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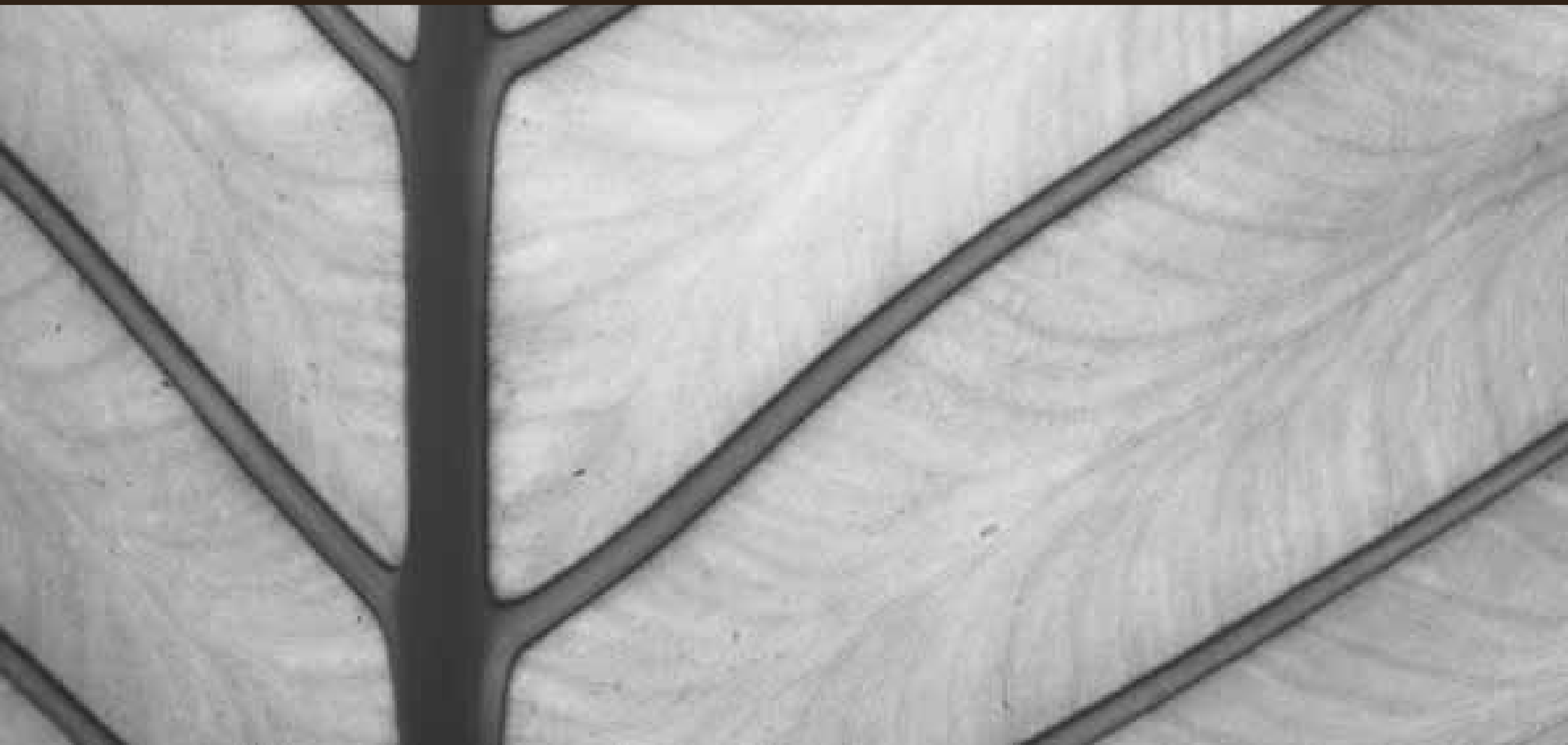
Putting investors at the heart of the financial system



ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our 147,000 members and 424,000 students throughout their careers, providing services through a network of 83 offices and centres. Our global infrastructure means that exams and support are delivered, and reputation and influence developed, at a local level, directly benefiting stakeholders wherever they are based, or plan to move to, in pursuit of new career opportunities. Our focus is on professional values, ethics, and governance, and we deliver value-added services through our global accountancy partnerships, working closely with multinational and small entities to promote global standards and support.

We use our expertise and experience to work with governments, donor agencies and professional bodies to develop the global accountancy profession and to advance the public interest.

Our reputation is grounded in over 100 years of providing world-class accounting and finance qualifications. We champion opportunity, diversity and integrity, and our long traditions are complemented by modern thinking, backed by a diverse, global membership. By promoting our global standards, and supporting our members wherever they work, we aim to meet the current and future needs of international business.

ABOUT GRANT THORNTON

Grant Thornton UK LLP is a leading financial and business adviser, operating out of 27 offices including three staff support sites. Led by more than 200 partners and employing nearly 4,000 of the profession's brightest minds, we provide personalised assurance, tax and specialist advisory services to over 40,000 individuals, privately-held businesses and public interest entities.

We are a member firm within Grant Thornton International Ltd, one of the world's leading international organisations of independently owned and managed accounting and consulting firms. Clients of member and correspondent firms can access the knowledge and experience of more than 2,500 partners in over 100 countries and consistently receive a distinctive, high-quality and personalised service wherever they choose to do business.

