies);
- information about the company's sensitivity to shifts in macro-economic indicators, such as exchange rates, interest rates, consumer spending;
- information about the company's exposure to environmental costs; and
- information about the nature, quantity and management of items which do not presently appear in financial statements and yet which are critical to the company's long term success eg intellectual capital.

The treatment of intellectual capital is worthy of further discussion, since it is viewed as being of critical importance in attaining sustainable competitive advantage in a knowledge and services-based economy. Intellectual capital has been defined as 'intellectual material that has been formalised, captured and leveraged to produce a higher valued asset' (Stewart, 1997). Intellectual capital is the transformation of knowledge, which is in turn created from information and, in turn, raw data. There are three types of capital which interact to create value: physical capital;
financial capital; and intellectual capital. The elements of intellectual capital must first be identified and defined, prior to measurement (SMAC, 1998a). Brooking (1996), one of several consultants in the area, distinguished three measurement approaches: cost approach; market approach; and income approach. As practices in this area develop, the concepts will become accepted more widely and the measurement methods will become more reliable. At this stage of development, we recommend that companies, especially knowledge based organisations, report externally on the measurement and management of intellectual capital.\(^{15}\)

**Frequency of library updating**

<table>
<thead>
<tr>
<th>Proposal</th>
</tr>
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<tbody>
<tr>
<td>We propose that regular, periodic reporting be retained; and that a moderate increase in frequency be effected as users adapt to changing practice.</td>
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<table>
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<tr>
<th>Benefits</th>
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<tr>
<td>We believe that this:</td>
</tr>
<tr>
<td>- overcomes the moderate dissatisfaction with timeliness; while</td>
</tr>
<tr>
<td>- retaining the advantages of regular, periodic information flows.</td>
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</table>

Our survey respondents were moderately dissatisfied with the timeliness of business information flows, although research has shown that all parties value the structured, cyclical flow of information, which encourages and supports the practice of periodic review. The timing of the annual report set the timetable for private meetings.\(^{16}\) The desire for timely information has to be balanced against the cost and practical difficulty of frequent updating, detracting company management's attention and the ability of users to comprehend and apply rapidly
changing information. On balance, we believe that the frequency of updating the database is probably an industry issue. Some companies will update monthly, others quarterly.

Significant events affecting the company should, however, be disclosed immediately. We do not propose a system of 'real-time' reporting ie continuous updating of the entire database, although it is technically possible, since market makers do not currently appear to have any desire to engage in continuous monitoring, preferring the structure and discipline of periodic review linked to reporting cycles17.

Confidence: shift to assurance of processes rather than outputs and multiple levels and forms of assurance

<table>
<thead>
<tr>
<th>Proposal</th>
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<tbody>
<tr>
<td>We propose that there is a shift towards the assurance of processes in addition to outputs; and that multiple levels and forms of assurance be developed.</td>
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<table>
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<tr>
<th>Benefits</th>
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<tbody>
<tr>
<td>We believe that this:</td>
</tr>
<tr>
<td>- addresses the need to obtain confidence in the reliability of information, whether factual or subjective, to the extent that it can be provided by a competent and independent third party; and</td>
</tr>
<tr>
<td>- given the expanded pool of information available, opens up the possibility of providing assurance as to the relevance of information eg via pre-packaged, standard templates.</td>
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</tbody>
</table>
Security

Security is a basic issue. If users are to have the necessary level of confidence in business information, the data must be secure. The security of electronic information in a network environment is an issue of general concern to society and techniques, both to undermine and enhance, continue to develop (Manchester, 1997; Black, 1997; Daily Telegraph, 1997). Developments in this area are likely to determine the most secure location of corporate libraries, ie company website, regulatory body’s website or commercial intermediary’s website.

Reliability

Reliability, particularly formal attestation, is an issue of obvious concern to the accountancy profession. While our survey showed that users place great emphasis upon informal modes of attestation, 67% also place reliance on the external audit. With the anticipated move to a corporate library, we must consider the extent to which the attester should be attesting processes, ie the database and its controls, as opposed to output\textsuperscript{18}. Attestation of outputs will, however, still be necessary to some extent where the output involves a subjective judgment. We envisage various levels of attestation of the content of the corporate library, depending on the nature of information. Core quantitative, historical financial and historical non-financial information could be subject to current levels of audit. Quantitative forward looking information could have the reasonableness of any underlying assumptions (and the arithmetic) attested to\textsuperscript{19}. It is likely that members of the accountancy profession do not currently have the expertise to attest to all soft, subjective types of business information. In some cases, professionals other than accountants may have to be involved in the attest function in these areas. The current trend, particularly among the larger accountancy firms, towards pooling different professionals internally and working in a truly multidisciplinary way, is likely to accelerate.
The Elliott Committee (AICPA, 1997)

The AICPA has been at the forefront of efforts to address the future of the auditing/assurance function. The Special Committee on Assurance Services (the Elliott Committee) was set up in 1994 and reported in late 1996 (AICPA, 1997). Attestation is defined in Statements on Standards for Attestation Engagements No. 1 as the issuance of a written communication which expresses a conclusion about the reliability of a written assertion which is the responsibility of another party. Audit is, therefore, a specific type of attestation. Assurance is defined by the Elliott Committee as ‘independent professional services that improve the quality of information, or its context, for decision makers’. In this definition, the ‘quality’ concept embraces decision usefulness. Assurance services, therefore, can add confidence about information by enhancing reliability and/or relevance. ‘Context’ refers to the decision process employed by the user or the format in which the information is presented. This definition encompasses audit and other attestation services. All involve independent verification, but assurance can involve any type of information: financial or non-financial; discrete phenomena or on-going processes or systems. In assurance, no written report is necessary although users must somehow be made aware of the outcome.

