

The background of the cover is a photograph of a sailboat's mast and rigging, viewed from a low angle looking up. The mast is a thick wooden pole, and several ropes (shrouts and stays) are attached to it, extending outwards. The sky is a pale, overcast grey. A horizontal yellow band is superimposed over the middle of the image, containing the title text.

# The Future of Financial Reporting 2008: Measurement and Stakeholders

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# **The Future of Financial Reporting 2008: Measurement and Stakeholders**

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## Preface

The Financial Accounting and Reporting Special Interest Group (FARSIG) is a group set up under the aegis of the British Accounting Association. The main purposes of the FARSIG are to further the objectives of the British Accounting Association and for that purpose to encourage research and scholarship in Financial Accounting and Reporting; establish a network of researchers and teachers in Financial Accounting and Reporting; enhance the teaching of Financial Accounting and Reporting; provide support for PhD students in Financial Accounting and Reporting; develop close links with the accounting profession so as to inform policy; publish a newsletter and organise targeted workshops; develop and maintain relationships with the British Accounting Association and the Professional Accountancy Institutes and provide a forum for interaction of ideas among accounting academics.

The symposium, which is one of an annual series, provided a forum for academic, practitioner and policy-orientated debate. Such forums are useful for expressing and developing rounded opinion on the current meta-issues facing financial reporting. They are also useful in that they serve to illustrate the policy relevance of current academic thinking and outputs in accordance with Economic and Social Research Council (ESRC) and The Advanced Institute of Management Research (AIM) calls for relevant and rigorous research through a combination of

practitioner and academic perspectives. The importance of the current debate, and in particular that surrounding the issue of the basis of measurement, is further highlighted by a current *European Accounting Review* special edition on 'Measurement Issues in Financial Reporting'.

We would like to express our thanks to all five presenters and their co-authors for their presentations at the symposium and their subsequent time and comments that they provided in the development of this discussion paper. We have tried faithfully to capture the flavour of the original presentations. Nonetheless, although we ran our commentary of the presentations past the original authors, any errors or omissions remain our own. We would also thank ACCA for hosting the symposium and for its support in the publication of the discussion paper. Finally, for any readers who wish to learn more about FARSIG or to become a FARSIG member, please contact either of the authors.

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This paper is available in PDF from [http://www.accaglobal.com/publicinterest/activities/library/financial\\_reporting/other](http://www.accaglobal.com/publicinterest/activities/library/financial_reporting/other)

# 1. Introduction

Financial accounting and reporting is a curious mix of dynamism and stability. Thinking about the theory and practice of financial accounting and reporting is constantly evolving from generation to generation. Nonetheless, at its core are several key issues that apparently remain eternal, such as a conceptual theory to underpin accounting, how to measure elements within the financial statements and the users of accounting information.

A symposium at the ACCA offices in London, on 11 January 2008, explored some modern views on such perennial topics as conceptual theory, measurement and stakeholders. This report aims to synthesise and provide some informed commentary on the five papers presented at the symposium. These five papers were:

1. *Conceptual Framework: Revisiting the Basics. A Comment on Hicks and the Concept of Income in the Conceptual Framework* (Bromwich, M., Macve, R., and Sunder, S.)
2. *Deciding on Basis of Measurement – Users’ Needs or Public Interest?* (Chisman, N.)
3. *Fair Value – An Ongoing Controversy* (Martin, R.)
4. *Fair Value and the IASB/FASB Conceptual Framework Project – An Alternative View* (Whittington, G.)
5. *Communication between Management and Stakeholders: A Case Study* (McInnes, B., Beattie, V. and Pierpoint, J.)

The first four papers addressed a perennial accounting question: how should one measure elements within the accounts? This was addressed from very different perspectives, but all were critical of present measurement practices as encapsulated in current accounting standards. Bromwich et al. challenged current practice from an academic point of view while Chisman drew on his experience as a practising accountant and prior involvement with accounting standards setting to challenge the validity of the ‘one size fits all’ approach to accounting measurement. He suggested a dual approach based on public and private companies and their differing ownership structures. In the third paper, Martin, head of financial reporting, ACCA, addressed the current and future nature of fair value as a measurement system from the perspective of a professional accountancy body. He showed how the use of fair value had gained in popularity, but also the difficulties in defining and using it and the trade-off between reliability and relevance in accounting measurement and financial statements. The final paper in this area was by Whittington. He provided a thoughtful and reflective critique of the current conceptual framework and measurement debate and then provided an Alternative View counter to the Fair Value View implicitly preferred by IASB.

A particular concern of the papers presented was ‘fair value’. There has already been considerable discussion over how to define fair value and how it might be applied. Of the common definitions used within this research

SFAS157 is most frequently cited but other relevant sources of fair value use are also referred to, for instance in IAS39,40 and 41.<sup>1</sup>

The joint FASB/IASB conceptual framework review project provides the background and the context against which the seminar and paper presentations can be set. In October 2004, the FASB and IASB added to their agendas a joint project to develop a common conceptual framework building on and converging their own current frameworks, namely the IASB *Framework for the Preparation and Presentation of Financial Statements* and the FASB *Statements of Financial Accounting Concepts*. At a joint IASB/FASB meeting in London in April 2005, *The Conceptual Framework – Objectives of Financial Reporting* was outlined. This related to the convergence of the respective frameworks and reporting standards. It covered, inter alia, the objectives of financial reporting, the roles of decision-usefulness and stewardship, and the range of users of financial statements. Additional detail is provided in a FASB/IASB paper of May 2005, *A New Conceptual Framework Project* by H. G. Bullen (FASB senior project manager) and K. Crook (IASB senior project manager). The overall joint conceptual framework project is being undertaken in phases and comprises the following.

- Objectives and qualitative characteristics.
- Elements and recognition.
- Measurement.
- Reporting entity.
- Presentation and disclosure.
- Framework purpose and status.
- Application to not-for-profit entities.
- Remaining issues.

The papers presented at the symposium primarily contribute to the first three of these main areas as well as more generally to the debate on the conceptual framework. They provide an informed critical review from academic, practitioner and policy-orientated perspectives. The papers address areas central to this debate and provide reflection on issues of the foundation of past, present and future measurement bases within financial statements, the trade-off between relevance and reliability (now replaced by faithful representation), the role of stewardship and decision-usefulness, and the underpinning market assumptions upon which the conceptual framework is constructed.

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1. For a more in depth debate concerning fair value and its meaning as defined by IASB see Alexander (2007) ‘A Recent History of Fair Value’ and more generally Walton (2007).

The first joint IASB/FASB discussion paper on the conceptual framework was published in July 2006, and set out the preliminary views of the IASB and FASB on the objectives of financial reporting and the qualities that make the information useful for decision making. The importance of the debate was highlighted by Ian Mackintosh, ASB chairman, who stated:

‘While many may think of the conceptual framework project as simply an academic subject far removed from the practical day-to-day world of accounting, that is not the case. The framework will have far-reaching practical implications in influencing the future direction of financial reporting. The ASB believes that it is important that all constituents are made aware of the proposals and their implications and we will be playing an active role in the debate on these issues’ (see [www.iasplus.com/uk/0607frameworkasbpr.pdf](http://www.iasplus.com/uk/0607frameworkasbpr.pdf)).

It is against such sentiment that the symposium provided a forum for critical discussion of the current issues within the conceptual framework project and for the future orientation of financial reporting. An up-to-date review of the continuing development of the joint conceptual framework and its phases is available at [http://www.fasb.org/project/conceptual\\_framework.shtml](http://www.fasb.org/project/conceptual_framework.shtml)

The debate concerning measurement is timely and contextualised against the current global financial situation. The US Federal Reserve chairman, Ben Bernanke, sees mark-to-market or fair value accounting as contributing to the destabilisation of the financial markets due to the write down of distressed assets to fire sale prices (reported, April 2008). He views fair value as more appropriate in times of financial stability and calm. Further, the initial rejection by the US House of Representatives of the proposed US Paulson bail-out plan for the financial markets also raised the issue of calls for stricter rules on accounting practices and measurement away from mark-to-market accounting. Against these current challenges to mark to market, there is strong support for its continued use. The Council of Institutional Investors, which manages more than \$3 trillion-worth of pension assets, opposed the rescinding of mark-to-market accounting. Both regulators at the Securities and Exchange Commission (SEC) and standard setters at the Financial Accounting Standards Board (FASB) are working on additional guidance for mark-to-market accounting at the time of writing (October, 2008, see Financial News Online, 1 October 2008). In the UK, Michael Izza, chief executive of the Institute of Chartered Accountants in England and Wales, has also highlighted the wider public importance of the current debate on mark-to-market accounting, when speaking on Radio 4, 2 October 2008. The impact of the current financial turmoil and the needs of financial markets are also evident within recent IASB/FASB announcements with Robert Herz, chairman of FASB, stating ‘we will continue our dual objectives of working toward global convergence while addressing reporting issues of critical importance to *US investors and financial markets*’ (emphasis added by authors, 11 September 2008 IASB/FASB press release).

The fifth paper, by McInnes, Beattie and Pierpoint provided an academic perspective on another accounting issue of continuing interest: stakeholder communication. The study adopted a multi-stakeholder group perspective to examine a wide range of information sources and their levels of uptake.

These five papers thus provide new insights into old topics. For the topics of a conceptual framework, accounting measurement and stakeholders have been addressed for many decades, if not centuries. For example, Edwards, J.R. in *A History of Financial Accounting* (1989), outlines the continuing debate over what constitutes accounting measurement throughout the nineteenth and twentieth centuries and before.

Edwards focuses on the historical development of accounting practice, emphasising the need to understand the legal, economic and social context in which such changes occur. ‘Since then [the mid-nineteenth century] there has been a change in emphasis from record keeping to financial reporting and, as regards the functions of those reports, from using them as a means of assessing stewardship to their use as the basis for resource allocation decisions’ (Edwards 1989: 15).