ABOUT ACCOUNTANTS FOR BUSINESS

ACCA's global programme, *Accountants for Business*, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

www.accaglobal.com/en/research-insights.html

Foreword

Though several years have now passed since the peak of the global financial crisis in 2008, the reverberations continue. Numerous bodies have proposed multiple solutions and 'patches' to fix perceived problems with the global financial reporting framework, but still the global economy remains fragile. Investors, businesses and their advisers remain uncertain about the future.

ACCA and Grant Thornton have identified possible reasons for these problems – the piecemeal, fragmented way in which solutions are being proposed and, in particular, a failure to place investors at the heart of the reform process.

As a global body, ACCA is well placed to bring together investors and investor group representatives with members of the accountancy profession to discuss a better way. Grant Thornton has also, through its co-chairmanship of Global Auditor Investor Dialogue (GAID), demonstrated its willingness to engage with investors and share current thinking. Together, ACCA and Grant Thornton seek to encourage a more focused, integrated and investor-centric approach to developing proposals for strengthening the global financial reporting framework.

Investors and accounting professionals may not always agree on where weaknesses in the current financial reporting framework lie, or the areas that should be prioritised for reform. As this report shows, investors do not always agree among themselves on the best way forward. Nevertheless, by stimulating debate and sharing opinions, greater understanding of these different views can emerge. Continuing this debate should enable even greater clarity about how the needs of investors can best be met and, by extension, how global capital markets and economies can be strengthened.

Helen Brand
ACCA chief executive

Steve Maslin
Partner, Grant Thornton

Executive summary

ACCA and Grant Thornton believe that investors should be the primary focus for global financial and accounting standards, and yet their voices in shaping future standards are not being clearly heard. While investors do comment on current issues and challenges, theirs is not a consistent voice, nor is it seen by all policymakers as the appropriate starting point for a debate on the value of audit and accountancy. Investor opinion is certainly not seen as a reference point against which to prioritise issues; nor does it drive an agenda for continuous improvement in transparency and measures to meet the needs of shareholders.

The two organisations facilitated a number of round tables, involving investors and investor representative organisations from a number of markets, to discuss the current and future challenges, their aspirations for reform, and the potential barriers they foresee in addressing their concerns.

On the basis of the round-table discussions, held in the last quarter of 2011, it is clear that the current fragmented response to the financial crisis is in danger of creating new problems – a multitude of individual responses from multiple regulators and jurisdictions driven by their own particular agendas.

There is, however, another way.

SETTING AN INTEGRATED REFORM AGENDA WITH INVESTORS' NEEDS AT ITS HEART

Investors, according to this study, would like to see new and improved accounting, auditing and corporate governance standards developed in a more integrated manner. They also emphasise the importance of basing any reform proposals on an initial and solid understanding of investors' needs and priorities. Without these two developments, the financial reporting system is likely to become ever more complex, disjointed and unwieldy – without necessarily creating conditions that increase investors' confidence in financial markets and support the free flow of capital to companies.

CONTINUING TO DEVELOP GLOBALLY CONSISTENT STANDARDS

Investors manage global portfolios, irrespective of their physical location. Global consistency is essential, in the financial statements companies produce, in the accounting standards they apply and in the auditing standards used to provide assurance. Investors seek comparable information to enable them to make informed capital allocation decisions.

BROADENING THE REPORTS ISSUED BY COMPANIES

Investors see potential for the development of integrated reporting to help fill some of their information gaps. Integrated reporting that more closely aligns risk management with performance, together with the provision of clear environmental social and governance reports, could enhance investor confidence in management's ability to perform in future.

SPREADING HIGH STANDARDS OF CORPORATE GOVERNANCE

The adoption and enforcement of corporate governance frameworks and codes is more advanced in some jurisdictions than others. Investors in all locations see value in wider adoption of high corporate governance standards. Without this, investor confidence, not only in individual companies but also in local financial markets, is weakened. Investors place particular emphasis on the need for strong internal audit, quality audit committee reporting and the presence of truly independent directors. Indeed, in some regions, corporate governance enhancement was seen as the highest priority in relation to improved confidence.

EXPANDING ASSURANCE PROVISION AND AUDITORS' REPORTS

Investors are keen to explore whether auditors could expand on the current format of their audit reports. There is a desire for more information on the audit process and any issues identified, as well as on issues related to the effectiveness of the company's management and the corporate procedures in place. Investors could be willing to pay for greater assurance, if it is truly adding value and is seen to reduce the cost of capital.

ENABLING GREATER INVESTOR PARTICIPATION IN SETTING THE REFORM AGENDA AND DEVELOPING NEW STANDARDS

Investors are already playing an increased role in the development of new accounting standards. They are keen to continue raising their profile with standard setters, regulators and other key bodies to ensure that their needs are prioritised when reforms to the financial reporting system are debated.

SHARING OPINIONS TO ENCOURAGE FURTHER PROGRESS

Investors are keen to share opinions and ideas among themselves, to encourage the wider adoption of best practice and to ensure that they maximise their influence with investee companies. They are also supportive of greater dialogue with the auditing profession to increase understanding of the challenges that each party faces.

WHAT NEXT?