The Elliott Committee identified six principal new service opportunities, of which three address the needs of external users of business reports: risk assessment; business performance measurement; and information systems reliability. It believes that these services will eventually be demanded by external users with demand initially coming from internal management. Previously, the Jenkins Committee had recommended ‘flexible auditor association with business reporting, whereby the elements of information on which auditors report and the level of auditor involvement with those elements are decided by agreement between a company and the users of its business reporting’ (AICPA, 1994, p105). It is considered likely that additional levels of assurance, in addition to the current ‘audit’ and ‘review’ levels, may be necessary to cover some types of information.
The reporting of assurance

The Research Committee agrees with these views. It also notes the launch in 1997 of the CPA WebTrust program for web sites conducting electronic commerce (one of the six assurance service opportunities identified above). This seal certifies that WebTrust principles, relating to business practices disclosure, information protection, etc, have been met. It is refreshed every 90 days and is audited to professional attest standards.

We suggest that the concept of a seal may translate effectively to the business reporting context, as a means of indicating certain assurance characteristics of the information to the outside user. This seal could be ‘tagged’ to individual pieces of information, with different formats representing different levels of assurance. Initially, external assurance provision is likely to relate mainly to the audit of the financial statements and the review of related annual report material. In time, assurance could be extended to the reporting of operational risks and business performance measurement. An alternative to tagging individual information items would be to tag entire web site pages. Given the ability to jump to other pages of the same site, or indeed other sites, via hot keys, it would be necessary to incorporate electronic warnings at the ‘gateways’ between assurance levels.

Assurance on the quality of management

Our survey showed that users obtain confidence primarily from their own subjective judgment of the quality of management. It may be possible to identify observable factors related to this, and report them in conjunction with independent verification. The reporting of directors’ biographical details is a first step in this direction.

Implementing change

The Research Committee believes that changes to the current business reporting model are desirable. We believe that, within a relatively short time, the reporting of additional non-financial performance
indicators in the private sector will become as common as it now is in
the public sector. We recognise, however, that any attempt to mandate
radical change, with the potential to destabilise the capital markets and
provoke a litigation crisis, is too risky to be a viable option. Instead, we
propose that the profession actively encourages and assists in bringing
about change incrementally. This can be achieved by fostering discussion
and debate among interested parties, by undertaking empirical and
theoretical research into, for example, the measurement of non-financial
indicators and into the nature of related assurance services, and by
encouraging companies to experiment with the form and content of
their business reporting package.

It is likely that both printed and electronic formats of traditional
business reports will run in parallel for some time, as fundamental changes
in the regulations surrounding business reporting will be necessary before
the current system could be replaced.

Many of the larger, listed companies are, however, leading the way
forward, by responding to user demands for more information. These
leading edge companies see benefits in more extensive disclosure,
suggesting that commercial confidentiality concerns are overstated\textsuperscript{21}.

Examples of companies which are at the leading edge of some aspect
of business reporting include the following:

- Company A’s Annual Report and Accounts includes a section
  reporting on key indicators, mostly non-financial, relating to key
  stakeholder groups: employees; franchises; suppliers; community trade;
  customers; community; and shareholders. The achievement or non-
  achievement of numerous targets in each area is reported on. Many
  targets relate to external benchmarks.

- Company B’s Annual Review provides detailed biographical
  information on each of its directors, which allows their qualifications
  and experience to be assessed. It also provides two separate reports
  relating to the company’s wider social responsibilities. These
documents state policies, provide self-assessment and independent
reports and report on key non-financial indicators.
• Company C’s main environmental performance report identifies specific targets and reports on progress achieved. This report has been externally verified by a big five accountancy firm and a detailed ‘verification statement’ is included.
• Company D, a Scandinavian company which operates as a virtual organisation selling financial products and services worldwide, has been at the forefront of reporting, internally and externally, on intellectual capital, a practice which has now been expanded throughout the group. Only some of the measures are common to all divisions.
• Company E’s annual report provides additional segmental information. Operating assets and return on capital employed are analysed by both geographical area and business segment.

We urge individual organisations and researchers to continue research into business reporting. In the UK, the ASB has set up a working party to examine the overall reporting package, while the DTI’s fundamental review of company law launched in 1998 aims, inter alia, to update the law for modern technology and current expectations (DTI, 1998).