Initial attempts at profit measurement were crude and often haphazard and in many businesses the owner would assess profit on the cash reserves that could be drawn from the business. Throughout the industrial revolution the main item of significance for businesses was the amount spent on machinery and consequently attention was drawn foremost to the measurement of fixed assets. In general terms, however, ‘the absence of a general agreement about which profit measurement and asset valuation procedures should be used provided ample scope for nineteenth-century managers to prepare reports designed to meet managerial objectives rather than to portray fairly the underlying economic facts’ (Edwards 1989: 125). Until the development of accounting and legal regulations in the period after the Second World War, with Technical Advisory Committee recommendations (1942–69) and successive Companies Acts governing financial reporting, there was ‘considerable variation in the treatment of published items of income, expenditure and appropriations to profit (Edwards 1989: 130). Thus the measurement debate is not new, although the arguments within it may have become more sophisticated.

The current debate on the conceptual framework, measurement and stakeholders can probably be traced back to at least the 1970s. Taking the UK as an illustrative example over the past generation, there has been a succession of pronouncements on a conceptual framework and on measurement. These include:

1971	ASC, <i>SSAP2 – Disclosure of Accounting Policies</i>	<p>current IASB/FASB Conceptual Theory documents). These issues included the objective of financial statements; the qualitative characteristics of financial information; the elements of financial statements; recognition in financial statements; and measurement in financial statements. These issues were widely addressed and critically discussed by our presenters as set out in Chapter 2 below.</p> <p>The remainder of this research report can be divided into three chapters. In the next chapter, we outline the five papers that were presented. Then, in the Discussion chapter, we attempt to synthesise some commonalities and discontinuities in approach between the authors. Finally, in the Conclusion we summarise and suggest some ideas for future development.</p>
1975	ASSC, <i>The Corporate Report</i>	
1975	Sandilands, F., <i>Inflation Accounting: Report of the Inflation Accounting Committee</i>	
1981	Macve, R., <i>A Conceptual Framework for Financial Accounting and Reporting: The Possibilities for an Agreed Structure</i> (ASC)	
1988	ICAS, <i>Making Corporate Reports Valuable</i>	
1989	Solomons, D., <i>Guidelines for Financial Reporting Standards</i> (ICAEW)	
1991	Arnold, J. et al., <i>The Future Shape of Financial Reports</i> (ICAEW/ICAS )	
1999	ASB, <i>Statement of Principles for Financial Reporting</i>	

Possibly the most influential, as it set the scene, was *The Corporate Report*, which was issued as a discussion paper by the ASSC (1975). It raised questions over the aims and quality of financial reporting and to whom such reporting was addressed and marked the ‘first real attempt by the accounting profession in the UK to develop a conceptual framework’ (Ernst and Young 2001: 106). It sought to identify user groups for financial accounts and their respective information needs for making decisions. Two user groups, shareholders and creditors, and five additional groups were identified, namely employees, government, financial analysts, the business contact group and the general public. The issue was how financial reporting could address the sometimes-conflicting needs of these groups and the need for greater disclosure. Measurement issues, such as the inadequacies of historic cost, were discussed as part of the paper.

*The Corporate Report* itself was overtaken by events with the publication of the Sandilands Report (1975) on Inflation Accounting, which explored current purchasing power, current value accounting and cash flow accounting as measurement systems. After this there were a succession of reports such as the Macve Report (1981, reprinted in Macve 1997), *Making Corporate Reports Valuable* (MCRV) (1988), *The Future Shape of Financial Reports* (Arnold et al. 1991) and the Solomons Report (1989), all of which grappled with conceptual and measurement issues.

Finally, the *Statement of Principles for Financial Reporting* was issued in 1999 by the ASB; this stemmed from a 1995 exposure draft that had adopted a balance sheet focus. The original exposure draft was widely criticised for its position on the move to current values and the recognition of gains/losses in the profit and loss account or the proposed Statement of Total Recognised Gains. The final publication in 1999 contained eight chapters. These chapters continued to grapple with the issues raised in *The Corporate Report* (ASSC 1975) (and, indeed, those in the

## 2. Symposium Papers

### 2.1 CONCEPTUAL FRAMEWORK: REVISITING THE BASICS. A COMMENT ON HICKS AND THE CONCEPT OF INCOME IN THE CONCEPTUAL FRAMEWORK. MICHAEL BROMWICH, RICHARD MACVE AND SHYAM SUNDER<sup>2</sup>

This paper, which was presented by Richard Macve, critically examines the FASB/IASB project on the conceptual framework; its assertion of the primacy of the ‘asset/liability’ approach to income against the ‘matching’ of revenues and expenses approach; and its claimed underpinning by Hicks’s definition of income. The FASB/IASB (2005) paper *Revisiting the Concepts* lays down the approach that a concept of income founded ultimately on the definition of assets is necessary because, among the proponents of the alternative revenue and expense view, none could meet the challenge of defining income directly without reference to assets or liabilities or recourse to highly subjective terminology (like proper ‘matching’). As the Boards’ definition of liabilities is derived from that for assets, the conceptual primacy of assets has become the bedrock of the Boards’ frameworks and it is claimed that such primacy is derived from Hicks’s definition of income (1946).

Macve et al. critique this ‘bedrock’<sup>3</sup> and argue that Hicks’s concept has been misquoted and, therefore, misunderstood and misapplied. They review some alternative approaches and conclude by challenging the Boards’ view that accounting ‘conventions’ need replacing by ‘conceptual principles’ within the Conceptual Framework Review. Their paper argues that accounting concepts and conventions must be seen as complementary rather than as standing in opposition to one another.

According to FASB/IASB the overriding objective of financial statements is their usefulness in making economic decisions by giving assistance in predicting future cash flows.<sup>4</sup> The Boards’ focus is on ‘enterprise resources, claims to those resources and changes in them’; a focus which leads to and is consistent with their definitions of elements within the financial statements. In this, assets are characterised as ‘probable future economic benefits obtained or controlled...as the result of past transactions’. As all other elements can be derived from assets, they have conceptual primacy and this supports the superiority of the asset/liability view of income against the revenue/expense approach. Income is the increase in net resources in terms of increases in assets and

decreases in liabilities and can be objectively determined from the change in the entity’s wealth plus what is consumed during a period. Further, it is claimed that the definition of assets does not encompass the ‘deferred debits’ that result from a revenue/expense or matching approach to measuring income. Nonetheless, as it has long been recognised in traditional accounting texts that ‘deferred revenue expenditure’ is only carried forward in line with the economic benefits that are expected to accrue in future years, Macve et al. argue that this is effectively equivalent to the Boards’ definition of ‘assets’.

The Boards cite Hicks (1946) in support of the objectivity of the ‘primacy of assets’ view of income. Macve examined in detail how Hicks (1946) has been taken out of context and misapplied, so that reliance on his support is invalid. As a consequence, this undermines the whole basis of the ‘primacy of assets’ approach.

The differences between what Hicks actually argued and what the Boards’ 2005 paper claims he said are summarised in Figure 1.

**Figure 1: Implications of FASB/IASB’s vs Hicks’s view of ‘income’**

IASB/FASB	Hicks
‘Net assets’	Firms <sup>5</sup>
‘Objective’	Largely subjective
Income ex post	Income ex ante <sup>6</sup>
Income ‘No. 1’	Income ‘No. 2’ <sup>7</sup>

2. The full working paper is available at <http://www.lse.ac.uk/collections/accounting/facultyAndStaff/profiles/macve.htm>

3. ‘...a wise man, which built his house upon a rock...a foolish man, which built his house upon the sand...and it fell; and great was the fall of it.’ *Matthew, 7: 24-27.*

4. The ‘stewardship’, ‘contractual’ and other functions of accounts are not explored further here. Whittington (2008) deals with them in detail.

5. Developed in Hicks (1979) as ‘proprietors’

6. cf. Hicks (1948)

7. Or ‘No.3’ (Hicks, 1946): cf. Paish (1940)

The paper reviews each of these significant differences in turn.

#### **i. 'Net assets' or 'firms'?**

Hicks (1946) discussion is about individuals' income. In a later paper (1979), he examines firms' income but conceptualises this as the income of the owners of the firm (collectively) not by considering the firms' assets and liabilities. There is no justification for FASB/IASB regarding Hicks's 'capital value' as being fully captured in the firm's assets and liabilities.

#### **ii. 'Objective' or 'subjective'?**

Hicks (1946) regards 'income' or 'profit' as representing how much can be (safely) taken out of the business. This estimated profitability is a matter of judgement, but such use of judgement may cause disparity of opinion between parties connected to the business—the owner against tax authorities for instance—and so profit cannot be measured in that way for practical purposes. Bringing in the need for fixed asset depreciation and overhead allocation further emphasises the accounting and economic judgements that have to be made, clouding the issue further as to the maximum (profit) that can be safely taken out of the business.

FASB/IASB (2005) quotes Hicks (1946) as saying that 'Income No 1 ex post is objective'. In fact, the full relevant sentence reads 'so long as we confine our attention to income from property,<sup>8</sup> and leave out of account any increment or decrement in the value of prospects due to changes in people's own earning power... Income No.1 ex post is not...subjective;...it is almost completely objective'. Nonetheless, as markets are not complete or perfect there will be a large element of the value of future cash flows that is not captured in the value of current net assets ('property'). This value, which derives from the quality of the management of those assets within the business, is what Hicks (1946) labels 'Human Capital'. So the only objective ex post measure of business income would be the change in capital value at the stock market rather than entity net assets level (ie changes in the value of market capitalisation and dividend). This makes financial reporting to shareholders of the firm's activities and net assets redundant.

