

The Corporate Report

**A discussion paper
published for comment by
the Accounting Standards Steering Committee**

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This is a discussion paper issued for comment on behalf of the

**Accounting Standards Steering Committee of
The Institute of Chartered Accountants in England and Wales**
in association with

The Institute of Chartered Accountants of Scotland

The Institute of Chartered Accountants in Ireland

The Association of Certified Accountants and

The Institute of Cost and Management Accountants

and

The Chartered Institute of Public Finance and Accountancy

and does not necessarily represent the views of the Committee or of the
Councils of these bodies

Comments on the discussion paper are invited and should be
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All replies will be regarded as on public record unless confidentiality is
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The Corporate Report

A Discussion Paper

To the Accounting Standards Steering Committee

We began work in October 1974 with the following terms of reference:
‘The purpose of this study is to re-examine the scope and aims of published financial reports in the light of modern needs and conditions.

It will be concerned with the public accountability of economic entities of all kinds, but especially business enterprises.

It will seek to establish a set of working concepts as a basis for financial reporting. Its aims will be to identify the persons or groups for whom published financial reports should be prepared, and the information appropriate to their interests.

It will consider the most suitable means of measuring and reporting the economic position, performance and prospects of undertakings for the purposes and persons identified above. The conclusions of this study should be presented in summary or blueprint form not later than June 1975.’

We have agreed to the report which follows and which takes the form of a discussion paper.

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July 1975

Acknowledgements

We wish to acknowledge the assistance of Professor Edward Stamp and Ken Peasnell of the International Centre for Research in Accounting and of Michael Renshall and Leon Hopkins, of the Institute of Chartered Accountants in England and Wales, in researching and writing this discussion paper.

We also wish to thank all those numerous organisations and individuals who contributed evidence, ideas and views which helped to develop the paper. Their names are recorded in appendix 7 but the views expressed in this paper are our own and are not necessarily shared by the organisations and individuals who gave us the benefit of their views.

The Corporate Report

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Foreword

The Discussion Paper which follows is intended to be the starting point of a major review of the users, purposes and methods of modern financial reporting. It is a first step, not the last word.

When in 1970 the Accounting Standards Steering Committee embarked on the task of narrowing the areas of difference and variety in accounting practices and establishing objective standards of financial reporting, it was plain that a major review of the fundamental purpose of financial reports and of users' needs was necessary. But equally problems of the moment had to be tackled, and ASSC directed its first efforts into a programme of establishing and advancing standards on the basis of an existing situation. That programme is now coming to fruition, and it is time to lay the groundwork for new developments.

"The Corporate Report" was prepared by a working party whose eleven members were drawn from the six major UK and Irish accountancy bodies and included five from industry, three from public practice and one each from the financial, local government and academic fields. The Report is published without alteration by ASSC. It does not purport to suggest solutions to all the major questions facing the accounting profession: a task which would have been impossible in the time available. Its purpose is to promote discussion by indicating possible directions for future development. I emphasise that the Report does not necessarily represent the views of the ASSC nor of any individual accounting body.

By chance, its appearance closely coincides with the publication of the Sandilands Report on inflation accounting. "The Corporate Report" takes a wider view of the whole area of financial reporting, but necessarily touches on the fundamental problem of measurement of profit which is the concern of the Sandilands Report. It should be stressed that "The Corporate Report" was prepared without benefit of any knowledge of the contents of the Sandilands Report. Taken together, the two reports will, I believe, contribute greatly to the accountancy profession's approach to the problem of asset valuation and profit measurement.

I believe "The Corporate Report" will be of interest to all those concerned with the published financial reports of significant enterprises particularly those in senior management on whom ultimate responsibility in these matters rests. ASSC invites discussion, comment and above all testing of the ideas it contains.

Ronald Leach, *Chairman*,
Accounting Standards
Steering Committee, July 1975

Introduction to and plan of this paper

The subject of our discussion paper

0.1 Our subject is, in essence, the fundamental aims of published financial reports and the means by which these aims can be achieved.

0.2 The form of report with which we are dealing we have termed the 'corporate report', by which we mean the comprehensive package of information of all kinds which most completely describes an organisation's economic activity. It will include more than basic financial statements, by which we mean those statements required to be published by law or other competent authority and which are primarily concerned with reporting financial transactions and positions. Examples of basic financial statements include the balance sheet, profit and loss account, and funds statement; they are typically subject to audit. In addition to such statements, the corporate report will contain narrative and descriptive statements and often, illustrative material. Examples of such additional statements include the Chairman's statement and the 'results at a glance'.