Over time, we anticipate that a critical mass of evidence and knowledge will be built up regarding the overall form and content of the business reporting package. At this point, further, more fundamental regulatory change may or may not be desirable, either to codify best practice or to force preparers to respond to legitimate user demands, and also to create a regulatory environment consistent with new business reporting practices.

Summary

This chapter has put forward a blueprint for business reporting by listed companies. This blueprint is grounded explicitly in the findings of a large scale survey of users’, preparers’ and auditors’ attitudes to current corporate reporting. It encompasses both public and private forms of communications. Figure 5.1 is a diagrammatic representation of the main features of this blueprint.
Figure 5.1  A blueprint for business reporting

- **Company**
  - Relevant subset of existing corporate database
  - Forward looking, non-financial and soft information not currently captured by management information systems; relating to performance, risk, intangibles, etc.
  - Company meetings: records of general meetings; minutes of one-to-one meetings

- **Electronic library of publicly available corporate information, updated regularly, incorporating assurance 'tags'**

  **Assurer:** independent verification (at multiple levels) of reliability and/or relevance of systems and outputs

  - User-defined, unrestricted search facility
  - Predefined, layered stakeholder-oriented templates, offering user-driven browsing

- **Shareholder**  **Lender**  **Employee**  **Supplier**  **Creditor**  **Social**  **Environmental**

- **User**

- **Decision**

**Key:**
- □ = Information set
- = Activity
- = Information flow
- = Direct link (via Internet)
Our proposals pre-suppose the use of the Internet as the means of information dissemination. We emphasise the importance of expanding the information set available to users. The balanced scorecard approach advocated for internal management is extended to external stakeholders. This recognises the importance of performance measurement to external users. Many stakeholder groups are interested primarily in the drivers of profit and cashflow and non-financial performance indicators are known to lead these financial indicators. There is also enhanced disclosure of forward looking and soft information.

We also emphasise the importance of integrating the business reporting package by linking the expanded corporate database with records from private company meetings and external databases. This highlights the relationships between various information types and supports comprehensive, user-defined search and analysis protocols.

To support non expert users a set of pre-defined stakeholder-oriented templates is also available. These permit user-driven browsing down through the available layers of information. The public disclosure of records from company meetings overcomes concerns regarding the unfair advantage obtained by attendees at these meetings.

For users to have confidence in this expanded, integrated information pool, new forms of assurance will need to be developed. Currently, the reliability of selected outputs from the corporate database, the financial statements, is attested to. Ways must be found to give some level of in-depth verification on the reliability of non-financial and soft information, and on the information systems generating these outputs. The provision of assurance regarding the relevance of this information must also be addressed.

This blueprint sets an agenda for future research effort. Research needs are outlined in the final chapter of this discussion document. We also welcome comments on our proposals outlined in this chapter.

**Endnotes**

1 This represents a shift from the recommendation in MCRV (ICAS, 1988) that the information given to external users should be the same in kind, although not in detail, as that used by management.
‘Drilling-down’ is the action of navigating through successive layers of data to obtain more detailed information.

The success of a data warehouse is assisted by the development of sample report templates and queries (SMAC, 1998b, p35).

Bouwman et al (1987) and Bouwman (1995) have conducted extensive research into the information search strategies adopted by expert users specifically, financial analysts. It was found that financial analysts employ ‘scheme-driven’ search strategies. These are of two types: a ‘standard checklist’ to commence the evaluation; and a ‘conditional checklist’ involving a directed search for specific information. They also retrieved financial ‘templates’ containing specific expectations for the line items in the financial statements.

This is made possible by advances in data digitalisation.

Alternatively, this could be stored on a Stock Exchange or commercial database.

Digital television will soon provide viewers with some 200 channels of entertainment, news and sport through a ‘set-top box’ and we envisage that within a very few years public access to company databases and other such sources will also be possible by this means. Regulatory guidelines recently published by the regulator discuss the question of the ‘smartcard’, the electronic device which identifies the subscriber and gives access to the digital services (Cane, 1997).

These proposals are similar to the proposals made by Marston (1996; 1999).

Highly trained transcribers turn speech to text and then software converts the shorthand into English, checks it for errors and then sends it out across the Internet. There are plans to use this technology for AGMs and employee meetings as the system also allows the person reading the text to type in questions for the speaker. Further developments to introduce a shareholders’ voting system are being considered, although there is some management concern over the difficulties in managing such developments.

ICAS (1993) argued for a ‘total picture’ of business measurement which encompassed key financial and non-financial performance measures.

One benchmarking expert whom we consulted told us that he worked around confidentiality fears by emphasising the benefits of shared information.

The trend towards increased disclosure of prospective information is acknowledged in a recent APB discussion document (APB, 1998).

Holland (1997).

This suggestion is in line with that made in a recent ICAS consultation paper, Breaking the Code (ICAS, 1998).

Lev (1997) is among those who also propose this.

Holland (1997).