#### **iii. 'Ex post' or 'ex ante'?**

Ex ante income reflects what is expected about future cash flows (which must be subjective) and ex post what has actually happened to cash flows during the period, together with revisions to expectations of the future at the period end (which could be objective only under the restricted conditions discussed above). Hicks (1946) argues that ex post calculations have no significance for conduct and no relevance to decision-usefulness, but instead form part of economic and statistical history. For FASB/IASB's 'asset primacy' to be a bedrock then it surely must satisfy the basic criterion of decision-usefulness, the

primary purpose of financial statements: so reliance on Hicks's ex post concept of income (1946) must fail this test.

#### **iv. 'No. 1' or 'No.2'?**

Hicks's 'Income No. 1' (1946) is equivalent to the maximum amount that could be distributed to shareholders in a period while leaving intact the firm's initial capital value. When interest rates change, however, this is not the same as the maximum amount that could be distributed so as to leave intact the ability to distribute the same amount in future, which is Hicks's 'Income No. 2'.

Disclosure of such 'permanent' or 'standard income' would provide future decision making usefulness. Given that income stream and an appropriate discount rate, a market value for the firm can be calculated. Indeed, companies themselves now often report levels of permanent or maintainable income. Macve et al. use AstraZeneca's 'Business Highlights' section of its interim report for the half year ended 30 June 2007 (17) as an example of such reporting: 'Management believes that investors' understanding of the Company's performance is enhanced by the disclosure of core EPS, as it provides understanding of the underlying ability to generate returns to shareholders'. So for quoted companies Income No.2 would relate to the maximum maintainable level of dividends that can be paid in the current and all future periods. Macve et al. contend that given such maintainable income (and its practice-based disclosures), under further restrictive assumptions, assets and liabilities can be derived from it, not it (income) from them (net assets). This is consistent with Ohlson (2006), who argues that reporting such maintainable earnings, as a starting point for investors' future decision making, would require that assets and liabilities be derived from income and not vice versa: so the alleged superiority of the assets approach to income is dismissed.

When Hicks in full is considered, there is no justification for regarding 'capital value' as fully captured in assets and liabilities. The debate continues as to how far the concepts and alternative measures of asset and liability values are consistent with Hicks's capital value and how changes in net assets can be related to Hicks's Income No. 1, and what assumptions are necessary to accommodate this.

If any measure of income is relevant for decision making it must be ex ante income, which is necessarily subjective. Historic, ex post income, can, however, help predict the future ex ante income and gives importance to the underlying statistics that accounts record. To serve this purpose accounts should contain the maximum of information within the prescribed limits. The main issue with ex post income is how much it helps in forming expectations about future income ex ante and therefore fulfils the decision-usefulness criterion. This depends, inter alia, upon the permanent elements of income as against the transitory ones, and their ability to be differentiated. While accounting conventions themselves can be improved upon, the purpose of accounting information is to facilitate decision making and decision makers themselves are

8. That is, exchangeable assets for which everyone faces the same prices (eg Beaver and Demski, 1979)

probably most able, and best placed, to make appropriate adjustments, as they see fit, to an underlying statistical record (Brief 1982).

Hicks's (1946) Income No. 1 is concerned with capital value changes, Income No. 2 with maintainable income. The relevant income concept to use will bring more insight into the assets/liabilities versus income/expenses debate, as to the most useful approach to measuring enterprise income.

The final part of the paper questions the Board's pitting of 'conventions' against 'conceptual principles'. It is noted that FASB/IASB (2005) views the Conceptual Framework Project as a crusade against conventions, arguing that standards should be rooted in fundamental concepts rather than a collection of conventions. In their presentation paper, Macve et al. argue that this is a false opposition. Conventions are necessary social constructions and the role of concepts is to question whether, why and how conventions need changing or replacing and whether, by doing so, better decision making would result. To rewrite a key sentence from page 1 of the FASB/IASB (2005) paper: 'To be principles-based, standards have to be a collection of (socially) useful conventions, rooted in fundamental concepts'. It is therefore important that the FASB/IASB Project 'revisits the concepts' in a much more fundamental way if it is to base the conclusions on solid foundations.

## 2.2 DECIDING ON BASIS OF MEASUREMENT – USERS' NEEDS OR PUBLIC INTEREST? NEIL CHISMAN

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This presentation provided practitioner-based insight and discussion into the current and future bases of accounting measurement. Neil Chisman outlined current measurement bases, before turning to issues of company size and ownership and the purpose of accounting information to address the needs of stakeholders. The presentation provided a critique of accounting bases and moved on to discuss the validity of a dual basis for measurement, compared with the current mixed measurement approach or a single measurement basis.

Four main and commonly used bases of accounting measurement were outlined:

- recoverable historic cost (RHC) – lower of cost or net realisable value
- fair value – defined by SFAS157 as 'the price that would be received for an asset or liability in a transaction between market participants'
- value in use – the net present value of future cash flows
- mixed basis – combinations of the above for different balance sheet items.

Currently, a mixed basis is used when preparing accounts, giving rise to the anomaly that different bases of measurement are used within the financial statements rather than a single unified measurement basis, which would facilitate simpler and more coherent accounting and accounting standards. The first issue that needs addressing is the underlying purpose of financial statements and then from that there is a need to adopt a suitable basis of measurement. Too often the debate over accounting standards has revolved around the size of an entity and the differences between large and small companies, but the real issue to be addressed is that of ownership, as there are clear principles associated with ownership that can then be used to provide a framework for an appropriate basis of measurement. Public and private companies have different ownership structures, giving rise to different purposes and needs for their financial statements, and accordingly these should be considered separately. If the very purpose of accounting is different for public and private companies why should the basis of measurement be necessarily the same?

One common purpose of accounts for all companies is creditor protection, i.e. allowing creditors to assess the financial viability of the business. For public companies, a second fundamental purpose is for investor protection (arising from agency costs), but for private companies where the shareholders and the directors are common, this is not the case. For private companies, the basis of measurement needs to ensure appropriate creditor protection and then beyond that to be simple and not burdensome so that the owners of the business can

concentrate on their business and not on complex accounting issues. By adopting RHC the simplest accounting basis would be used, clearly showing a prudent net assets position of the business and so satisfying the need of basic creditor protection. In essence: 'Little GAAP is RHC accounting'. Nonetheless, there are some small companies that have shareholders who are not directors and this raises the issue of appropriate investor protection as well as the now-resolved creditor protection. A solution to this is two-fold. If all the shareholders are happy with RHC as a basis for measurement then that can be adopted; alternatively, if they are not happy with RHC then the company would need to follow the 'Big GAAP' rules that apply to public companies and are designed with investor protection as a key consideration. It may also be that many larger private companies would also adopt 'Big GAAP' rules, but that would be decided on by the shareholders.

For public companies, the financial statements need to satisfy creditor and investor protection requirements and, consequently, the appropriate basis of measurement is that which reflects the rationale of shareholder value creation and the overall value of the business, as well as protecting creditors. Another issue emerges at this point, namely the general lack of consensus, as well as biased personal motivations, between financial stakeholders and shareholders in public companies over the format of financial reporting and their respective needs. To find common ground, the question of the fundamental purpose of public company accounts really needs to be resolved. First, to enable investors (users) to make buy/sell/hold decisions, and second, to decide if management intervention is needed owing to poor performance. Both these types of decision require cash flow forecasts and a company valuation, which will also focus the company (and its investors) on value creation. At present, users do not have sufficient information on which to base decisions and rely on sketchy valuations, management meetings and their own forecasts. Potential consequences of this are sub-optimal decision making, unclear performance objectives and associated underperformance, and a focus on short-term profit rather than longer-term value creation. Financial statements that reflect value creation and clear reporting are needed to enable optimal shareholder decision making. Nonetheless, while forecasts and valuations would be welcomed to satisfy this objective, they remain estimates and lack the reliable objective factual information that RHC provides.

Looking at the balance sheet, the single most important item is 'fixed assets', both in value terms and also in their use in enabling the business to operate. By combining fixed assets within the business, 'cash generating units' are created and these in turn comprise business segments that then make up the overall business. In determining a fixed asset purchase, net present value and forecasts are used by management to justify the decision and assess its impact on long-term value for the business. Fixed assets and their accounting need to be understood, rather than current net assets, whose values are more readily determined as they revolve around operating transactions.

In this presentation, each of the bases of measurement was then considered in relation to fixed asset accounting and the need to satisfy investor protection and the focus on value creation.

### **Recoverable historic cost (RHC)**

RHC is well understood and is the traditional measurement basis for recording fixed assets at cost and then reducing them by an appropriate depreciation charge over their useful economic life. The cost is reliable and although depreciation is based on a management estimate, it is not complex and is viewed as prudent valuation. Nonetheless, it relies on cost as the prime driver of measurement rather than any earnings potential for which fixed assets are purchased for, thus its direct relevance as a measurement basis is very limited in terms of investor needs.

### **Fair value**

As outlined in SFAS157, fair value has good application to traded assets such as financial instruments (options) and can be applied to some fixed assets such as real estate, hotels and pub chains. The crux with fair value is that the value is derived from the sale of those assets in the market. This means that for fixed assets, which may be unique to a company and therefore not readily benchmarked with similar assets, the value would only come from their sale to another party. By implication those assets are now no longer part of the original business nor generating income under the original businesses' management and knowledge. So the fair value of fixed assets would relate to their future cash flows after sale rather than their future cash flows within the current business. This presents considerable measurement and estimation problems, based on the use of the fixed assets and the management of them within a new business, and appears almost untenable as a basis of measurement. The concept is that of winding-up value rather than investment value. It may be better applied in a winding-up situation, where any value can be based on the assets' future use rather than its written down historic cost. The purpose of this debate is, however, to obtain a suitable measurement basis for continuing businesses rather than failed ones.