0.3 Our discussion centres round three main elements; the types of organisation which should be expected to publish regular financial information; the main users of such information and their needs; and the form of report which will best meet those needs. Our view is that all types of organisation of significant economic size whether in the public or private sectors, whether commercially orientated or not, and however constituted in law, should be expected to publish regular financial reports as a matter of good practice, if not of law. The users with whom we are concerned are not those possessing special authority (managerial, proprietorial or statutory) to demand particular information at discretion whenever they require it, but that larger class of general users to whom a responsibility to report is owed and who are not in a privileged position to enforce special demands.

Our approach

0.4 In recent years there have been numerous studies of different aspects of our subject and it was obvious we were unlikely to produce anything wholly original. Nevertheless, we found that not all aspects of the subject had been covered comprehensively. For instance, little has been said about who should report to whom, why and how often. We have tried to remedy this omission.

0.5 Our approach differs from previous studies in several other respects. We have taken the view that financial reporting must cover a wider range of information than a narrow conventional interpretation of the term 'financial' would allow. We have endeavoured to propose the form and content of a package of information which will convey a rounded picture of economic activities rather than simply a view of financial position and transactions. Again, we have tried to combine generalised conceptual statements with suggestions of how the principles we adduce can be implemented in practice.

0.6 Another major difference from previous studies is that, although we have given special attention to reporting by companies as the prevailing form of enterprise in the private sector of the British economy, we have broadened our study so as to be capable of application in principle to all classes of economic entity, whether in the private or public sector, whether profit seeking or non-profit seeking. However, while much of this discussion document is applicable to the public sector and to non-profit organisations we have not attempted to study reporting in these sectors in detail.

0.7 Nor have we attempted to write an accounting manual, or to deal in detail with the numerous items of information which corporate reports should or could contain. Broadly, we have accepted as our starting point existing reporting standards and have not, for example, attempted to develop a check list of items we consider should be disclosed in income and expenditure or financial position statements. Instead we have tried to indicate the concepts which we believe should underlie the corporate report, and then, in practical terms, the broad framework round which the report should be built.

0.8 In this paper we have tried to suggest improved ways of describing, presenting and reporting the operations of economic entities. But we recognise that there is no final answer to the problem of effectively communicating economic information. Needs and expectations change over time and each new generation seeks its own answers. We hope this paper makes a contribution to the development of useful responses to the demands of our time.

General plan of this discussion paper

0.9 The general plan of our work is as follows. It is divided into three parts. Part one, containing sections one to four, is concerned with discussing and identifying the underlying concepts and aims of corporate reports. In section one we state our basic philosophy in

approaching this study. As this is related to the satisfaction of user needs we go on in section two to consider who those users are and what are their likely information needs. In section three we state our conclusions as to the fundamental objective and desirable characteristics of corporate reports. Section four is devoted to a review of the present state of corporate reporting in the context of existing and probable future legal and social requirements.

0.10 Part two of the paper, containing sections five, six and seven, is concerned with the manner in which these concepts and aims can, in practical terms, be achieved. Section five discusses means of communication, publication and distribution. The remaining sections six and seven put forward our proposals as to the way in which corporate reports can, in the immediate future, begin to meet the information needs identified earlier.

0.11 Part three, containing section eight, summarises our discussion paper.

Part I
Concepts and aims

Section one

Our basic philosophy

Who should report what to whom

1.1 Our basic approach has been that corporate reports should seek to satisfy, as far as possible, the information needs of users: they should be useful. To identify user needs and thereby arrive at the fundamental objective of corporate reports it is first necessary to determine who should publish corporate reports and why.

1.2 In our view there is an implicit responsibility to report publicly (whether or not required by law or regulation) incumbent on every economic entity whose size or format renders it significant. By economic entity we mean every sort of organisation in modern society, whether a department of central government, a local authority, a co-operative society, an unincorporated firm, a limited company, or a non-profit seeking organisation, such as a trade or professional association, a trade union or a charity. By significant we mean that the organisation commands human or material resources on such a scale that the results of its activities have significant economic implications for the community as a whole. We suggest tests of such significance in appendix I.