The investor round-table discussions organised by ACCA and Grant Thornton provide a springboard for further debate. Investors are willing to explore new approaches to developing financial reporting reforms. They support the concept of a more integrated process that emphasises the interrelated nature of accounting, reporting, auditing and corporate governance standards and regulations. They fully endorse the prioritising of investor needs, ensuring that any proposals for reform begin first with a sound analysis and understanding of the challenges investors face and their most urgent priorities for improvement.

ACCA and Grant Thornton will explore means of facilitating further debate, and continue their efforts to bring the views and interests of investors to the forefront of that debate. Policymakers, standard setters and professional bodies alike must put investors' needs at the heart of the agenda to enhance the accountancy profession.

ACCA and Grant Thornton welcome further debate to take these issues forward.

1. Introduction

How can investors be assured that their voices are heard clearly by policymakers and regulators when the latter are proposing changes to the financial system? How can a system be created in which future proposals for improving the financial reporting framework are developed and debated in an integrated manner?

ACCA and Grant Thornton put these and other questions to investors and investor bodies in round-table discussions in the last quarter of 2011. Representatives of equity and derivatives, institutional and retail investors from Australia, China, Germany, Hong Kong, Malaysia, the Netherlands, Singapore, the UK and US shared their views on the key actions that could improve their confidence in the global financial markets.

Asking these questions now is important. Governments, regulators and other bodies continue to rake over the ashes of the financial crisis, seeking to understand how it could have been prevented. The roles of the profession, standard setters and other key players in the financial reporting system have all been subject to scrutiny and debate. Hence a plethora of public inquiries, reports from regulators and other authorities, consultation papers from government bodies and widespread media attention.

ACCA and Grant Thornton have welcomed the attention given to the profession as evidence of its importance in business life and as an opportunity for continuous improvement. The way in which issues and reform proposals have emerged could, however, be creating new problems rather than providing a clear agenda for the future.

FRAGMENTED RESPONSES

Since the financial crisis,issues have been raised and discussed in a highly fragmented manner. Consultation documents continue to be released for comment by different bodies with no clear overall coherence. Nor is the relative urgency or importance of each issue always made clear.

DISCONNECTED STANDARD SETTING

Individually, standard setters are generally doing a good job, but issues are often considered from their own particular perspective. There is little focus on the interrelatedness of issues – despite the fact that the financial audit can only relate to what is disclosed by a company, and the process of reporting itself is strengthened by strong ethical codes and good standards of corporate governance. Standards are ultimately interdependent, but this is not fully considered in their development.

FUZZY FOCUS

Forming a complete picture of the issues and determining the order in which to address them is difficult – symptomatic of a complex global financial system with many stakeholders and diverse jurisdictions relating to accounting and auditing. As a result, numerous voices offer their views, but few are in a position to drive change themselves.

THE NEED FOR STRUCTURED SHAREHOLDER ENGAGEMENT

While investors comment on current challenges, theirs is not a consistent voice, nor is it seen by all policymakers as the appropriate starting point for a debate on the value of audit and accountancy. It is certainly not seen as a reference point when prioritising issues and it does not drive an agenda for the promotion of continuous improvement in transparency.

Engagement with shareholders cannot solve all current problems, but it could deliver a number of benefits, helping with:

- developing a positive agenda for change to strengthen the reporting and assurance chain, including corporate governance
- placing investors at the heart of the accounting and auditing system, so that an understanding of their needs and priorities drives debate
- assisting policymakers and regulators in identifying issues and priorities, offering evidence and a 'route map' to aid the legal and regulatory processes
- generating an overview of all issues in relation to each other, promoting a more integrated picture of the wider financial and accounting system, and
- obtaining structured evidence to inform wider debates in business, the profession, and the political sphere.

INFORMED DEBATE

ACCA and Grant Thornton believe in the need to place investors at the heart of the accounting, reporting and governance system. The recent round-table debates held with investors and investor representatives delivered valuable insights into their concerns, priorities and needs.

The discussions were freeform, though inspired by the concepts set out above and guided by a series of related questions (see Appendix).

This report captures key issues raised. It aims not only to trigger further debate, but also to encourage a groundswell of support for a new, more integrated system for developing reforms to the financial reporting system. While the report itself does not purport to be based on a statistically significant sample, it nevertheless presents a compelling overall picture that can be used as the basis for further focused debate on future directions.

2. Investor concerns

The series of round-table discussions organised by ACCA and Grant Thornton with investors and investor representatives from around the world triggered lively debates. They uncovered substantial investor concern about the current approach to reforming the financial system in the wake of the global financial crisis.

Investors are worried about the multiple and disconnected responses being generated by different bodies. They also have some concerns about pushing for convergence on standards without due regard to quality issues. Investors also note that debates can misrepresent their needs and motivations, indicating a lack of understanding of the investor universe.

FRAGMENTED CONSULTATION FRAMEWORKS

The round tables were triggered by ACCA and Grant Thornton's concern over the fragmented manner in which issues are being raised and discussed since 2008. Consultation documents are being released by different governmental, political and regulatory bodies with no clear connection or narrative setting out a broader agenda. Investors echoed this analysis, expressing concern at the array of proposals, consultation and discussion documents in circulation around the world.