### **Value in use**

Value in use is the basis that represents the investment value. It uses discounted cash flow analysis based on forecasts of future cash flows from the fixed assets as part of their cash generating unit within the business. The forecasts could be presented with sufficient supporting disclosures around management assumptions so enabling investors to focus on value and management performance rather than having to create their forecasts from historically based accounts. Nonetheless, the forecasts are not facts and may be skewed by management. So how can such forecasts and the underpinning assumptions be made more reliable and acceptable to enable value in use to be considered as a basis for measurement? First, it can be done by greater disclosure of forecast information, which is currently produced for internal use but not disclosed, although cash flow forecasts are disclosed to debt rating agencies (see McInnes et al. 2007). Forecasts

are also used as the basis for prospectuses. Secondly, it can be done by disclosure of the management assumptions on which the forecasts are based and their rationale, which could include, inter alia, strategic fit and risk assessment. This gives a framework for companies to tell investors about their future value creation and their strategy. Forecasts and assumptions would then be used to monitor future performance by focusing on value creation and the ability to meet forecast levels so fostering the need to make credible and achievable forecasts. This approach would also steer future buy/sell/hold decisions and management intervention on the basis of any future underperformance. It remains true, however, that reliance is on estimates rather than on recorded fact.

The issue is then a trade off between forecast information that would facilitate focus on value versus factual historic information that does not focus on future value. To adopt a single basis of measurement results in deciding between the two choices of RHC and value in use. An alternative is to consider both bases in parallel rather than to apply one basis to some areas of the balance sheet and another basis to others, as currently happens. No single basis is satisfactory on its own so therefore a Dual Basis is proposed. The accounts would report all items under RHC (the same as Little GAAP discussed earlier) to give objective reliability, and would then report under 'value in use' to provide forecast and value-driven information. To achieve this, two formats could be followed, either by giving separate RHC and value in use statements or by adding a bottom half to the profit and loss account and balance sheet so that the bottom line gives the investment value information. The balance sheet would be the statement of company value, and the profit and loss account the statement of value creation.

The dual basis for public companies and those private companies that require more than just RHC meets all requirements. There is a factual basis of measurement (RHC) providing appropriate creditor protection and there is a forecast and value-driven basis of measurement from value in use, providing appropriate protection and information for investors. Rather than having to produce second-hand forecasts based on historic information, investors and analysts could now focus on management forecasts and their assumptions. This means that public companies focus on value creation while at the same time, through RHC, they provide appropriate creditor protection. Private companies not requiring any more than RHC (little GAAP), which addresses creditor protection, are able to focus on their business objectives without worrying about complex accounting issues and associated time-consuming bureaucracy.

A clear distinction is now possible, based on ownership: itself a factual base. For private companies there is straightforward RHC. If necessary, as determined by the shareholders, private companies can also adopt the dual basis. The dual basis would be applied to all public companies. The dialogue between managers and investors becomes more focused on value, underperformance is

easier to identify, and investor time is spent more effectively, analysing real company forecasts and their underlying assumptions. Whether this becomes reality and is applied in the future is another debate for all accounting bodies and stakeholders.

## 2.3 FAIR VALUE – AN ONGOING CONTROVERSY, RICHARD MARTIN

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Richard Martin, head of financial reporting at ACCA, examined the present and future for fair value reporting. Owing to the problems of measuring cost and the number of potential bases of measurement, fair value is a means of providing values/costs for assets and liabilities. Nonetheless, it is not problem free, for instance there are issues concerning market measurement, reliability and the role of provisions. Fair value has been applied to intangible assets, investment properties, derivatives and financial instruments, both traded and non-traded. While historic costs remain a permanent record with appropriate amortisation or depreciation charged to reflect the use of the asset, fair values will change over time. These changes in fair value affect profit for the year. Appropriate accounting standards already exist in specific areas (for instance, IAS39 for Derivatives and Traded Financial Instruments; IAS40 for Investment Properties; and IAS41 for Agriculture). A similar change in value occurs through asset revaluations such as those for fixed and intangible assets.

Because extant accounting standards now use a fair value approach, fair value has become a mainstream basis of measurement, giving us the possibility of fair value accounting. This is further evidenced in the Business Combinations Revision and Insurance Contracts – Part 2. The overriding consideration is how to consistently ascribe fair value to all items and to answer the posed question of ‘what exactly is fair value?’ This is substantially dealt with in the proposals of SFAS157 and the proposals in the IASB (2006) discussion paper giving a more precise meaning and instances of application. Fair value is an exit value for the owner as a market participant, recording the transaction price and the fair value of assets and liabilities. Under SFAS157, there are three levels for determining fair value: Level 1 for quoted prices in an active market; Level 2 for observable information other than in an active market; and Level 3 where no observable market data exist. There is thus a hierarchy of values: market prices, comparable prices, and unobservable inputs. The fair value hierarchy is inherent in the application of IAS39. For derivatives traded or held in an active market, there exists a quoted daily price where the relevant bid price is used but no extra value is recorded for a large block holding even though it is potentially material. Where there is no active market, a valuation model is applied using all relevant factors that affect valuation, including time to maturity, credit risk, volatility of market and underlying asset, liquidity risk.

Using this framework, can fair value be applied to more items rather than to more specific categories such as derivatives or investments? There are very different views on this, with its most ardent supporters arguing that fair value is the only information relevant to financial decision making and thus as such should be fully adopted to satisfy decision-usefulness. The Canadian Discussion Paper favoured fair value and the proposed measurement hierarchy would follow in the order fair value, current cost and lastly historical cost. The advantage of fair value is that it is able to capture more information that is also

relevant for future decision making. It is market-specific, not entity-specific, and so captures a consistent market value of items. By using fair values all assets and liabilities are recorded and recognised consistently so adopting a common treatment and not separated by the issue of their historic purchase price. It is their value within the business that should be measured and not the price at which they were purchased. Market rather than entity valuations are more objective and so enable greater comparability between businesses and enable comparison for future decision making rather than transactional past decisions.

Nonetheless, fair value is also, like any of the competing measurement bases, subject to a number of weaknesses and criticisms. It results in volatility of asset and liability measurement. By moving away from a transactions base, there is an early recognition of gains (rather than a more conservative approach) and, while relevant for future decision making, it may not be reliable. Furthermore, it is more costly for all businesses to apply and, for some elements, current fair value is difficult to ascribe and thus reliability, rather than relevance, becomes a concern. Issues of reliability are material in the light of Enron, the subprime crisis and recognition of insurance liabilities, but is there too much subjectivity once you move away from market values?

The conceptual framework’s objective is to achieve a reporting that is an honest record of recent performance. This will facilitate future cash flow prediction and consequently business valuation. The best thinking of the time is incorporated into current accounting standards, and assets and liabilities are dealt with properly, although this means a mixed basis of measurement. To reduce the complexity, a single basis of measurement needs to be considered, but one basis may not present a uniform solution to all of the issues. Historic cost is the default basis for many operating assets and liabilities; fair value (current market exit value) is useful for traded financial instruments and derivatives; and value in use has potential for future cash flows for provisions, insurance and trade receivables. A key question for fair value, is whether the reporting of fair value changes can be simplified, as even based on existing treatments, there are problems with areas such as associates and joint ventures, deferred taxation and hedge accounting.

At present there exist a variety of measurement bases and consequent different treatment of items within financial statements. There has been a growth of fair value accounting in more recent accounting standards and a detailed recognition of fair value in SFAS157. The trade off between reliability and relevance is an issue facing all bases of measurement, but greater understanding and clarity is needed for reliability and the need for relevance within financial statements should be recognised. Fair value can be more supported with greater consistency of application and precision of meaning that may contribute to an eventual reduction in accounting complexity towards a single, unified, measurement base. To support this, a revised conceptual framework, with fair value as an adopted basis of measurement, may be required.

## 2.4 FAIR VALUE AND THE IASB/FASB CONCEPTUAL FRAMEWORK PROJECT – AN ALTERNATIVE VIEW, GEOFFREY WHITTINGTON

Geoffrey Whittington's presentation outlined and discussed the issues arising from the IASB/FASB's project to develop a joint conceptual framework for financial reporting standards, in particular the implications for the basis of measurement. He articulated two 'world views' underlying the current framework and measurement debate: A 'Fair Value View', as the perceived preference of the IASB, and an 'Alternative View'. Each of the world views were illustrated with reference to specific standards and their practical implications. The presentation concluded with a summary of the respective 'world views' and implications for some IASB proposals affected by the 'Alternative View'. Interested readers are urged to read Geoffrey's full paper which is published in *Abacus*, Volume 44, Number 2, June 2008, pages 139–68.

Fair value as the basis of measurement is the perceived preference of the IASB. Two papers issued (but not necessarily endorsed) by the IASB discussed fair value as the basis of measurement. They were a discussion paper in 2005, authored by staff at the Canadian ASB, and FASB's SFAS157 in 2006, which interpreted fair value as being current market sale price, ignoring transaction costs and free of entity-specific assumptions. The Fair Value View is based on the assumption that markets are relatively perfect and that financial reporting should meet the needs of passive investors and creditors (the focal group for establishing needs) by reporting fair value derived from current market prices. The Fair Value View emphasises decision-usefulness and relevance to current and prospective investors and creditors (not just present shareholders) with the focus on forecasting future cash flows so that accounting information ideally reflects future, rather than past, transactions.

The 'Alternative View' is the collective term used for a world view that is based upon a different set of assumptions from the Fair Value View. It implicitly encapsulates criticisms of the IASB fair value based pronouncements. The 'Alternative View' embraces the whole framework, including measurement, and is based on the assumption that markets are relatively imperfect, so that reliability matters, and that in such a setting financial reports must meet the needs of current shareholders as proprietors, and therefore explicitly recognise the importance of stewardship. Present shareholders have a special status and stewardship is equally as important as decision-usefulness. Financial reporting entails reporting past transactions and events using entity-specific measurements that reflect the opportunities actually available to the reporting entity. Moreover, past transactions and events are important for both stewardship and as an input to help predict future cash flows.