Public accountability

1.3 We consider the responsibility to report publicly (referred to later as public accountability) is separate from and broader than the legal obligation to report and arises from the custodial role played in the community by economic entities. Just as directors of limited companies are recognised as having a stewardship relationship with shareholders who have invested their funds, so many other relationships exist both of a financial and non-financial nature. For example, economic entities compete for resources of manpower, management and organisational skills, materials and energy, and they utilise community owned assets and facilities. They have a responsibility for the present and future livelihoods of employees, and because of the interdependence of all social groups, they are involved in the maintenance of standards of life and the creation of wealth for and on behalf of the community.

1.4 The reporting responsibility we identify is an all-purpose one, intended for the general information of all users outside those charged with the control and management of the organisation. In short, we are

concerned with general purpose reports designed for general purpose use. Some users may have interrogatory powers and the right to require specialised information. Their needs will not be met by general purpose corporate reports but by special purpose reports not necessarily intended for publication.

1.5 In this context public accountability does not imply more than the responsibility to provide general purpose information. Whether or not subsequent questioning or action results will depend on the circumstances and reactions of users. User groups are able to exert pressure if they so desire either by direct action (as in the case of shareholders who are able to vote at general meetings) or indirect action through the market place (as in the case of consumers in purchase decisions). Information is valuable to the extent that it enables users to judge whether or not it is appropriate to exert such pressure.

1.6 Corporate reports are the primary means by which the management of an entity is able to fulfil its reporting responsibility by demonstrating how resources with which it has been entrusted have been used. We consider it desirable for the following types of economic entity, provided they are of such a size or format as to be significant (see appendix I), to publish corporate reports:

- (a) Limited companies, whether listed or unlisted.
- (b) Nationalised industries and other commercially orientated public sector bodies.
- (c) Partnerships and other forms of unincorporated business enterprises.
- (d) Non-commercially orientated central government departments and agencies.
- (e) Local authorities.
- (f) Trade unions and trade and profession associations.
- (g) Pension schemes, charitable and other trusts and non-profit seeking organisations.

1.7 We have not attempted to consider in detail how non-commercial public sector entities might fulfil their responsibilities to report. So far as local authorities are concerned the Chartered Institute of Public Finance and Accountancy is working on recommendations which it will be discussing with the Accounting Standards Steering Committee before issue. We believe this work to be an important step and recommend, in the spirit of the accord between the two bodies, that the opportunity is taken to discuss the wider aspects of reporting for the public sector as a whole.

Users of corporate reports

1.8 Users of corporate reports we define as those having a reasonable right to information concerning the reporting entity. We consider such rights arise from the public accountability of the entity whether or not supported by legally enforceable powers to demand information. A reasonable right to information exists where the activities of an organisation impinge or may impinge on the interest of a user group; and where the provision of such information is not in conflict with the constraints discussed in section three.

1.9 The groups we identify as having a reasonable right to information and whose information needs should be recognised by corporate reports are :—

- (a) **The equity investor group** including existing and potential shareholders and holders of convertible securities, options or warrants.
- (b) **The loan creditor group** including existing and potential holders of debentures and loan stock, and providers of short term secured and unsecured loans and finance
- (c) **The employee group** including existing, potential and past employees.
- (d) **The analyst-adviser group** including financial analysts and journalists, economists, statisticians, researchers, trade unions, stockbrokers and other providers of advisory services such as credit rating agencies.
- (e) **The business contact group** including customers, trade creditors and suppliers and in a different sense competitors, business rivals, and those interested in mergers, amalgamations and takeovers.
- (f) **The government** including tax authorities, departments and agencies concerned with the supervision of commerce and industry, and local authorities.
- (g) **The public** including taxpayers, ratepayers, consumers and other community and special interest groups such as political parties, consumer and environmental protection societies and regional pressure groups.

The rights and information needs of these groups are considered in more detail in section two.

1.10 There are practical constraints and limitations on the type and quantity of information which can reasonably be expected to be included in general purpose reports. These constraints and limitations are dealt with in section three.

1.11 We have endeavoured to propose in later sections a form of report which will contribute more than at present to user information needs and which we believe to be a practical step forward at the present time and in the context of the size of reporting entity we have defined as being significant. Since management has final responsibility for the production and publication of the corporate report it is essential it exercises judgment in preserving a balance between the needs and interests of user groups. This will be especially so where the needs of one user group would appear to be in conflict with the interests of the majority of users, (for instance, where confidential information is involved).