Others also caution against a headlong leap into continuous reporting, for example, Shah and Higson (1997) and RSA (1998).
18 One of the big five accountancy firms believes that industry will need accountants who can provide companies with assurances that the on-line environment is under control, secure and safe for business (International Accounting Bulletin, 1997). The Canadian Institute of Chartered Accountants believes generally that chartered accountants should be improving organisational performance through using their assurance skills and specifically that they will be required to assure to the reliability of information gathering processes (CICA, 1995).

19 This is in line with the recent APB proposals on prospective information.

20 The other three are electronic commerce, healthcare performance measurement and ElderCare Plus.

21 Some writers believe it to be 'unlikely that preparers will significantly increase disclosure or begin to develop business reporting databases in the absence of an initiative by users or regulators' (Pratt and Storrar, 1997, p217).
CHAPTER SIX

RESEARCH IMPLICATIONS

The Research Committee’s recommendations for future research directions are, at this time, necessarily stated in broad terms. Before more specific proposals can be made a great deal of further research is required. In this final chapter of our report, we set out eleven areas where we believe detailed empirical and theoretical work is needed most urgently for the development of business reporting.

General

The following three areas relate to the monitoring and use of business information and the underlying financial reporting model.

Monitoring of corporate business reporting practices

The content of external business reports, irrespective of the mode of delivery, needs to be monitored to identify the incidence of disclosure of new types of information, non-financial, forward looking, and the use of new measurement bases.

Over the next few years, practices in relation to the electronic dissemination of information via the Internet are likely to evolve rapidly. Descriptive analysis is needed of the content and structure of these corporate websites.

In both cases, the identification of best practice will be of particular interest.
The use of business information by stakeholders

As the business reporting package begins to change, existing research about where stakeholders obtain information and how they use it will become increasingly irrelevant.

New studies will be needed to understand the search, selection and analysis strategies adopted by different stakeholder groups and by expert versus non expert users. Studies which focus on employee, customer and supplier groups are required to complement studies of capital providers.

The use of the Internet presents an added dimension to these questions. Behavioural studies which use tracking software to follow how users navigate their way through a website might prove useful in this context.

Conceptual development of the financial reporting model to suit new business structures

Theoretical work is required to explore the applicability of the traditional financial reporting model to new business structures, characterised by short term, strategic alliances and a shift away from physical, asset-based companies towards knowledge-based and service companies. To what extent are two of the fundamental postulates of the traditional accounting model: the entity concept; and the going concern assumption challenged? The traditional model must be adapted or changed as necessary.

Additional information to be made available

The following five areas concern the additional information to be made available to external users.
Internal use of non-financial performance indicators

Inevitably, developments in the use of new indicators for external reporting depend upon their use internally. The adoption of balanced scorecard measures appears to be increasing rapidly. Up-to-date research describing the nature and extent of use of non-financial indicators internally is urgently required. Detailed investigation is needed of the definitions being used, the underlying constructs being measured, and the bases of measurement employed. Analysis from a cost benefit perspective would be particularly valuable.

It is to be expected that many indicators will be industry specific. Research which aims to establish which, if any, indicators are of generic value and which are of relevance to only selected industries is required.

Reporting of intangible assets

Intangibles are economic assets which contribute to the process of value creation. Such assets eg trademarks, intellectual capital are not generally incorporated into the reporting package. What alternative recognition and measurement criteria can be developed to allow incorporation into the financial statements. Research is required into the definition, recognition, measurement, disclosure and management of these complex assets. What dimensions of these assets can be captured by information systems? It is also critical to establish whether sufficiently reliable reporting methods can be devised to make information about these key assets of use to external users in assessing future performance.

Reporting on quality of management

This is perceived as the most critical driver of company performance and also the main source of user confidence. Research is required which explores whether, and if so how, this concept can be operationalised for reporting purposes.
Relationship between financial and non-financial indicators

One of the reasons cited for using non-financial indicators is that they are ‘leading’ indicators. Research is required to investigate the relationship, ie whether associative or causal and the length of the time lag, between specific performance indicators.

Market value relevance of additional disclosures

Capital market based studies of the impact of disclosure of non-financial indicators or forward looking information on security prices, shares and bonds, are required. Linsmeier (1997) reviews the few existing studies, all of which relate to the US. These studies will complement the findings of behavioural studies using survey or experimental methods.

Assurance provision

The following three areas concern the provision of assurance regarding the expanded information set.

Extent and nature of demand for related assurance services

Research is required to establish the extent and nature of stakeholders’ demand for independent assurance relating to the various components of the ‘new’ business reporting package. What type of assurance is required eg reliability of systems, reliability of specific data, relevance of overall information to specific decision?

Development of relevant assurance procedures and reporting formats

As the nature of the assurance services demanded in relation to the new business reporting package becomes clear, the means of supplying them must be addressed. There are two aspects to this: the procedures to be adopted by the assurance provider eg online auditing systems; and the way in which assurance is to be communicated.
Skills base of professional accountancy firms

Ongoing research is required to understand the structure and dynamics of the market for independent assurance services, as it evolves. Who is providing assurance? Is it professional accountancy firms or other independent specialists? As the nature of demand for assurance services changes, are the accountancy firms changing their skills base or internal organisational structures? What implications does this have for the governance of these firms?