The IASB/FASB Joint Conceptual Framework Project started in 2005 with two objectives. A primary objective was to converge the two conceptual frameworks to form a consistent base for the convergence of financial reporting standards. Both IASB and FASB frameworks already emphasised decision-usefulness as the primary focus of financial reporting, as opposed to legal and stewardship purposes. The second objective was to make improvements, for instance by filling gaps, such as critical guidance on measurement, and to provide greater consistency, such as the definition of a liability and the distinction between liabilities and equity. A series of discussion papers followed by exposure drafts have been and will be issued as part of the project timetable. The first discussion paper (Phase A) was published in July 2006 entitled, 'The Objectives of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting' and this was discussed in detail in Geoffrey Whittington's presentation as outlined below. Subsequent discussion papers (Phases B to H) covering Elements and Recognition, Measurement, Reporting Entity, Presentation and Disclosure Framework, Purpose and Status, Application to Not-for-profit Entities and Remaining Issues are to be issued from 2007/8 onwards.

Chapter 1<sup>9</sup> of the discussion paper is on the 'Objective of Financial Reporting' and this is fundamental to the Framework debate. This reiterated the need to produce 'general purpose financial statements' to meet the needs of all external users, with investors and creditors as the focal group. This is consistent with the current conceptual framework and implies a focus on valuation by financial markets.

What of the special role of present shareholders as proprietors of the business and the issues of stewardship, agency tensions and accountability? Any special role for current shareholders is rejected by the discussion paper on the grounds that a 'broad' entity perspective is more inclusive than a 'narrow' proprietary perspective and any stewardship obligation within reporting requirements could be subsumed within the general objective of decision-useful information derived from future cash flows. Thus stewardship is not specified as a distinct objective of financial reporting in the discussion paper.

The 'Alternative View' rejects the subsuming of stewardship in this way. Under this view, accountability and the needs of the present shareholders entail more than the prediction of future cash flows, as they are concerned with monitoring the past as well as predicting the future. The Alternative View also recognises that the past and future are interlinked and overlap. For example, information (and monitoring) on past transactions and events and the past conduct of management and policies may be relevant to predicting future cash flows. The stewardship process can affect behaviour and therefore

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9. Since the talk was given (January 2008), the IASB has issued revised versions of Chapters 1 and 2 as an Exposure Draft (May 2008)

influence future cash flows and their perceived risk. By explicitly recognising stewardship as an objective of financial reporting, agency concerns and accountability issues are more fully addressed. The differences between the two objectives of decision-usefulness and stewardship is more one of emphasis, but the 'Alternative View' recognises the distinct role of stewardship, which is not subsumed within the single objective of decision-usefulness.

Chapter 2, 'Qualitative Characteristics of Decision-Useful Financial Information' was discussed next. As expressed in its title, it is based on the general objective of decision-usefulness for financial reporting, with stewardship subsumed. Additionally, there are changes to both the form and language used in the existing conceptual frameworks. With regard to form, a sequential rather than the previous simultaneous approach (in which trade-offs were made) to applying the qualitative characteristics is advocated. For language, there is the replacement of reliability with faithful representation. The combined effect is to eliminate the trade-off that previously occurred between relevance and reliability. Such a trade-off was previously used under the present framework as a reason not to use fair value measurements, because these were perceived to be relevant but not reliable. Under the proposed new Framework (supportive of a Fair Value View), relevance is to be considered first followed by faithful representation. There are, however, different levels of relevance and faithful representation, which give rise to trade-offs between them. As relevance is considered first, this will prevail, despite the potential problems and issues of unreliability. An increase in reliability is thus not regarded as a factor to outweigh relevance. The change to faithful representation can also be seen to be supporting a 'Fair Value' view. Information must be a faithful representation of real-world economic phenomena depicting the economic substance of the underlying transaction or event – and it must be verifiable, neutral and complete, which may serve to emphasise economic substance over accuracy (see QC16 of the discussion paper for a full definition of reliability and faithful representation). What is explicitly missing from the new definition is any mention of 'free from material error and bias', which was included in the previous definition of reliability and is now subsumed into verifiability and neutrality. If fair value is deemed better able to capture economic substance, then historic cost (despite its reliability) might be deemed an inappropriate measure. Similarly, a Fair Value View is accommodated by the absence of consideration of material error and bias, as fair value can rely more on estimation and subjectivity than alternative measurements.

As part of the discussion, the concepts of neutrality and prudence were considered. The present IASB Framework refers favourably to prudence and attempts to reconcile prudence with neutrality (similarly, ASB 1999, Statement of Principles) with the application of caution when making estimates so as not to overstate assets/income nor

understate liabilities/expenses. This therefore helps the reliability of accounting information. The discussion paper explicitly rejects prudence because of its inconsistency with neutrality and freedom from bias. Therefore, there is now no need for a trade-off between neutrality and prudence. By rejecting prudence there are implications for stewardship. To ensure that financial performance is correctly reflected in financial reporting against any desire by managers to overstate income, for example, where managers are rewarded through shares or share options, there is a need for appropriate caution and reliability. Prudence helps address any agency tensions that may arise between management and present shareholders over reported financial performance. Furthermore, if prudence is removed and neutrality applied, current financial reporting standards would be inconsistent. This would mean a symmetric view of gains and losses. Currently IAS36 asserts that carrying values of assets can only be reduced by impairment testing. Similarly, IFRS4, dealing with insurance, states that the carrying value of liabilities can only be increased by liability adequacy tests. These both reflect prudence, rather than a symmetric neutrality, in valuing assets and liabilities respectively.

Phase B, the second proposed discussion paper, covering Elements and Recognition, was then considered. The focus of this work, which is still in progress, has been on the definitions of assets and liabilities, so reaffirming the balance sheet approach embedded in the current Framework. This emphasises the 'conceptual primacy' of assets and liabilities over income and expenses. The proposed definition of an asset deletes two significant phrases from the current IASB definition. First, that an asset arises 'as a result of past events' and secondly 'that future benefits are expected to flow from an asset'. These deletions were also applied to liabilities. The implications of these are that the deletion of a reference to past events reduces the importance of stewardship of past transactions and, in turn, may serve to impair the reliability of financial statements. Secondly, the deletion of expected future benefit is inconsistent with current recognition criteria (IASB Framework: 83), which explicitly recognise an element (asset) if it is probable that future economic benefit will flow to/from the entity. Any uncertainty would now be reflected in measurement rather than in recognition criteria. These two changes, both of which would accommodate a Fair Value View, potentially serve to erode the recognition criteria in the current Framework. Perhaps significantly, recognition criteria were not addressed as a part of Phase B.

Given the issues arising from assets and liabilities, the next element to be addressed in Phase B, equity, is perhaps even more problematic, particularly the distinction between equity and liabilities (on which FASB currently has a project). Equity is seen as a residual in the current Framework but this raises the issue of what constitutes equity as compared with liabilities, beyond issued share capital, especially given the current wide variety of financial instruments, such as options and warrants. One

possible solution from the current FASB project is a 'claims approach' where all balance sheet credits are regarded as claims and there is no debt/equity distinction. An alternative approach is to classify two-tier equity, with the existing shareholders as one tier and then other equity instruments as the other tier. Such an approach would be consistent with the view whereby present shareholders are regarded as a special group, but would not fit in with IASB's broad-entity approach, as it would single out a specific group. Other elements such as income and expenses have yet to be discussed within Phase B, but given the balance sheet approach so far adopted it is likely that discussion of these will come as part of Phase E, Presentation and Disclosure. The IASB/FASB already have a joint project on performance reporting which favours a single comprehensive income statement. Comprehensive income includes changes in fair value measures but raises concerns over fair value volatility and reliability.

Phase D considers the Reporting Entity. One issue arising is in relation to holding company accounts, as opposed to group accounts. The current IASB entity-perspective view is that only one set of general purpose financial statements should be prepared, ie group accounts. For those who view present shareholders as a special group and see the need for a proprietary perspective, then holding company accounts, as well as group accounts, should also be prepared as they provide useful additional information to the current shareholders.

Phase C considers Measurement and while work has already started this will be a contentious area. One of the current Framework gaps has been clear guidance on measurement. This was avoided by earlier Frameworks, which reflected the indecisive outcome of the inflation accounting debate by discussing the desirable properties of measurement without advocating a single measurement objective. Broadly, this debate was about historical cost versus some version of current cost. More recently, as in IAS39 (Financial Instruments) and IAS41 (Agriculture), there has been an increased preference for fair value, defined as an exit (sale) value. The recent IASB discussion paper, based on SFAS157, defines fair value on an exit price, not a replacement cost basis, with transaction costs excluded. Exit price is based on transactions between market participants, thus being market based and non-entity specific. Clearly, based on current developments in accounting standards, fair value and its underlying assumptions have strong support. The debate has far wider concerns than just measurement, however, or the question of whether fair value is or is not a good measure. It concerns the purpose of financial accounting and the context in which it operates.

From the earlier discussions it is possible to identify two broad world views: the Fair Value View and the Alternative View. These are summarised with their respective implications below:

#### **a) Fair Value View:**

This is the view that is generally supported by FASB and IASB and is apparent in many of the proposed revisions of the Framework. The Fair Value View emphasises decision-usefulness as the sole objective of financial reporting and its relevance to current and prospective investors and creditors as the user groups. It emphasises the role of financial reporting in serving investors in capital markets. To facilitate decision-usefulness, accounting information should reflect future, not past, transactions, and consequently forecasting and disclosing future cash flows is required to meet the principal need of those groups. Relevance is the primary characteristic required in financial statements, whereas reliability is less important and is replaced by representational faithfulness as an objective, implying greater concern for economic substance than for statistical accuracy. Current market prices, on an exit basis, give a neutral, non-entity specific informed view of cash flow potential. Markets are generally complete and efficient enough to provide evidence for representationally faithful measurement.