'Everybody seems to be running at the corporate reporting model from every direction', commented Liz Murrall from the Investment Management Association (IMA) and chair of the International Corporate Governance Network (ICGN) Accounting and Audit Practices Committee. 'We have national standard setters setting requirements for the front of the accounts, and international standard setters setting requirements for the back. This is resulting in a framework that is not cohesive. Everyone is running at this – we are getting numerous consultations – and it would be helpful if all this was brought together and addressed in one framework. We support a coherent framework of accounts that are harmonised internationally. But I am not sure, the way we are going about it, that we are going to achieve it.'

This is not to say that investors necessarily want to see the creation of single, global regulators. Potential benefits may arise when different bodies look at issues from different angles.

Jeff Mahoney from the Council of Institutional Investors (CII) noted: 'In some cases, having different organisations in different countries issue proposals can be beneficial to the extent there are policymakers or regulators who are focusing on investor needs and requests, and that competition between regulators could help provide better information to investors globally.'

SUPPORT FOR CONVERGENCE IN PRINCIPLE, BUT...

Many proposals are driven by the goal of achieving convergence in financial reporting around the world, particularly in relation to accounting standards. Investors are supportive of convergence – the ability to compare the performance of companies across multiple jurisdictions is a vital requirement of their capital asset allocation activity. They also believe that individual jurisdictions benefit from the adoption of the International Financial Reporting Standards (IFRS) developed by the International Accounting Standards Board (IASB).

'The whole world is seen to be converging towards a common platform', said Paul Chan, founding board member and deputy president of Malaysian Alliance of Corporate Directors (MACD). 'The reason we're doing what we are doing is because we want to be plugged into the global investing market. If we don't need the foreign investor, then we can do anything we like. But if we want to play the game, then we need to understand the common standards. So we can come up with any standard of our own, but the international investor just won't come.'

Even so, investors also emphasise the importance of high-quality financial reporting – and they do not seek convergence at any price.

Giving a US viewpoint, Jeff Mahoney (CII) explained: 'We have been very supportive of a single set of high-quality global accounting standards, but the Council membership is concerned that, unless certain criteria are put in place, if we switch from US GAAP and the FASB [Financial Accounting Standards Board] to IFRS and the IASB,such a change may reduce the quality of reported information for US investors in the short and, of more concern, the long term.'

Liz Murrall (IMA and ICGN) added: 'We support a single set of accounting standards and convergence, but there have been concerns in the past about the IASB – on occasion it may have compromised quality in the interest of convergence with the US. There is a concern as to whether IFRS is going in a direction where we no longer have prudence and whether or not the technical accounting standards are really auditable.'

ARE INVESTORS UNDERSTOOD?

Investors have noticed that some consultations appear to use simplistic analysis and do not seem to have adequate understanding of their needs and activities. For example, short-term investment is frequently considered to be a bad thing – though it is in fact essential for properly functioning markets.

Claudia Kruse from APG Investments, said: 'We feel it is important that investors communicate, not only to the market but also the regulators, about the fact that long-term investors, in order to meet regulatory requirements and their liabilities, need to have sufficient liquidity and pursue some shorter-term strategies as part of a well-balanced investment portfolio.'

The situation is complicated by the fact that investors are not a uniform body of organisations and individuals. Some are active (and hence potentially able to use their weight to influence companies), some passive. Some investors may make judgements on performance over a relatively short timeframe, whereas others could be seeking returns over a far longer period, to match their long-term liabilities.

Dr Ian Wood, head of sustainable share funds of AMP Capital, explained: ' If you are an active investor you have a timeframe over which you are generally being judged, be it three months or a year or three years' performance. Our clients could be pension funds, which are operating over a much longer period of time, because that's what their exposure is. So there are different types of investors.'

All types of investor have an important role to play in the global economy, and policymakers and standard setters should seek more effective engagement with a wide range of investors to inform the direction of future reforms.

3. A better way

Investors identified a number of ways in which approaches to improving the financial reporting system could be enhanced. In particular, standard setters and regulators need to begin any reform proposals with a clear understanding of investors' needs. Solutions should also attempt to be forward-looking – not just to try to address past or current issues. Investors also strongly believe that the markets will ultimately reward good standards of corporate governance.

CUSTOMERS' NEEDS SHOULD DRIVE REPORTING FRAMEWORK CHANGES

Investors believe strongly that their needs –as the ultimate customers of the financial reporting system – are too often overlooked or inadequately considered.

Liz Murrall (IMA and ICGN) commented: 'One of the faults there may have been with the accounting standard setters was that often it was difficult to see if what they were proposing was a noticeable improvement to the information that was reported to the capital markets, and whether or not, in setting their priorities, that had been a consideration.'

When changes are proposed to any element of the financial system, investors' needs should lie at the heart of any cost/benefit analysis. 'When we talk about accounting and auditing proposals and changes, we need to be focused on the primary customers to those products – who are investors', said Jeff Mahoney (CII). 'When discussing the benefits and costs of a change to accounting or auditing, the focus should be on the benefits and costs to the primary customer. That should be part of the basis of any discussion of change to accounting and reporting generally.'