Endnote

1 For example, experts have been shown to differ in terms of their interruptability. Some frequently interrupt their overall search to follow up immediately on a current issue while others insist on first completing the current search objective (Bouwman et al, 1987).
APPENDIX A

INTERVIEW GUIDELINES

On establishing the telephone link:

- Introduce yourself; greetings/pleasantries

- Remind the interviewee that the conversation is being recorded, but that everything said will be in the strictest confidence:

  Can I start by thanking you once again for taking the time to complete our questionnaire and talk to me today. What I would like to do is ask you to explain some of the answers that you gave in the questionnaire, to help us understand the reasoning behind those views and beliefs.

  The questionnaire covered five [only four for preparers and auditors' version] broad areas and I have your completed questionnaire in front of me now. I would like to ask you to expand on some of your key answers in each area. Is that OK?

- The first section of the questionnaire is about the cyclical nature of formal business information flows from companies to users; it is about the timing of these information flows rather than their underlying content or quality.

At this stage, pick a non-neutral answer to A2-A5, in particular A5, and say You said that you 'disagreed' with the statement that … Why is that?

Go through each of the sections in a similar manner, the key questions to look out for in each are:

The second section of the questionnaire concerns one-to-one informal meetings between company management and certain users of business information. Focus on B1A - B1D, B3d, B4.
The third section of the questionnaire is about the possibility of information overload. Focus on C1, any extreme views on C3.

The fourth section of the questionnaire is about users’ confidence in business information. Focus on extreme views on D2.

[Users only] The fifth section of the questionnaire is about the key drivers of company performance. The first part of this asks about the importance of general types of business information. You said x things were very important (list them) Why?

The second part of this section asks about the importance of 30 different specific types of business information. You said that the three most important of these were (from E3). Can you explain why you think those are so important? Ask about one or two items rated as no or little importance too.

• That’s been very useful.

Thank interviewee.
Offer a copy of final report.
# Appendix B

**Differences between Individual Groups’ Views of the Four Themes**

Table A

<table>
<thead>
<tr>
<th>Question asked (abbreviated)</th>
<th>Average (dispersion shown below)</th>
<th>Significant differences</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Users</td>
<td></td>
</tr>
<tr>
<td>Description reflects accurately my experience</td>
<td>(L)  1.7</td>
<td>(L)  1.8</td>
</tr>
<tr>
<td></td>
<td>(L)  1.6</td>
<td>(L)  1.6</td>
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<tr>
<td></td>
<td>(L)  1.6</td>
<td>(L)  1.6</td>
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<td></td>
<td>(L)  1.8</td>
<td>(L)  1.8</td>
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<tr>
<td></td>
<td>(L)  1.6</td>
<td>(L)  1.6</td>
</tr>
<tr>
<td></td>
<td>(L)  2.0</td>
<td>(M)  2.0</td>
</tr>
<tr>
<td>Cycle provides timely information</td>
<td>(L)  2.7</td>
<td>(L)  2.3</td>
</tr>
<tr>
<td></td>
<td>(M)  2.9</td>
<td>(M)  3.1</td>
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<td></td>
<td>(M)  3.1</td>
<td>(M)  2.6</td>
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<td>(M)  2.4</td>
</tr>
<tr>
<td></td>
<td>(M)  2.6</td>
<td>(M)  2.6</td>
</tr>
<tr>
<td>Cycle assists in ready information</td>
<td>(L)  2.5</td>
<td>(L)  2.3</td>
</tr>
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<td></td>
<td>(M)  2.6</td>
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</tr>
<tr>
<td></td>
<td>(L)  1.8</td>
<td>(L)  1.8</td>
</tr>
<tr>
<td>Cycle provides good basis assessing future performance</td>
<td>(M)  3.0</td>
<td>(M)  3.0</td>
</tr>
<tr>
<td></td>
<td>(M)  3.5</td>
<td>(M)  3.0</td>
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<td></td>
<td>(M)  3.1</td>
<td>(L)  3.1</td>
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<td>(M)  3.1</td>
<td>(M)  2.6</td>
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<td>(M)  3.1</td>
<td>(M)  2.6</td>
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Table B