Summary of section one

1.12 Our basic approach has been that corporate reports should seek to satisfy, as far as possible, the information needs of users. We believe there is an implicit responsibility to report incumbent on every economic entity whose size or format renders it significant. This responsibility arises from the custodial role played in the community by economic entities. Although we believe this principle of public accountability to be applicable to every type of entity we have not attempted to consider in detail non-commercial public sector reporting. We recommend further study in this area.

1.13 We define users as those having a reasonable right to information concerning the reporting entity arising from the public accountability of the entity. We have assembled a list of user groups which we identify as the equity investor group, the loan creditor group, the employee group, the analyst-adviser group, the business contact group, the government and the public. Although corporate reports should seek to satisfy as far as possible the information of these user groups it is impractical to suggest all needs of all users could be entirely met by such general-purpose reports.

Section two

Users and their information needs

User groups reviewed

2.1 In this section we review the bases of users' rights to information and those information needs which are capable of being met by corporate reports. By rights we do not mean legally enforceable powers, but rights arising from the public accountability of entities.

The equity investor group

2.2 The rights of the equity investor group to information arise from the direct financial relationship or potential relationship between the group and the reporting entity.

2.3 Investors require information to assist in reaching share trading decisions, in deciding whether or not to subscribe to new issues and in reaching voting decisions at general meetings (if members at the time). The decision-making process generally involves making comparisons with earlier years and with other companies.

2.4 In particular investors will wish to make judgements concerning likely movements in share prices, likely levels of future dividend payments and management efficiency. In each case information concerning present position, future prospects and management performance will be relevant.

2.5 In the past, share prices have been valued mainly on earnings and dividend criteria and the profit and loss account has been the section of the corporate report which has been of most interest to investors. But the past record is only of interest as a guide to the future; it is the likely future movements of earnings and dividends that are of prime importance. Thus investors are always interested in information concerning future prospects. More weight is placed on such statements where a company has a history of having made successful forecasts in the past.

2.6 The rapid rise in inflation in recent years, and the attendant shortage of corporate liquidity has led investors to seek information about the internal cash generating processes of companies. There has been increasing interest in information derived from financial position statements (e.g. balance sheets) and flow of funds statements.

2.7 Although investors must be assumed to base their share trading and voting decisions largely on their desire to maximise their total return from their investments, other factors such as the social impact of the activities of the enterprise are clearly also considered. Information about such activities is therefore of interest.

2.8 Corporate reports may be able to contribute to meeting the needs of the equity investor group in:

- (a) Evaluating the performance of the entity.
- (b) Assessing the effectiveness of the entity in achieving objectives established previously by its management, its members or owners. This includes compliance with stewardship obligations.
- (c) Evaluating managerial performance, efficiency and objectives, including investment and profit distribution plans.
- (d) Ascertaining the experience and background of company directors and officials including details of other directorships or official positions held.
- (e) Assessing the economic stability and vulnerability of the reporting entity.
- (f) Assessing the liquidity of the entity, its present or future requirements for additional fixed or working capital, and its ability to raise long and short term finance.
- (g) Assessing the capacity of the entity to make future reallocations of its resources for economic purposes.
- (h) Estimating the future prospects of the entity, including its capacity to pay dividends, and predicting future levels of investment.
- (i) Making economic comparisons, either for the given entity over a period of time or with other entities.
- (j) Estimating the value of users' own or other users' present or prospective interests in or claims on the entity.
- (k) Ascertaining the ownership and control of the entity.

The loan creditor group

2.9 The rights of the loan creditor group to information arise from the direct financial relationship or potential relationship between the group and the borrower to whom funds are entrusted.

2.10 The information needs of loan creditors are similar in many respects to the needs of equity investors. If their securities are listed on a stock exchange they will have to make trading decisions while if a secured loan becomes enforceable a decision as to the efficiency of existing management may be necessary. In addition, holders of long

term debt securities will wish to compare current prices with likely future payments of interest and repayments of capital.

2.11 Holders of long term debt securities will wish to assess the economic stability and vulnerability of the borrower. But unlike equity investors (unless the security is convertible) they are primarily concerned with the risk and consequences of default. If restrictive covenants in articles of association or debenture deeds commit an enterprise to maintain working capital and liquidity within certain limits, loan creditors may look to the financial statements to confirm that these restrictions have been observed.

2.12 Short term loan creditors are likely to be interested in estimating enterprise cash and near cash assets, net cash flow in the immediate future, the realisable value of assets and the priority of various claims. They will wish to estimate the risk and consequences of default and the probable timing of repayments.