DISCUSSIONS SHOULD BE FORWARD-LOOKING

Investors argue that attention needs to be placed not just on fixing current issues, but also on potential problem areas of the future. 'We need to stop reacting', said Kevin Scully, executive chairman and founder of NRA Capital. 'The regulatory environment is reacting to failures in the system. If we can get through the current crisis, we need to look forward to where the next problems will come from.'

Mary Morris from CalPERS commented: 'Outreach to share owners is important for gaining perspective on the customers' needs. Tapping into different users' and investors' perspectives, continuing that dialogue, is key to understanding where the next issues will pop up, and where the next financial market crisis is going to happen.'

MARKETS WILL RECOGNISE AND REWARD GOOD GOVERNANCE STANDARDS

Listed companies with high standards of governance trade at higher multiples than those that do not. Companies need to appreciate that the costs of meeting corporate governance requirements or related assurance costs should be covered by increased investor interest, lower cost of capital and higher company valuations.

David Gerald, president and CEO of Securities Investors Association (Singapore), said: 'There is a cost in shaping up corporate governance practices, but that would attract investors, and the market will price the company. The question of cost is diminished, because investors will bring their money into the company.'

Liz Murrall (IMA and ICGN) noted: 'If investors have confidence in the quality of the information that is reported, it would have an impact over time on the cost of capital and so help companies raise that capital. That would benefit everybody – companies, and investors. So it is vital the market has confidence in the information reported.'

Jimmy Vong, founder and managing director of Equities Tracker.com, agreed that enhanced disclosures would support market prices and investor loyalty: ‘The more you disclose, even when your prices tank, your investors support you because they know the reasons’, he said.

Mary Morris (CalPERS) added: ‘There are lots of different studies that show that once you have the efficiencies of the market, confidence through the building block of the auditor, the quality of the financial statements... then it is going to lower the cost of capital.’

On the other hand, investors do not want to see excessive red tape – they do not want over-regulation to impose unnecessary or disproportionate costs on companies, which may not deliver additional benefits.

‘In Singapore we see a quite significant P/E differential between companies with good corporate governance and companies without’, said Kevin Scully (NRA Capital). ‘If we go down the road of more governance, and there is a cost to governance, what is the trade-off in terms of corporate margin and finally in dividends to shareholders? It’s a fine balance. I don’t know if we are going to over-swing and over-regulate – that’s my concern.’

4. Priority areas

During the round-table discussions, investors were asked to identify areas within the financial reporting system that should be prioritised for attention – the areas that, if strengthened, could most enhance investor confidence in financial markets. There was strong interest in the development of integrated reporting to help give investors a fuller picture of corporate potential and inform their decision making. Strong corporate governance was also highlighted as a priority – particularly in jurisdictions where certain elements of good corporate governance are perhaps less well developed. Investors place particular value on internal audit, high-quality audit committee reporting and truly independent directors.

INTEGRATED REPORTING COULD CREATE A MORE COMPLETE PICTURE

Integrated reporting is seen as an important means of helping investors understand more thoroughly the companies, the risks they face and their performance potential. There is strong support for the work of the International Integrated Reporting Committee. Investors are keen for standard setters, preparers and auditors to support the rapid development of integrated reporting.

'Integrated reporting and ESG [environmental, social and governance] reporting are increasingly important', said Christian Strenger from DWS Investment, the largest European fund manager. 'Whether ESG matters should be in an integrated report and, if companies have a lot to tell, should be reflected in a separate report, needs further consideration.'

Claudia Kruse (APG) commented: 'We strongly believe that integrated reporting has to be taken forward. It's important that the standard setters participate in this effort. Embracing the integrated agenda and actively contributing their expertise to its development would be highly valuable.'

Paul Chan (MACD) noted: 'Increasingly important now is the reporting on corporate social responsibility, whereby certain investors may want to look into what a company represents...When we talk about improving the annual report, it's not just about padding it, but providing the key information.'

CORPORATE GOVERNANCE STANDARDS ARE VITAL

Investors see continuous improvement in corporate governance standards as essential for maintaining their confidence in the financial reports that companies produce, and hence the wider global financial system. They would like all companies, regardless of jurisdiction, to meet the highest standards, for example, in the separation of the roles of chairman and CEO and establishment of key committees, such as audit and remuneration committees.

Ernest Wong, executive director and CFO of China Private Equity Investment Holdings Limited, commented: 'When we look at a company, the disclosures and the corporate governance for us are important. If we don't trust the numbers, it's difficult to invest money in the company. So it's urgent to improve corporate governance.'

Tan Meng Chai, executive director of Memory Lane, noted: 'Human capital plays a very important role – in this case, corporate governance. The first thing the investor should do is check out the background of the company and who are the directors, and how does the company conduct itself. That is fundamental. Does it concentrate a lot on risk management? The risk management perspective is very important.'

Investors appreciate, however, that companies from high-growth markets that list on stock markets in jurisdictions with well-established, perhaps Western-inspired corporate governance regimes can find the adjustment difficult to make.

David Gerald (SIA Singapore) noted: 'We are grappling with cross-border cultural, legal and governance issues. We have companies coming here that have been brought up in a different culture. They find it hard because the accounting standards and governance practices are very different. Ideally we should have uniformity in corporate governance practices, but it's not going to happen for a very long time. When you talk about different world regions, they have different practices and expectations.'