Differences between individual groups' views of differential access

<table>
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<tr>
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<th>Significant differences</th>
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<tbody>
<tr>
<td></td>
<td>P</td>
<td>A</td>
<td>CL</td>
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<td>General attitude:</td>
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<tr>
<td>Create the perception of unfair advantage for some</td>
<td>2.2</td>
<td>2.7</td>
<td>1.9</td>
</tr>
<tr>
<td>(M)</td>
<td>(H)</td>
<td>(M)</td>
<td>(L)</td>
</tr>
<tr>
<td>Do create an unfair advantage for some</td>
<td>2.7</td>
<td>3.2</td>
<td>2.2</td>
</tr>
<tr>
<td>(H)</td>
<td>(M)</td>
<td>(M)</td>
<td>(H)</td>
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<tr>
<td>Are beneficial to the investment community as a whole</td>
<td>2.8</td>
<td>2.1</td>
<td>3.0</td>
</tr>
<tr>
<td>(M)</td>
<td>(M)</td>
<td>(H)</td>
<td>(M)</td>
</tr>
<tr>
<td>Disbeneficial to the investment community as a whole</td>
<td>3.6</td>
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<td>(H)</td>
<td>(M)</td>
<td>(H)</td>
<td>(M)</td>
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<tr>
<td>Specific views:</td>
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<tr>
<td>Managers learn about the market's perception</td>
<td>2.2</td>
<td>2.1</td>
<td>2.3</td>
</tr>
<tr>
<td>(L)</td>
<td>(M)</td>
<td>(M)</td>
<td>(M)</td>
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<tr>
<td>Users gain additional understanding about key drivers</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>(L)</td>
<td>(L)</td>
<td>(L)</td>
<td>(M)</td>
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<tr>
<td>Market gains as users have a better understanding</td>
<td>2.4</td>
<td>2.2</td>
<td>2.5</td>
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<tr>
<td>(M)</td>
<td>(L)</td>
<td>(M)</td>
<td>(M)</td>
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Table B (continued)

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<tr>
<td></td>
<td>U</td>
<td>P</td>
</tr>
<tr>
<td>One-to-one meetings should be:</td>
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<td></td>
</tr>
<tr>
<td>Allowed to continue at present level</td>
<td>2.2</td>
<td>1.9</td>
</tr>
<tr>
<td></td>
<td>(M)</td>
<td>(L)</td>
</tr>
<tr>
<td>Extended because of benefits to investment community</td>
<td>2.8</td>
<td>3.1</td>
</tr>
<tr>
<td></td>
<td>(M)</td>
<td>(M)</td>
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<td>Extended for some other reason</td>
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<td>3.3</td>
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<td>(M)</td>
<td>(L)</td>
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<td>Prohibited</td>
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<td>4.7</td>
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<tr>
<td></td>
<td>(H)</td>
<td>(L)</td>
</tr>
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<td>Confidentiality prevents reporting of key drivers</td>
<td>2.3</td>
<td>2.1</td>
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<td>(M)</td>
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Table C(a)

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<tbody>
<tr>
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<td>Users</td>
<td></td>
</tr>
<tr>
<td>Information overload currently a problem for some</td>
<td>U 2.8 (H)  P 2.7 (M)  A 2.5 (H)</td>
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</tr>
<tr>
<td></td>
<td>CL 2.9 (M)  FM 2.8 (H)  IA 2.8 (M)</td>
<td>3.0 (H)</td>
</tr>
<tr>
<td>Information overload currently a problem for me personally</td>
<td>U 3.6 (M)  P -  A -</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CL 3.5 (H)  FM 4.1 (L)  IA 3.1 (H)</td>
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</table>
### Table C(b)

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<th>Significant differences</th>
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</thead>
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<tr>
<td></td>
<td><strong>Users</strong></td>
<td><strong>Pr</strong></td>
</tr>
<tr>
<td>company filtering based on my/users' specification of my/their needs</td>
<td>3.0 (H)</td>
<td>2.8 (H)</td>
</tr>
<tr>
<td>company using filters devised by standard setters</td>
<td>3.0 (H)</td>
<td>2.8 (H)</td>
</tr>
<tr>
<td>third party filtering based on my/users' specification of my/their needs</td>
<td>2.7 (H)</td>
<td>3.9 (M)</td>
</tr>
<tr>
<td>reducing amount of information</td>
<td>4.1 (M)</td>
<td>3.1 (H)</td>
</tr>
<tr>
<td>company filtering according to its perceptions of my/users' needs</td>
<td>4.3 (H)</td>
<td>2.5 (M)</td>
</tr>
<tr>
<td>third party filtering according to their perceptions of my/users' needs</td>
<td>3.8 (H)</td>
<td>4.0 (M)</td>
</tr>
</tbody>
</table>

* None of the IA experienced information overload.
Table D

Differences between individual groups' views on confidence in business information

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<th>Significant differences</th>
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<tr>
<td></td>
<td>U</td>
<td>P</td>
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<tr>
<td>Confidence is based upon:</td>
<td></td>
<td></td>
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<tr>
<td>assessment of quality of management</td>
<td>1.7 (L)</td>
<td>1.8 (L)</td>
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<td>one-to-one meetings</td>
<td>1.9 (M)</td>
<td>1.8 (M)</td>
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<td>external audit</td>
<td>2.4 (M)</td>
<td>2.6 (M)</td>
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<tr>
<td>brokers' reports</td>
<td>3.1 (M)</td>
<td>2.4 (M)</td>
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</table>
### APPENDIX C