2.13 Lenders and creditors of all kinds have an interest in knowing whether dividends have been distributed solely from income.

2.14 Some loan creditors, for example banks, are often well placed to obtain special purpose reports from management. Corporate reports may be able to contribute to meeting the general information needs of loan creditors which are similar to those already identified for equity investors and in:

- (a) Estimating the future prospects of the entity, including its capacity to make cash payments;
- (b) Assessing the position and prospects of individual companies within a group.

The employee group

2.15 The rights of the employee group to information arise from their personal ties with the employer. The reporting entity has a responsibility for the future livelihood and prospects of its employees and possibly its past employees (insofar as the entity is a source of part or all of the past employees' present or future pensions).

2.16 Employees and prospective employees require information in assessing the security and prospects of employment and information for the purpose of collective bargaining.

2.17 The matters which are likely to be of interest to past, present and prospective employees include the ability of the employer to meet

wage demands, management's intentions regarding employment levels, locations, and working conditions, the pay, conditions and terms of employment of various groups of employees and the contributions made by employees in different divisions. In addition, employees are likely to be interested in indications of the position, progress and prospects of the employing enterprise as a whole and about individual establishments and bargaining units.

2.18 General purpose corporate reports cannot fully meet all the needs of this group and it is likely that employees will more suitably obtain the information they need by means of special purpose reports at plant or site level. However, corporate reports may be able to contribute to meeting the information needs of employees which are similar to those already identified for investors and loan creditors and in:

- (a) Evaluating managerial performance, efficiency and objectives, including employment plans;
- (b) Estimating the future prospects of the entity, including its capacity to pay remuneration and predicting future levels of employment.
- (c) Assessing the position and prospects of individual establishments within a group.

2.19 Employees may also look to the corporate report to confirm the reliability of the basis of information provided previously in the form of special purpose reports.

The analyst-adviser group

2.20 The rights of the analyst-adviser group to information arise from their concern with promoting the interest of those involved or potentially involved in a direct relationship with the reporting entity. Analysts and advisers can be regarded as acting in an agency capacity for other users.

2.21 The information needs of the analyst-adviser group are likely to be similar to the needs of the users who are being advised. For example, the information needs of stockbrokers are likely to be similar to the needs of investors and those of trade unions are likely to be similar to the needs of employees. The existence of an adviser group fulfilling an interpretive function will lead to a demand for more elaborate information than otherwise would be the case.

The business contact group

2.22 The rights of the business contact group to information arise from their existing or potential direct relationship with the reporting entity. For example, suppliers, trade creditors and customers are all likely to place trust in the reporting entity to fulfil an implied or explicit responsibility. Users in a different class are competitors who (like those interested in merging or amalgamating) promote the interests of other user groups by acting as a spur to efficiency.

2.23 Regular suppliers need information not only about the ability of their customer to pay for goods and services supplied, but also about the longer term viability of the customer. The supplier may have to decide whether to gear up production and possibly to increase capacity to meet demand for several years. Information concerning financial stability and prospects, profit margins and market conditions may be useful in this respect.

2.24 Trade creditors need information about the ability of their customers to pay outstanding amounts and about the level of risk and consequences of default.

2.25 Customers need information concerning the current and future supply of goods and services offered, price and other product details and conditions of sale. Much of this information can be obtained from sales literature or from enterprise employees and officials or trade and consumer journals. Customers may require information about the enterprise itself especially when reliability as a continuing source of supply or ability to execute long term contracts is important or where payments in advance of delivery are made.

2.26 Information about plant capacity changes, stoppages for whatever reason, and order book position is helpful in determining reliability as a source of supply. Information concerning financial position, cash flows and profitability may help customers to decide on an enterprise's ability to meet demand for products and services, whether prices and fees are justified and if financial resources are likely to be sufficient to meet warranty obligations.

2.27 Competitors and business rivals seek information both as potential investors (or take-over bidders) and to promote their own efficiency by making economic comparisons. Much of the information that is sought will be common knowledge in the industries concerned or will be available from specialist sources. Although we believe competitors and business rivals must be considered as users having

rights to information we also recognise that there are serious constraints on providing much of the information required by this group. On balance we consider the information needs of competitors and business rivals can only be met insofar as they coincide with those of other user groups.

2.28 Competitors and business rivals are likely to be interested in all aspects of enterprise affairs, including information about its resources, the profitability of operations, pricing and marketing policies, product methods, research and development, and investment plans.