The implications of the Fair Value View are that present shareholders have no special status among investors, but form part of the wider investor community, and that stewardship is not a distinct objective of financial statements but, instead, market value is the universal concern. Accounting information (financial statements) will reflect future not past transactions and events, and such past transactions or events are only relevant as part of predicting the future. Thus cost (entry value) is an inappropriate measure as it relates to a past event whereas future cash flow will result from future exit measured by fair value. Prudence is a distortion of accounting measurement as it brings bias against neutrality and violates faithful representation. Overall, the measurement objective should be fair value, with the balance sheet as the most important statement, showing the current fair value of the entity, supported by a comprehensive income statement.

#### **b) Alternative View:**

The Alternative View presented brings together the collection of issues raised by a range of observers typically commenting on particular issues rather than developing a coherent framework model. This does not prevent the formulation of an Alternative View; rather, it shows its origins and recognises the variety of potential issues that exist. The main features of this Alternative View are that present shareholders of the holding company do have a special status. They are the owners of the business and need to be informed of past transactions and events as well as future cash flows, so that stewardship is a distinct objective of financial reporting and ranks equally with decision-usefulness. Past transactions and events need to be reported as they are important for both stewardship and as inputs for predicting future cash flows. Future cash flows may be endogenous, and financial reporting relieves asymmetry in an uncertain world with incomplete and imperfect markets, in which opportunities are entity

specific, so reliability within financial statements does matter and is an essential characteristic.

The following implications arise from the Alternative View. The information needs of present shareholders, including stewardship requirements, must be met. Past transactions and events are relevant information and, together with other recognition criteria, enhance reliability. Reliability of financial statements can be further enhanced by prudence. Cost is a potentially relevant measure as an input to the prediction of future cash flows as well as for stewardship purposes. The economic environment is characterised by imperfect and incomplete markets in which opportunities are entity specific and so entity-specific assumptions reflecting real opportunities available are relevant and financial statements should reflect such an entity-specific position.

The underpinning market assumption of the Alternative View that markets are imperfect and incomplete does not lack theoretical support. It is compatible with Hicks (1946) and with Edwards and Bell (1961), whose analysis emphasises income rather than the balance sheet and considered how ex post accounting income, based on past transactions and events, could be used to evaluate performance. This is based upon current cost measures, not fair value. Beaver and Demski (1979) argued that markets are imperfect and incomplete and that accounting provides useful information rather than definitive measures.

The IASB view has usually been consistent with a Fair Value View. Nonetheless, a number of IASB proposals have been criticised, in some cases showing alternative views from within the board. Some IASB proposals affected by the Alternative View are discussed below.

#### **Present shareholder focus**

IFRS2 share-based payment measurement should be based on exercise date, not grant date from the perspective of present shareholders.

#### **Entity-specific assumptions**

IAS36, Impairment of Assets, bases recoverable amounts on projected cash flows, which will inevitably be based upon entity-specific management forecasts. IAS37, Provisions, similarly allows entity-specific assumptions of the best estimate to settle an obligation at the balance sheet date.

#### **The relevance of cost**

The use of historic cost measures for recognition of assets and liabilities is widespread in current IASB and ASB standards. SFAS157 proposals preclude the interpretation of fair value as replacement cost. This would change practice in terms of IAS16, Property, Plant and Equipment, and IAS17, Leases, where replacement cost may seem a more relevant measure of future cash flows. The use of fair value in IAS39, Financial Instruments, can give rise to 'day one' profits, although such profits are not yet earned. This is why retailers, for instance, conventionally record stock at cost not selling price.

#### **Reliability and Prudence**

In IFRS 3, purchased goodwill is measured at cost rather than at fair value. Amortisation of goodwill was replaced by impairment testing, which should be prudent although it does not include a subsequent cash-flow test of impairment value. Impairment is asymmetric and not neutral in its application to purchased goodwill.

#### **Recognition criteria**

The two recognition criteria in the existing IASB Framework are the probability that the entity will receive future cash flows from an asset, deleted in the proposed asset definition, and reliability of measurement, now replaced in the new proposals by faithful representation.

Overall, the Fair Value View emphasises the role of financial reporting in serving investors in capital markets, which are viewed as complete and competitive. Financial statements reflect forward-looking content, impounding future cash flows from a non-entityspecific market perspective. The Alternative View also seeks to serve investors, broadly defined, but gives special accord to present shareholders and equates stewardship as an important and distinct function of financial reporting. This approach assumes information asymmetry and that imperfect and incomplete markets are common. Past transactions and events are important for accountability as well as being relevant in predicting future cash flows. Given the competing demands of reliability and relevance, there exist a multitude of measurement bases that can be applied in current financial statements, negating the adoption of a universal single measurement. There is, however, a need for a single measurement objective.

## 2.5 COMMUNICATION BETWEEN MANAGEMENT AND STAKEHOLDERS: A CASE STUDY. BILL MCINNES, VIVIEN BEATTIE, AND JACKY PIERPOINT

Bill McInnes and Vivien Beattie presented their recent research examining communications between company management and stakeholders. The research was funded by the ICAEW Centre for Business Performance and a briefing or full research report is available through the ICAEW ([www.icaew.com/index.cfm?route=153386](http://www.icaew.com/index.cfm?route=153386)). The presentation covered the key aspects of their research into stakeholder communications from empirical findings through to theorising on stakeholder communication uptake. The research was based upon a single case company and involved internal interviews with key company managers and directors, and stakeholder interviews with internal stakeholders (employees) and a comprehensive range of external stakeholders.

A common focus of previous accounting research into communication between management and stakeholders has been the annual report. There has been very little investigation of other information sources used by stakeholders. Previous research has also tended to focus on a relatively small number of stakeholder groups, primarily equity investors and analysts, and consequently does not address the information usage by other groups. New reporting models have been proposed calling for the annual report to be redesigned to fulfil more of the needs of a range of stakeholder groups (see ICAEW 2003 for a summary and discussion).

The research by McInnes et al. represents a major contribution to the literature on communication between management and stakeholders. It adopts a multi-stakeholder group perspective to examine a wide range of the information sources and communication channels used by the case company and by third parties (for instance, analyst reports or news media coverage) in their stakeholder communication. The broad research aims were:

- to identify the range of information sources and communication channels used by a case company and third parties to communicate with the company's stakeholders
- to examine the extent to which the information sources were used and the communication channels were accessed by a range of stakeholder groups.

For the research, a single case company was selected and full access was obtained to relevant management and internal and external stakeholders. In total, five key company management interviews were performed and 36 stakeholder interviews were conducted during the research phase covering the following stakeholder groups:

- equity investors
- equity analysts
- credit investors
- credit analysts
- credit raters
- private shareholders
- employees
- suppliers
- customers.

The case company is a UK- and US-listed regulated utility and accordingly has a wide reporting remit and a wide range of stakeholder groups, which made the company appropriate for the empirical research.

Key findings of the research covered the following aspects:

- conceptual issues
- communication offerings
- stakeholder communication uptake and emergent theoretical model
- other miscellaneous observations.

Each of these main areas is summarised in turn below.

### i. Conceptual issues

Recent conceptual framework documents (eg IASB 2006) have recommended that financial reporting should provide information from which it is possible to assess a company's future cash flows. This objective is particularly relevant to stakeholders who are finance professionals. Major companies already generate such information internally to enable them to forecast future earnings, free cash flow, etc, but the issue remains as to the extent of the external disclosure of such information. At present, limited disclosure does exist. The case company did provide such forecast disclosure to its credit rating agencies. While such information may be (share) price sensitive, companies are permitted by the Listing Rules (FSA 2007) to provide such information on a confidential basis to credit rating agencies. The raters perceive the forecasts as important in the rating process. Given the confidential nature of the disclosure and the surrounding Listing Rules regulatory framework, widespread disclosure would be problematic, and hence leaves the current position where credit rating agencies have greater access to some information than do other stakeholder groups. This opens the question for the IASB of whether, and if so how, a similar approach for forecast disclosures could be adopted for other stakeholder groups.

Wider information sources are then considered, and a clear distinction made between information sources and communication channels. This distinction is not made in the extant literature. Information sources are the content (eg annual report) whereas communication channels are the medium of dissemination (eg paper copy or website). For effective stakeholder communication both possible sources and appropriate channels need to be considered by companies. A wide array of information sources are included in the research, which covers, inter alia:

- company announcements
- annual reports
- social and environmental reports
- question and answer sessions, and
- forecasts.

Similarly, a wide range of communication channels exist to disseminate information and include, for instance:

- newswires
- newspapers
- website
- results meetings
- CDs
- employee roadshows
- one-to-one meetings
- intranet
- email.

Depending on the information source, an appropriate means of communication can be adopted to optimise take-up by stakeholder groups. Interestingly, all stakeholder groups, especially the finance professionals, viewed the website as an electronic library of background information rather than as an interactive forum.

The appropriate communication channel may also be dictated by the timeliness required for the information. Often, the arguments about timeliness relate to finance professionals, for whom it is important that information is disseminated as soon as it becomes available (eg through announcements or presentations). Paper-based dissemination results in a time lag and so is less useful for finance professionals. Nonetheless, it is still useful for more passive stakeholder groups, so that the annual report, as a paper document, can be used by employees, customers or suppliers to assess company performance.

Thus information to the latter groups is timely if it is able to inform and influence current and future decisions.

## **ii. Communication offerings**

Information sources available to stakeholders are provided by the case company and by third parties. From the case company, some of the sources such as the annual report and press releases are directed at a general audience of all stakeholders. Other sources of company information are targeted at specific stakeholder groups, for instance the forecasts for credit raters, and in those instances such information is not available to other stakeholder groups. Similarly, some communication channels are available only to specific groups, such as the road-shows for employees. In addition to company sources, stakeholders are also able to access third-party information including equity analysts' reports, news and media coverage and regulatory reports. All stakeholder groups made use of such third-party sources for three main reasons: to obtain new information; to obtain benchmarking information; and to access expert analysis.