KEY ASPECTS OF GOOD CORPORATE GOVERNANCE REQUIRING ATTENTION

Underneath the broad corporate governance banner, investors identify a number of specific areas of high importance.

Internal audit can act as a first defence

Internal audit has a key role to play. Internal auditors need to be independent, acting as the voice of the investor within organisations, reporting to the audit committee chairman and able to provide early warning signals of potential problems or concerns.

'Our worry is integrity of numbers', said David Gerald (SIA Singapore). 'We are clamouring for a mandatory internal audit process and that there should be an internal auditor who is independent, who could be the voice for investors within the organisation, who reports to the board and the audit chairman, not the CEO. We want early warning signals that can come from an effective internal audit process.'

Consistent, high-quality audit committee reporting

Investors believe audit committees play a key role in ensuring the effectiveness of the audit and the auditor. Nonetheless, there is much room for improvement in the quality of their reporting to investors, and a need for global best practice guidance to be shared and applied.

'We have international audit standards and international accounting standards, but we haven't got international standards for audit committees', said Liz Murrall (IMA and ICGN). 'You can't have international audit and accounting standards, and not have international standards for the entity that bridges the gap. There are certain requirements in the UK for audit committee reporting – but what they report is what they have done; they don't give any judgements or meaningful information. The quality of audit committee reporting needs to improve, not just in the UK, but [also] internationally. There is a group of global investors who are in the course of finalising disclosure standards for audit committees, and I would welcome their promulgation more widely.'

Independent directors must really be independent

'Independent directors' need to be truly independent. Investors fear some are too close to majority shareholders, rendering them impotent. ''The key area of defence is the independent directors', said Kevin Scully (NRA Capital). I have a view that the independent directors should only be voted in by minority shareholders. The independent directors here [Singapore] are elected by the majority shareholders, so there is no independence because if they don't support the major shareholders they are likely to be voted out at the next AGM.

Some investors also argue that the power of independent directors can be weakened by their dependence on internally generated information and the work of internal audit.

One of the expert commentators suggested that the debate should be taken even further. Zaki Awang Ahmad, senior manager, Finance and Services Division, PFM Capital, commented: 'The purpose of appointing independent directors is to protect investors' interests. Currently, the problem is the independent director still relies on the management to give them whatever. They are there as assurance to make sure the company is run properly, but the problem is they have internal audit to manage, to give information, feedback. But like it or not, the internal audit is paid by management, so how effective are they? To get an independent view, the internal audit could be outsourced to get more reliable information on company performance, as a check and balance for independent directors.'

Risk disclosures need beefing up

Investors want more effective disclosure of the broad risk-management policies and practices that companies apply.

Dr Ian Wood (AMP Capital) commented: 'One area of focus is more effective disclosure of risk management – not just the traditional financial instruments that are used for risk management, but broader risk management issues of where the key assets lie within the organisation, probably non-financial assets, or those not represented in typical accounts.'

Proportionality is debateable

In some investors' opinions, large listed companies should be expected to meet higher standards of corporate governance than smaller listed and small private companies.

Stephen Wong, MD and member of the Fixed Income Management Committee (Asia Pacific) at RBS, said: 'The price of regulatory compliance should probably be proportional to the size of the listed company. If the company is big, it can afford it. If the company is small, it's harder to afford and also investors can probably exert more informal influence and control anyway. So to balance the cost and benefit, it makes sense to be a bit more stringent on the bigger companies.'

In fact, distinctions are sometimes made between the accounting and the regulation applied to different types of company.

Jeff Mahoney (CII) said: 'In my personal view, when it comes to accounting, an asset is an asset and a liability is a liability, and the recognition and measurement of those items should be the same whether the company is public or private. With respect to regulation, in the US there are some great advantages to being a public company and with that comes some responsibilities. So we have a lot of rules and regulations that are applied only to public companies for the protection of investors, and I think that is appropriate.'

Some investors believe there should be one regime for all companies. 'I know there is a movement among some standard setters to try to separate private entities from the public entities in standard setting', said Mary Morris (CalPERS). 'From our perspective – and we hold different types of investment – we believe the standard setters need to be consistent. Many private entities grow up to become public entities. So we don't believe that it [a different regime] is helpful to us.'

Bank regulation needs tightening

Investors want clarity on the regulatory standards to be applied to banks, and tighter regulation of investment banks in particular. Investors are concerned about systemic risk flowing through the global market.

Bill Liu, COO of UBS SDIC Funds Management Company, noted: 'The most important thing is regulation. Everybody knows that this financial crisis is not only about a company or bank – it's a failure of the system. So we should put regulation as a priority. Regulation for banks, governance...The government, the regulator, central bank should do more to avoid system failure.'

5. The role of the auditor

Investors place value on the work of external auditors and believe there is potential for the scope of audit and reporting to be extended and enhanced.

SCOPE OF AUDIT AND REPORTING COULD BE EXPANDED

Investors can be frustrated by the scope of the work that auditors are engaged to do, and hence the nature of the reports they produce. They are interested in exploring how the content of auditors' reports could be enhanced and expanded.