2.29 Those interested in mergers and amalgamations have the same information needs as investors plus an additional need for information about the likely outcome of possible courses of action open to management. In addition to information concerning financial position and prospects, this group may be interested in information concerning the possible alternative uses of resources.

2.30 The management, shareholders and employees of those firms which are the subject of take-over offers also have similar needs to investors in that they need to assess the past performance, present position and future prospects of the bidder. They may additionally need to know the management style and philosophy of the bidder and the alternative uses, if any, to which the bidder is likely to put resources. Sources of such information include corporate reports and specially prepared offer documents.

2.31 Corporate reports may be able to contribute to meeting the information needs of the business contact group which are similar to those already identified for other user groups and in:

- (a) Estimating the future prospects of the entity including predicting future levels of production.
- (b) Assessing the performance, position and prospects of individual establishments and companies within a group.
- (c) Ascertaining the nature of the entity's business and products.

The government

2.32 Central and local government departments and agencies have rights to information as representatives of the public and other user groups. Insofar as government sometimes has direct trade or credit relationships with entities it can also be considered to form part of the loan creditor and business contact group.

2.33 Government needs information to estimate the effects of existing and proposed levies and other financial and economic measures, to estimate economic trends including likely balance of payments figures, to promote economic efficiency, and as a potential or existing customer or finance creditor.

2.34 Many of these information needs are similar to those of investors, creditors, customers, employees and suppliers and are concerned with information about position, performance and prospects. However, where needs are not met government may require special returns and reports and this power is used to obtain information for tax collection, statistical survey and other purposes. Meeting many of these needs will involve complex analysis. For example the compilation and analysis of balance of payments data, particularly that related to individual entities, will involve consideration of the benefits and costs of import substitution.

2.35 Corporate reports may be able to contribute to meeting the information needs of government which are similar to those already identified for other user groups and in:

- (a) Assessing the effectiveness of the entity in achieving objectives established previously by society.
- (b) Assessing the capacity of the entity to make future reallocations of its resources for social purposes.
- (c) Evaluating the economic function and performance of the entity in relation to society and the national interest, and the social costs and benefits attributable to the entity.
- (d) Attesting to (particularly where independently verified) compliance with taxation regulations, company law, contractual and other legal obligations and requirements.

The public

2.36 The public's right to information arises not from a direct financial or human relationship with the reporting entity but from the general role played in our society by economic entities. Such organisations, which exist with the general consent of the community, are afforded special legal and operational privileges, they compete for resources of manpower, materials and energy and they make use of community owned assets such as roads and harbours.

2.37 Members of the community may wish to know about the role of economic entities as employers, the cash flows, profitability and efficiency of enterprises, contributions to political organisations,

pressure groups and charities, their impact on the balance of trade, transactions with home and overseas governments, compliance with law and voluntary actions and expenditure affecting society or the environment.

2.38 Corporate reports cannot satisfy all the imaginable information needs of the public. The limitations of even the most elaborate reports must be acknowledged. They can never describe the total quality of economic activity they portray, nor become the sole source of all the information needs noted above although they could contain more information of use to this user group if generally acceptable measurement techniques were developed.

2.39 At the present time corporate reports may be able to contribute to the information needs of the public which are similar to those already identified for other user groups.

Summary of section two

2.40 Having reviewed the rights and needs of user groups we conclude that corporate reports may be able to contribute to user information needs in:

- (a) Evaluating the performance of the entity.
- (b) Assessing the effectiveness of the entity in achieving objectives established previously by its management, its members or owners or by society. This includes but is by no means limited to, compliance with stewardship obligations.
- (c) Evaluating managerial performance, efficiency and objectives, including employment, investment and profit distribution plans.
- (d) Ascertaining the experience and background of company directors and officials including details of other directorships or official positions.
- (e) Assessing the economic stability and vulnerability of the reporting entity.
- (f) Assessing the liquidity of the entity, its present or future requirements for additional fixed and working capital, and its ability to raise long and short term finance.
- (g) Assessing the capacity of the entity to make future reallocations of its resources, for either economic or social purposes or for both.
- (h) Estimating the future prospects of the entity, including its capacity to pay dividends, remuneration and other cash outflows and predicting future levels of investment, production and employment.