**Users' Overall Ranking of Drivers of Company Performance: Distribution of Responses**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Factor</th>
<th>Percentage of respondents</th>
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<td></td>
<td>Generic factor</td>
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<tr>
<td>1</td>
<td>quality of management</td>
<td>66 32 1 1 -</td>
</tr>
<tr>
<td>2</td>
<td>company strategy</td>
<td>53 40 7 - -</td>
</tr>
<tr>
<td>3</td>
<td>industry within which company operates</td>
<td>41 48 11 - -</td>
</tr>
<tr>
<td>4</td>
<td>quality of assets</td>
<td>24 51 21 4 -</td>
</tr>
<tr>
<td>5</td>
<td>national economy within which company operates</td>
<td>11 47 33 9 -</td>
</tr>
<tr>
<td></td>
<td>Specific factor</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>integrity of management</td>
<td>62 34 3 1 -</td>
</tr>
<tr>
<td>2</td>
<td>vulnerability of company to competition</td>
<td>59 37 3 1 -</td>
</tr>
<tr>
<td>3</td>
<td>ability of management to achieve targets</td>
<td>51 38 10 - -</td>
</tr>
<tr>
<td>4</td>
<td>acquisition strategy (past performance and future plans)</td>
<td>35 58 6 - -</td>
</tr>
<tr>
<td>5</td>
<td>recent changes in quality of management, corporate succession and management style</td>
<td>40 42 18 - -</td>
</tr>
<tr>
<td>6</td>
<td>experience of management</td>
<td>39 44 16 1 -</td>
</tr>
<tr>
<td>7</td>
<td>corporate strategy re the development of existing operations</td>
<td>34 50 12 1 -</td>
</tr>
<tr>
<td>8</td>
<td>distribution of company's activities by business segment</td>
<td>32 53 12 3 -</td>
</tr>
<tr>
<td>9</td>
<td>impression of management on face-to-face meeting</td>
<td>30 43 19 4 -</td>
</tr>
<tr>
<td>Rank</td>
<td>Factor</td>
<td>Percentage of respondents</td>
</tr>
<tr>
<td>------</td>
<td>------------------------------------------------------</td>
<td>--------------------------</td>
</tr>
<tr>
<td></td>
<td>Specific factor</td>
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</tr>
<tr>
<td>10</td>
<td>customer and supplier</td>
<td>29</td>
</tr>
<tr>
<td></td>
<td>dependencies of company</td>
<td></td>
</tr>
<tr>
<td>11=</td>
<td>disposal strategy (past performance and future plans)</td>
<td>25</td>
</tr>
<tr>
<td>11=</td>
<td>flexibility of company to</td>
<td>31</td>
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<td></td>
<td>technological change</td>
<td></td>
</tr>
<tr>
<td>11=</td>
<td>capital expenditure plans</td>
<td>22</td>
</tr>
<tr>
<td>14</td>
<td>understanding of dividend policy and financing strategy</td>
<td>27</td>
</tr>
<tr>
<td>15=</td>
<td>distribution of company's activities by geographic sector</td>
<td>15</td>
</tr>
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<td>15=</td>
<td>vulnerability of company to exchange rate changes</td>
<td>17</td>
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<tr>
<td>17</td>
<td>vulnerability of company to interest rate changes</td>
<td>16</td>
</tr>
<tr>
<td>18</td>
<td>vulnerability of company to changes in government policy</td>
<td>11</td>
</tr>
<tr>
<td>19</td>
<td>corporate innovation</td>
<td>12</td>
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<tr>
<td>20</td>
<td>understanding the mechanics of new accounting policies</td>
<td>10</td>
</tr>
<tr>
<td>21</td>
<td>knowledge of current value of tangible assets</td>
<td>16</td>
</tr>
<tr>
<td>22</td>
<td>knowledge of value of intangible assets (eg intellectual capital)</td>
<td>7</td>
</tr>
<tr>
<td>23</td>
<td>other national economies affecting company</td>
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<tr>
<td>24</td>
<td>plans for investment in human assets</td>
<td>5</td>
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<tr>
<td>25</td>
<td>fiscal policy of national economy</td>
<td>4</td>
</tr>
<tr>
<td>26</td>
<td>impact of environmental issues</td>
<td>4</td>
</tr>
<tr>
<td>27</td>
<td>nature of the presentation of the annual report</td>
<td>7</td>
</tr>
<tr>
<td>28</td>
<td>knowledge of historical cost of tangible assets</td>
<td>7</td>
</tr>
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<td>29</td>
<td>knowledge of identity of valuer</td>
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## APPENDIX D

**DIFFERENCES BETWEEN USERS’ RANKING OF DRIVERS OF COMPANY PERFORMANCE**

<table>
<thead>
<tr>
<th>Rank*</th>
<th>Generic factor</th>
<th>Average (dispersion shown below)</th>
<th>User groups</th>
<th>Significant difference</th>
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<td></td>
<td></td>
<td></td>
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<td>FM</td>
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<tr>
<td>1</td>
<td>quality of management</td>
<td>1.1 (L)</td>
<td>1.5 (L)</td>
<td>1.5 (M)</td>
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<tr>
<td>2</td>
<td>company strategy</td>
<td>1.4 (L)</td>
<td>1.4 (L)</td>
<td>1.7 (L)</td>
</tr>
<tr>
<td>3</td>
<td>industry within which company operates</td>
<td>1.8 (L)</td>
<td>1.7 (L)</td>
<td>1.6 (L)</td>
</tr>
<tr>
<td>4</td>
<td>quality of assets</td>
<td>2.0 (M)</td>
<td>1.8 (L)</td>
<td>2.2 (M)</td>
</tr>
<tr>
<td>5</td>
<td>national economy within which company operates</td>
<td>2.2 (L)</td>
<td>2.5 (M)</td>
<td>2.4 (M)</td>
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</table>