Given the targeted dissemination of some of the information sources, stakeholder groups have access to a differentiated range of information. Some stakeholders are more privileged than others in the information available to them and in the communication channels to which they have access. Credit raters receive forecast information from the company and major equity investors benefit from one-to-one meetings with a company's senior management. Similarly, third-party conferences are available to finance professionals but not to private shareholders. Thus the stakeholder information field is not level, but distorted in favour of some more privileged stakeholder groups.

## **iii. Stakeholder communication uptake and emergent theoretical model**

Differences were found among the stakeholder groups in the level of information uptake and this was broadly a function of the importance of the case company to the stakeholder group. Two meta-stakeholder groups were identified, namely finance professionals (equity and credit investors, sell side equity and credit analysts, and credit raters) and the groups that were not finance professionals (private shareholders, employees, suppliers and customers). The finance professional group used (accessed) a wider range of information sources (communication channels) more intensely (frequently) compared with the groups that were not finance professionals. Within the finance professional group, the sell side equity and credit analyst groups used (accessed) a wider range of information sources (communication channels) than the equity and credit investor groups. This may be because the latter group has to manage a more diverse and larger range of investments and thus needs to focus on key information sources while lacking the time to adopt a wider search of information sources. Furthermore, the equity and credit investors rely upon their respective analysts for summaries of the wider information through their analyst reports and recommendations.

While there was some homogeneity within the groups of finance professionals for comparison of uptake, there was less homogeneity within the groups of stakeholders who were not finance professionals, particularly the supplier group. This may have arisen from the suppliers' different and varied relationships with the case company. The differences between the meta-groups were also highlighted by their use of the separate social and environmental report. This was not used by the finance professional groups, consistent with prior research, but was used by employees and suppliers.

Based upon the empirical findings a generic grounded theory model of stakeholder communication uptake was proposed: that the overall level of uptake is influenced by the importance of the company to the relevant stakeholder group. Communication uptake fulfils four distinct roles and reflects the need for:

- acquisition of timely, decision relevant information
- availability of reference source to facilitate company monitoring
- a means of assessing the level of trust that can be placed in company management, and
- a means of engaging with other stakeholders to seek their views on the company.

#### **iv. Miscellaneous observations**

The annual report, while important to some stakeholders, is not the only information source used by them, even though much accounting research has traditionally focused and relied upon the annual report as a prime reporting document. Key roles were identified in relation to stakeholder use of the annual report. For the finance professional groups, although it is not a timely document for capital market decisions, it is used as a historical reference document. For groups other than finance professionals, the annual report contains the first formal company results information and associated narrative and can be used as part of current and future decision making about the company. Further, the narrative sections, particularly the Chairman's statement and CEO report, are used by private shareholders as a means of assessing the trustworthiness of senior management, whereas such narrative sections were not seen as new information by the finance professional groups, who regarded the 'front end' as propaganda material.

In general, company management target the preliminary results narrative at the finance professional groups whereas the annual report narrative is aimed at a more general audience. Thus, in any future review of the regulation of narrative reporting and its influence over decision making, both preliminary results and annual reporting narratives should be addressed. Finally, some of the finance professionals preferred the more regulatory-driven US narrative reporting to the more voluntary UK reporting framework. This suggests that such narrative

results in higher-quality disclosure compared with the more voluntary-based UK narrative reporting disclosures.

Overall, the research highlights the range of both information sources and communication channels available from companies (and third parties). It provides evidence of the extent to which each information source is used and each communication channel is accessed by each of nine stakeholder groups. A generic grounded-theory model of stakeholder uptake is developed that identifies four distinct roles in which stakeholders used the information. The findings make a number of useful contributions to the literature and should provide the basis for future research in the area.

### 3. Discussion

In sum, therefore, these five papers provide a critical new look at some perennial accounting problems. Bromwich, Macve and Sunder's paper critically examines the FASB/IASB Conceptual Framework Project; its assertion of the primacy of assets approach as the bedrock of the framework and its claimed underpinning by Hicks. Additionally, it questions the Boards' pitting of 'conventions' against 'conceptual principles'. The primacy of assets approach supports the proposition that the concept of income is founded ultimately on the definition of assets and that income is the increase in net resources in terms of changes in assets and liabilities over a time period, and thus is objectively determined. It is claimed that such primacy is derived from Hicks' definition of income (1946). The authors argue that Hicks has been misquoted and not considered in full, with his results taken out of context and thus misapplied in their use, and hence this undermines the primacy of assets approach. The paper addresses the key differences between the IASB/FASB approach and that of Hicks as regards their respective views of income, and covers in turn the issues of net assets vs. firms, objective vs. subjective measurement, income ex post vs. income ex ante, and finally, Income No.1 vs. Income No. 2. As more companies are now reporting levels of permanent or maintainable income (core EPS), the paper contends that given such disclosure, assets and liabilities can be derived from income rather than vice versa and consequently the primacy of assets approach is dismissed.

Chisman gave insights from a practitioner perspective (and drew on his involvement with accounting standards as a former member of the Financial Reporting Council) on the suitability and appropriateness of the competing bases of accounting measurement in relation to satisfying the user requirements and purposes of financial statements. The paper outlined the current measurement bases: recoverable historic cost (RHC), fair value (FV), value in use (ViU) and the mixed basis that is currently used within financial statements. Chisman considered the relationship of ownership to the needs of the users of financial statements and the differences between private and public companies. If this difference is understood then appropriate bases of measurement for the preparation of financial statements can be advocated that satisfy the distinct user needs. For private companies, where shareholders are themselves directors of the business, the fundamental purpose of financial statements is creditor protection. In this instance, RHC would be adopted as providing a simple and objective basis of measurement. For public companies and larger private companies, there is a dual purpose: creditor protection and investor protection (ie, value creation and assessment of management performance requiring cash-flow forecasts). On the basis of measurement, there is trade-off between the objective, historic information of RHC compared with the subjective, forecast information of ViU. To satisfy the dual needs of creditor and investor protection a dual measurement basis would be adopted. The accounts of public companies would not only report all items under RHC, but would also report forecast and value-driven information under ViU. Creditor protection is covered by

RHC and the dialogue between managers and investors under ViU focuses on value creation and performance evaluation.

Martin set out his arguments for a single basis of measurement to reduce the current accounting complexity borne from multiple bases. The focus of the paper is on the adoption of fair value accounting as an appropriate measurement basis. This allows a focus on decision-usefulness, provides an objective, market-specific (rather than entity-specific) measurement base to capture consistent market values of items at any one moment so as to facilitate greater business comparability. Fair value recognises the change in asset value over time and its consequent impact on profit, and compared with RHC is not beset by transactional differences related to the historic purchase price of assets. The paper cited examples of where fair value is already applied (see for instance IAS39-41), but considered how it could be universally applied to all items rather than just specific items covered by current standards. SFAS157 provides three hierarchical levels of fair value application, reflecting market and data conditions that could be drawn upon to apply fair value to the individual components of the financial statements. The issue of the trade-off between reliability and relevance is addressed in the paper. While fair value provides relevant decision-useful information it also results in recording and accounting for asset price volatility and by moving away from a transactions base there is early recognition of gains that may not be reliable or materialised. Issues of reliability are now evident in the light of Enron and, since Martin's presentation, in the current subprime crisis. A single measurement base could reduce accounting complexity, but may require in its achievement wholesale revision of the conceptual framework.

Whittington's paper addresses the conceptual framework debate and its implications for the basis of measurement and is part of a wider debate on the purpose of financial accounting and the context in which it operates. He presented two world views: A Fair Value world view implicitly favoured by IASB, with decision-usefulness as the primary focus of financial reporting and an Alternative View (compatible with Hicks, 1946, and Edwards and Bell, 1961) which recognises stewardship as well as decision-usefulness as dual objectives of financial reporting. The Fair Value View is based on the assumption that markets are relatively perfect and that financial reporting needs to address the needs of passive investors and creditors. Fair value emphasises decision-usefulness, focuses on forecasting future cash flows, not past transactions, with relevance rather than reliability being the primary characteristic of financial statements. The Alternative View presented recognises that markets are relatively imperfect and so the reliability of financial statements matters and that the needs of current shareholders and the importance of stewardship ranks equally with decision-usefulness. Throughout the paper the relevance and reliability debate of financial reporting is addressed, linking into consideration of, inter alia, prudence, the conceptual primacy of assets and the meaning/definition of equity.

The paper provides a review of the IASB/FASB Joint Conceptual Framework Project and sets out in detail a critical review of the first Discussion Paper, 'Objectives of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting' before addressing subsequent discussion papers. The paper concludes with a summary of the two world views and their implications and reviews current IASB proposals showing how they are affected by the Alternative View.

The final paper in the series by McInnes, Beattie and Pierpoint provided an empirically-based examination of communications between a single case company's management and a range of stakeholders: investor and analyst groups, credit raters, employees, suppliers and customers. The paper addressed in turn conceptual issues, communication offerings, stakeholder communication uptake and various miscellaneous topics. The researchers developed a grounded theoretical model of stakeholder communication, which proposes that the overall level of communication uptake is influenced by the importance of the company to the relevant stakeholder group and that communication uptake fulfils four distinct roles. Important issues are raised, such as the consideration of publication and release of forecast information to all stakeholders and the current differentiated stakeholder access to various sources of information. The role and usage of the annual report and its contents to stakeholder groups was considered. From the empirical data, and the levels of access to information, two meta stakeholder groups were identified, finance professional groups and groups that were not finance professionals.

The papers in Table 1 have been organised into two groupings rather than in their actual order of presentation. In the first group (Bromwich, Macve and Sunder; Chisman; Martin; and Whittington) four very different reflections on measurement are presented. The fifth paper by McInnes, Beattie and Pierpoint is listed separately as it is primarily concerned with financial communication and stakeholders rather than measurement.