Dr Ian Wood (AMP Capital) commented: 'One of the challenges for auditors is that they get asked to say whether this [information in the annual report] is a fair and reasonable depiction of the company at a particular point. They might say yes, what's depicted is reasonable. The problem is, that doesn't mean it's right from an investor's perspective. The auditors can say what the company is hedging, but they are not in a position to say whether it's a good approach to hedging. That's the challenge.'

Nigel Khoo, CEO, Mayban Ventures, noted: 'If you look at the audit report, just go right to the very bottom paragraph and it's the same as what all the others say. I'd rather have a more quality audit report which tells me what auditors really think.'

Jimmy Vong (Equities Tracker.com) asked: 'Can the format of the auditor's report be a bit more proactive? Can auditors comment on the quality of accounting, quality of accounting standards in the company, compliance with procedures? Would it expand the scope of audit considerably? Because in the process of doing the audit, auditors can probably observe these things. But there's no comment currently.'

GREATER TRANSPARENCY NEEDED FOR VALUATIONS

There are concerns about understanding the valuations used when companies mark to market – investors seek clarity on the methodology applied. Similar assets can have very different valuations in different company accounts.

Stephen Wong (RBS) commented: 'The methodology of how they come up with the derivatives' mark to market – that is something I haven't seen great clarity on... If we look at the current market, investors are not confident about the banking system. Part of the reason is that it's hard to get hold of the exact valuation of some assets. People seem to be able to value the same assets at a very different price. That gives investors a lot of uncertainty about what's going on in terms of their banking book.'

It was noted that during the global financial crisis, equity markets didn't have sufficient transparency, for example, over the derivatives banks were using. Better regulation of such disclosures would be helpful. Greater transparency would help investors understand potential exposures better.

Dr Ian Wood (AMP Capital) noted: 'In the global financial crisis, the debt markets were seeing something the equity markets weren't seeing – and the debt markets were right. That had a lot to do with the fact that a lot of the derivatives and other aspects the banks were using, the equity market didn't really have a good see through. Better disclosure of those aspects which equity markets don't see very well is key.'

6. The role of investors

During the discussions investors expressed no doubts that they themselves need to take some responsibility for improving the financial reporting system. They are increasingly playing a role in the standard-setting process, and see this as an important activity. They also appreciate that they wield considerable power in terms of allocating their investment funds – power and influence that could be used to encourage high standards of reporting and corporate governance among listed companies. Investors are also keen to share best practice among themselves internationally, and to talk with other interested parties about the ideas of other groups, including the audit profession.

PARTICIPATING IN STANDARD SETTING

Investors appreciate that they need to play a proactive role to try to ensure that standard setters meet their needs. As Tan Meng Chai (Memory Lane) said: 'If investors are very fragmented, then we remain at the mercy of standard setters'.

Investors are willing to participate in the advisory groups that have been set up and pleased that these are becoming more widespread. For example, investor advisory groups have been set up in the US by the FASB, the Public Company Accounting Oversight Board and the Securities and Exchange Commission. And the FRC in the UK has introduced a Financial Reporting Lab, aiming to bring investors and companies together to address issues in corporate reporting.

Jeff Mahoney (CII): 'In my opinion, these groups have had and will continue to play a critical role in more effective communication of investors' views to accounting and audit standard setters and regulators in the US. They also serve as a pool of potential candidates for board positions on those policymaking bodies...For the first time in US history, FASB now has two individuals on the standard-setting board from the investor community.'

In Europe too, investors are participating in advisory committees.

Claudia Kruse (APG Investments) commented: 'I have been part of the EC advisory group on ESG disclosure on behalf of the ICGN, which I thought incredibly valuable, both from the EC perspective because they were able to bounce their ideas off a body of diverse stakeholders and also for investors, who could feed their views into it. Broad-based high-level mechanisms like this can be of great value.'

INVESTING WISELY

Investors appreciate the need to emphasise to all companies, but particularly those from emerging economies, the importance of achieving high standards of corporate governance. They can do so positively, encouraging high standards by talking to companies about their expectations and needs and by supporting award programmes that recognise and celebrate best practice achievements. On the other hand, investors wield a powerful stick – their ultimate sanction is to withhold investment from companies when they believe that those companies' standards of corporate governance are inadequate.

Mary Morris (CalPERS) said: 'We have corporate engagement. We take many of our policies and try to find the practical balance. When we talk to directors, CFOs and CEOs in companies where we see there are some issues, we try to provide that practical perspective, but also learn from the directors as well. That interaction is key.'

Ernest Wong (China Private Equity Investment Holdings) commented: 'If a company has bad corporate governance or reporting or the assurance is not good, we don't put money in. We walk from the deal. It's a more direct way than persuading the company to do better on corporate governance or do more assurance on the reporting.'

'At the end of the day, investors have a choice', said Kevin Scully (NRA Capital). 'They need to exercise that choice. They are already doing that in terms of the valuations they accord companies for better or less good governance.'

SHARING BEST PRACTICE

Investors are keen to share ideas, knowledge and concerns through international and regional bodies such as the ICGN and Asian Corporate Governance Association, and national organisations and groups such as the CII (US), the Corporate Reporting Users Forum (UK) and Company Reporting and Auditing Group (UK).