<table>
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<th>Significant difference</th>
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<td></td>
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<td>FM</td>
</tr>
<tr>
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<td>integrity of management</td>
<td>1.1 (L)</td>
<td>1.5 (L)</td>
<td>1.9 (M)</td>
</tr>
<tr>
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<td>vulnerability of company to competition</td>
<td>1.3 (L)</td>
<td>1.3 (L)</td>
<td>1.6 (L)</td>
</tr>
<tr>
<td>3</td>
<td>ability of management to achieve targets</td>
<td>1.6 (M)</td>
<td>1.6 (L)</td>
<td>1.7 (M)</td>
</tr>
<tr>
<td>4</td>
<td>acquisition strategy (past performance and future plans)</td>
<td>1.8 (L)</td>
<td>1.7 (L)</td>
<td>1.6 (M)</td>
</tr>
<tr>
<td>5</td>
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<td>1.5 (L)</td>
<td>1.9 (L)</td>
<td>1.9 (M)</td>
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<tr>
<td></td>
<td>succession, and management style</td>
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</table>

*Note: CL, FM, IA, SS stand for different user groups.*
<table>
<thead>
<tr>
<th>Rank*</th>
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<th>Significant difference</th>
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<td>8</td>
<td>distribution of company's activities by business segment</td>
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<td>9</td>
<td>impression of management on face-to-face meeting</td>
<td>1.7</td>
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<tr>
<td>10</td>
<td>customer and supplier dependencies of company</td>
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<tr>
<td>11=</td>
<td>disposal strategy (past performance and future plans)</td>
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<td>11=</td>
<td>flexibility of company to technological change</td>
<td>1.8</td>
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<tr>
<td>11=</td>
<td>capital expenditure plans</td>
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<td>14</td>
<td>understanding of dividend policy and financing strategy</td>
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<td>18</td>
<td>vulnerability of company to changes in government policy</td>
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<td>19</td>
<td>corporate innovation</td>
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<td>20</td>
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### APPENDIX D

<table>
<thead>
<tr>
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<th>User groups</th>
<th>Significant difference</th>
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<td>2.6 (M) 3.3 (M) 2.8 (M)</td>
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<td>23</td>
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<td>2.6 (L)</td>
<td>3.0 (M) 2.6 (L) 2.7 (M)</td>
</tr>
<tr>
<td>24</td>
<td>plans for investment in human assets</td>
<td>2.8 (M)</td>
<td>2.7 (M) 3.5 (L) 2.6 (M)</td>
</tr>
<tr>
<td>25</td>
<td>fiscal policy of national economy</td>
<td>2.8 (L)</td>
<td>3.3 (M) 3.1 (H) 2.7 (M)</td>
</tr>
<tr>
<td>26</td>
<td>impact of environmental issues</td>
<td>2.4 (M)</td>
<td>3.3 (M) 3.7 (M) 3.3 (M)</td>
</tr>
<tr>
<td>27</td>
<td>nature of the presentation of the annual report</td>
<td>3.4 (M)</td>
<td>3.2 (H) 3.8 (M) 2.3 (H)</td>
</tr>
<tr>
<td>28</td>
<td>knowledge of historical cost of tangible assets</td>
<td>3.5 (H)</td>
<td>3.1 (M) 3.5 (H) 3.2 (H)</td>
</tr>
<tr>
<td>29</td>
<td>knowledge of identity of valuer</td>
<td>2.8 (H)</td>
<td>3.3 (M) 3.9 (M) 3.2 (H)</td>
</tr>
</tbody>
</table>

* Rank based on overall user responses
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Linsmeier T J (Chair) (1997), 'Response to the FASB invitation to comment, "Recommendations of the AICPA Special Committee on financial reporting and the Association for Investment Management and Research"', *Accounting Horizons*, Vol.11(1), March, pp139-156.


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BUSINESS REPORTING:
The Inevitable Change?

In this discussion document the Research Committee of The Institute of Chartered Accountants of Scotland reports the findings of a large-scale survey to investigate the views of users, preparers and auditors regarding current financial reporting. Based on this survey and related ICAS-funded research, the Research Committee offers its proposals for change in the business reporting practices of listed companies. These proposals relate to the means of dissemination, the structure and content of the information provided and the nature of related assurance services. The proposals seek to address the needs of expert and non-expert users alike.

The discussion document is likely to be of interest to all those involved in or affected by the communications between companies and their stakeholders.

The Research Committee of ICAS consists of chartered accountants working in industry, commerce, public practice and academia. The Committee is chaired by Professor John Baillie, a practising auditor. Professor Vivien Beattie acted as editor for this project. She is Director of Research at ICAS and Professor of Accounting at the University of Stirling.