All the authors, except for Sunder (from the US) are British, but have very different perspectives on their topics. Three papers emanate from the academic sector. Bromwich and Macve are professors at the London School of Economics, their co-author, Sunder is a professor at Yale; Whittington is a professor at Cambridge University; and McInnes and Beattie are professors at the Universities of Stirling and Glasgow, respectively. By contrast, Chisman is an accounting practitioner and former finance director of Stakis plc and Thorn Ltd and also former member of the Financial Reporting Council and finally Martin is head of financial reporting at ACCA. The authors, therefore, bring a variety of different approaches to their papers.

These differing backgrounds were reflected in the nature of their outputs. Chisman and Martin both presented their views to inform the policy discussion and have a practitioner and professional accounting perspective. The remaining three papers are more academic in orientation.

Bromwich, Macve and Sunder's paper is available as a working paper on the LSE website (the full web reference is given within the paper commentary). McInnes, Beattie and Pierpoint's paper is available both as an ICAEW report and also a briefing document (again the full reference is given within the paper commentary) and Whittington's paper is published in an Australian academic journal, *Abacus*, 44/2, 2008.

The four papers that look at measurement show great variety in terms of focus, research approach and source materials. The Bromwich, Macve and Sunder paper examines a fundamental premise that has underpinned modern thinking about accounting. It revisits an old accounting chestnut: the debate on whether measurement should start with income (and the income statement) and thus have the assets and liabilities (broadly, the balance sheet) as residuals or conversely whether it should begin with assets and liabilities measurement and treat the income statement as residual. The latter is the approach used in the IASB's conceptual framework. Bromwich, Macve and Sunder critically evaluate the assumptions that underpin this approach. By contrast, Chisman focuses on a different problem: the interesting question of which of four commonly used bases of accounting measurement (ie, recoverable historic cost (RHC), fair value, value in use and the mixed basis) could be used for public and private companies. Martin's main focus is on fair value. He considers its growing use, the variety of ways in which it might be used, and its weaknesses and criticisms. In addition, Martin calls for a revision of the conceptual framework. Finally, Whittington, in a carefully argued approach, outlines two political world views underlying the current framework and measurement debate: a 'Fair Value View' implicitly preferred by the IASB and an Alternative View. Whittington, therefore, produces an alternative construct for financial reporting measurement. Meanwhile, Bromwich, Macve and Sunder suggest a different starting point and Chisman suggests a differential approach to measurement.

**Table 1: Thematic overview of the five papers presented**

Authors	Background	Output	Focus	Research	Source materials	Key findings
Bromwich, Macve and Sunder	Academic: Macve is academic adviser to the ICAEW's Centre for Business Performance. Bromwich is a former member of the ASC	Academic working paper	Income measurement and conceptual framework	Critical examination of prior literature with normative reasoning	Hicksian views of income and conceptual framework	Companies often report levels of permanent income and this can be used as the basis for determining useful reporting to complement reporting of changes in assets and liabilities
Chisman	Practitioner: former FD of Stakis plc and Thorn Ltd, and former member of the Financial Reporting Council	Presentation	Basis of measurement	Critical examination of practice using professional experience	Current standards	A dual reporting measurement scheme in which private companies use recoverable historic cost. A dual basis for public companies: recoverable historic cost and value in use
Martin	Professional: accountancy body, head of financial reporting, ACCA	Presentation	Fair value	Critical review of current literature	Current IASB and US standards and conceptual theory	An abundance of measurement bases and differing treatment of items within financial statements. Growth in fair value. Conceptual theory revision may be necessary
Whittington	Academic: with standard-setting experience and member of the Accounting Standards Board and formerly International Accounting Standards Board	Academic paper in Abacus (2008)	Fair value and conceptual framework	Critical review of current thinking using experience as a policy setter	Current IASB and US standards and conceptual theory	Outlines an Alternative View to the current Fair Value View that gives special accord to present shareholders and equates stewardship as a distinct and equal function to decision-usefulness in financial reporting
McInnes, Beattie and Pierpoint	Academic	ICAEW Research Report (2007)	Communication between management and stakeholders	Empirical study using interviews	41 semi-structured interviews with 5 key company officers and 36 stakeholders from 9 stakeholder groups	Companies communicate with stakeholders via a range of information sources and communication channels. Some stakeholder groups in a more privileged position than others. Development of a generic model of stakeholder communication uptake

There is less difference between the four *research approaches* to measurement. All four authors, in their own way, critically review the current standards and conceptual theory, but from very different backgrounds. Bromwich, Macve and Sunder, and Whittington start from academic backgrounds. In Bromwich and Macve's cases that is mediated by their roles as a former member of ASC and as academic adviser to the ICAEW's Centre for Business Performance Reporting respectively, whereas in Whittington's case his academic standpoint is informed by his experience and knowledge as a standard setter for both the Accounting Standards Board and International Accounting Standards Board. Chisman approaches the topic of measurement from his professional and also policy-relevant experience as a FTSE250 finance director and former member of the Financial Reporting Council (and also ICAEW Financial Reporting Committee), while Martin critically reflects on fair value in his role as the head of financial reporting at the ACCA. This enables rich debate around the subject areas and highlights the current complexities from both a conceptual and theoretical perspective. A further challenge is the practical orientation of any future conceptual framework and basis of measurement. Debates such as these are, therefore, vital to reflect the inputs from academic, professional and practitioner viewpoints.

Whereas Chisman and Martin draw primarily on their personal experience and a critical evaluation of the current standards and the conceptual theory, Bromwich, Macve and Sunder, and Whittington also draw on accounting theorists. In the former case, Bromwich, Macve and Sunder draw on the famous works of Hicks (1946, 1948 and 1979, as well as Paish, 1940) to support their argument that the IASB has used Hicks out of context to support the objectivity of the primacy of assets. Whittington also draws upon Hicks (1946), and Edwards and Bell (1961) for theoretical support for his underpinning assumption for the Alternative View that markets are imperfect and incomplete. The use of Hicks to support IASB/FASB fair value arguments is critically questioned by both Whittington, and Bromwich, Macve and Sunder.

The McInnes, Beattie and Pierpoint paper addresses a different issue from the other four. It is concerned with communication between management and stakeholders. This looks back to the debate in the UK, for example, on *The Corporate Report* in 1975, which was published to create a focus on the usefulness of published financial statements. The authors' research approach was an empirical study using 41 interviews. These interviews were then used to document a range of information sources and communication channels as well as to develop a generic grounded theory model of stakeholder uptake.

## 4. Conclusions

The papers presented in this report provide new insights into perennial accounting problems, particularly those of measurement, fair value, conceptual theory and stakeholder communication. Bromwich, Macve and Sunder argue that income can be used directly as a complimentary basis to reporting assets and liabilities rather than being derived from them. Chisman advocates a dual measurement system for private companies and public companies. Martin points out that the growth in fair value may require a revision to the conceptual framework. Whittington outlines an alternative world view underpinning the current measurement and conceptual framework debate based on special recognition of present shareholders and incorporating stewardship. Finally, McInnes, Beattie and Pierpoint construct a generic grounded theory model of stakeholder uptake of various information sources and communication channels.

All five papers present fresh insights into current financial reporting while addressing issues that have troubled both accounting academics and practitioners over many generations. What is particularly enriching is the differences in background, focus, research approach and source materials. The authors are academic, practitioner or professional in orientation and the consequent debate draws upon this experience and provides a richness of discussion, combining research, practice and policy. The focus varies between fair value, the basis of financial reporting measurement, income measurement in relation to conceptual theory, and communication between management and stakeholders. Four of the papers draw their inspiration from a critical review of current thinking, while the McInnes, Beattie and Pierpoint paper is based on an interview study. In terms of source materials, four of the authors are primarily interested in the current standards and conceptual theory, with two sets of authors (Bromwich, Macve and Sunder, and Whittington) drawing upon accounting theorists such as Hicks, and Edwards and Bell.

Given these differences in background, focus, research materials and source materials it is unsurprising that the authors produce very different key findings, which we summarise below.

- Permanent income can be used as the basis for determining useful financial reporting to compliment changes in assets and liabilities (ie not simply using changes in assets and liabilities to determine income as per the IASB conceptual framework) (Bromwich, Macve and Sunder).
- Hicks' definition of income (1946) has been misquoted and misapplied to support the primacy of assets approach (Bromwich, Macve and Sunder).
- A dual measurement system is possible in which private companies use recoverable historic cost and public companies use both recoverable historic cost and value in use, with the consequent dismissal of fair value as a useful basis of measurement (Chisman).
- Dual reporting would satisfy the needs of creditors (RHC) and investors (ViU). Dual reporting would be undertaken by all public companies and any private companies that elected for dual reporting beyond RHC (Chisman).
- There are a variety of different measurement bases currently used in financial accounting. The use of fair value is growing, but it has limitations and weaknesses. A revised conceptual theory may be necessary (Martin).
- Fair value can be used as a single measurement basis to reduce accounting complexity but the issue of trade-off between relevance and reliability and need for relevance within financial statements still needs resolving (Martin).
- Two potential world views are possible. First, the Fair Value View, implicitly preferred as the basis of measurement by the IASB, based on a relatively perfect market, emphasising decision-usefulness and relevance to current and prospective investors and creditors, with a focus on forecasting future cash flows and being based on market sale price, ignoring transaction costs and free of entity-specific assumptions. Second, an Alternative View based on imperfect markets, meeting the needs of current stakeholders and explicitly recognising the dual importance of stewardship alongside decision-usefulness (Whittington).
- Companies use a range of information sources and communication channels to communicate with stakeholders. Two meta-stakeholder groups: finance professional groups and groups that are not finance professionals are identified. The overall level of uptake, it is proposed, is influenced by the importance of the company to the relevant stakeholder group. Communication uptake reflects the four roles (timely, decision-relevant information; reference source; level of trust in company management; and means of engagement with other stakeholders) (McInnes, Beattie and Pierpoint).
- Different stakeholder groups have differential access to information sources and channels of communication. There should be consideration of a wider release of forecast information to stakeholder groups (McInnes, Beattie and Pierpoint).

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