Dr Ian Wood (AMP Capital) noted: ‘The ICGN conference is a good avenue for getting a collective view on corporate governance, at least from a US, European and Australian perspective. That’s the best place you start to see a convergence of what good corporate governance is. Then it’s up to investor groups to go back to their various regulators and tell them that these are what they see as good standards of corporate governance.’

OPEN TO DEBATE

Investors have expressed enthusiasm for the ACCA and Grant Thornton round-table discussions. They also value Global Auditor Investor Dialogue, and are willing to hear proposals from auditors on ideas for improving the financial system or responding to regulators.

Christian Strenger (DWS) said: ‘In terms of capturing our views, it is important that you, as professionals, tell us what needs support, what is of importance to you. If that matches with our views, then we can make a targeted approach to the regulators.’

WOULD INVESTORS PAY FOR MORE ASSURANCE?

Investors do value assurance, and some believe that additional assurance would be worth additional cost.

When asked his view of whether investors would pay for more assurance, Bill Liu (UBS SDIC Funds Management Company) was extremely positive. ‘Yes, investors would pay for more assurance, because it’s very important’, he said.

Nonetheless, ‘more’ is not always better. Some investors are sceptical about the value of quarterly reporting, for example. In contrast, better assurance through enforcement of the ‘comply or explain’ approach could be beneficial. ‘I don’t think there is a lot of value in quarterly reporting’, said Dr Ian Wood (AMP Capital). ‘The risk there is that the company has a too-short-term focus. But if assurance is through better corporate governance, then we have found that the ‘comply or explain’ approach works well. If you don’t want to comply with the corporate governance standards that have been set, you should explain why you don’t think you should. Then investors can make up their minds whether that’s a good enough excuse.’

7. Conclusion: what next?

The comments and suggestions emerging from the ACCA and Grant Thornton investor roundtables show the range of opinions on priorities and needs. Participants agreed, however, that this type of discussion was highly valuable for sharing views across geographies and between different types of investor and the auditing and accounting profession.

Looking ahead, ACCA and Grant Thornton believe there is a case for further examination of how a more integrated response to the financial crisis and the issues raised could be created. The points raised in the discussions certainly present a number of provocative questions and potential solutions that deserve further examination, by policymakers and influencers alike.

Important questions remain. How could standard setters in different disciplines be enabled to develop a more coordinated agenda? How could they be encouraged to consider the interrelated nature of the separate proposals they develop? Do we need a global corporate governance code, to strengthen and harmonise governance standards? A key theme emerging from the discusison. What more can be done to ensure that the voices of the prime users of financial statements – the investors –are heard clearly by standard setters, regulators and government bodies in the future?

Adjustments to the current financial reporting framework are needed – and will be made. If they are to be relevant and to create value, then greater and more coordinated thought needs to be given to the needs of investors around the world and the reforms that would do most to increase their confidence in global financial markets.

ACCA and Grant Thornton will facilitate further debate and means to bring the views and interests of investors to the forefront of that debate.

Together, we will create further opportunities for the views of investors to be heard, globally, and their opinions and requirements fed into the reform process. The two organisations welcome further debate, and encourage greater engagement with the investor community. Policymakers, standard setters and professional bodies alike must put investors' needs at the heart of the agenda to enhance the accountancy profession.

Appendix

A series of questions were posed to participants prior to the round-table discussions, to help stimulate ideas and debate. These then provided a framework for the discussions, though not every question was directly considered. The questions were as follows.

FRAGMENTED RESPONSE TO THE FINANCIAL CRISIS

How could policymakers, regulators and other bodies coordinate their responses more effectively?

What challenges does the disconnected standard-setting process across the entire reporting and assurance chain create for investors?

Who should play the key role in determining what needs to change in order to improve the global financial system?

What common characteristic links these current trends? Is it that the voice of investors is not being clearly heard?

YOUR PRIORITIES

Which of the current initiatives or proposals for change and reform affecting the current reporting and assurance chain do you think is most significant in terms of its potential impact, whether positive or negative?

What individual part of the corporate reporting landscape (accounting standards, auditing, reporting, corporate governance or regulation) would you focus on first in order to improve your confidence in financial markets?

Why do you think this is a priority?

What specific change would you like to see?

How would this change enhance the information you receive and/or your confidence n financial markets?

YOUR NEEDS

On what source of information do you place most reliance when making investment decisions?

What relative value do you currently place on real-time information compared with more formalised reporting?

What information source do you think will be most important to you in five years' time, if current trends continue?

If you value greater assurance, what price are you prepared to pay for that assurance?

To what extent are different regimes required for public interest entities (such as publicly listed companies) and privately owned businesses?

Would you be concerned by a real or perceived move towards greater nationalisation of standards and away from a more global approach? If so, why?

YOUR VOICE

What informal influence or persuasive power do investors currently exert to try to shape the direction of governance, assurance and reporting reforms?

What impact would you like the investor community to have on future reviews of standards and regulations affecting the reporting and assurance chain?

How can we capture investors' priorities, needs and concerns in future to ensure they are reflected in the way that regulators, policymakers and standard setters priorities their actions?

How can investors reach a consensus among themselves about core needs and priorities, in order to speak to business and policymakers with a clear voice?

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ACCA 29 Lincoln's Inn Fields London WC2A 3EE United Kingdom / +44 (0)20 7059 5000 / www.accaglobal.com