- (i) Assessing the performance, position and prospects of individual establishments and companies within a group.
- (j) Evaluating the economic function and performance of the entity in relation to society and the national interest, and the social costs and benefits attributable to the entity.
- (k) Attesting to compliance with taxation regulations, company law, contractual and other legal obligations and requirements (particularly when independently verified).
- (l) Ascertaining the nature of the entity's business and products.
- (m) Making economic comparisons, either for the given entity over a period of time or with other entities.
- (n) Estimating the value of users' own or other users' present or prospective interests in or claims on the entity.
- (o) Ascertaining the ownership and control of the entity.

Section three

The objective of corporate reports

The fundamental objective

3.1 In section one we stated that our basic approach in preparing this discussion paper has been that corporate reports should seek to satisfy, as far as possible, the information needs of users (paragraph 1.1). Having examined the users of corporate reports we consider to have reasonable rights to information and their information needs, we reach the following conclusion as to the fundamental objective of corporate reports.

3.2 The fundamental objective of corporate reports is to communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.

Desirable characteristics

3.3 If corporate reports are to be useful and to fulfil their fundamental objective we believe they must possess the following characteristics. They must be:

- (a) Relevant
- (b) Understandable
- (c) Reliable
- (d) Complete
- (e) Objective
- (f) Timely
- (g) Comparable

3.4 Relevance is the characteristic which embodies the fundamental notion that corporate reports should seek to satisfy, as far as possible, users' information needs. Whilst this notion is the essence of the objective of corporate reports, it has to be recognised that the users themselves are free to define their own objectives and the information with which they wish to be supplied. Such information needs are unlikely to be static but will evolve.

3.5 Understandability does not necessarily mean simplicity, or that information must be presented in elementary terms, for that may not be consistent with the proper description of complex economic activities. It does mean that judgement needs to be applied in holding the

balance between the need to ensure that all material matters are disclosed and the need to avoid confusing users by the provision of too much detail. Understandability calls for the provision, in the clearest possible form, of all the information which the reasonably instructed reader can make use of and the parallel presentation of the main features for the use of the less sophisticated.

3.6 The information presented should be reliable in that users should be able to assess what degree of confidence may be reposed in it. The credibility of the information contained in corporate reports is enhanced if it is independently verified although in certain circumstances it may be useful for an entity to supply information which is not verifiable in this way.

3.7 The information presented should be complete in that it provides users, as far as possible, with a rounded picture of the economic activities of the reporting entity. Since this is likely to be complex it follows that corporate reports as we define them are likely to be complex rather than simple documents.

3.8 The information presented should be objective or unbiased in that it should meet all proper user needs and neutral in that the perception of the measurer should not be biased towards the interest of any one user group. This implies the need for reporting standards which are themselves neutral as between competing interests.

3.9 The information presented should be timely in the sense that the date of its publication should be reasonably soon after the end of the period to which it relates so that it contributes meaningful new information about the entity and in the sense that corporate reports are more useful if they contain up to date measures of value.

3.10 The information should be expressed in terms which enable the user to compare the entity's results over time and with other similar entities. Consistency in the application of accounting concepts and policies is one means of achieving comparability, particularly for the comparison of the entity against itself. But consistency is a desirable characteristic only to the extent that it contributes to comparability and understandability. It is recognised that an unthinkingly mechanical application of generally accepted standards does not inevitably produce a fair presentation.

Limitations on disclosure

3.11 While a basic premise of this discussion paper is that only entities of a certain size or format have a responsibility to publish corporate reports (paragraph 1.2), our statement of the fundamental objective will generally apply to all corporate reports, whoever the reporting entity and whatever the reason for publication. However, our suggestions for provision of new information which follow in section six do not apply equally to all.

3.12 We consider that smaller entities (those below our suggested thresholds of significance in appendix 1) who choose or are obliged to publish financial reports should be allowed a lesser degree of disclosure. Three reasons for this are:

- (a) While every economic entity, regardless of size has, like individuals, a responsibility to the community which allows its existence and which it serves, the economic and social importance and impact of its activities will normally be greater the larger its size.
- (b) The proprietors or managers of small entities tend to be more easily accessible to employees, customers, and the public than is the case with larger economic entities. Lines of communication are able to function without the same need for formalisation imposed on larger concerns.
- (c) There is the practical consideration that the time and money cost to small entities of disclosing information of the type we suggest is disproportionate and very likely to outweigh the possible benefits to report users.

3.13 We have not considered in detail the degree of disclosure appropriate to the corporate reports of entities falling below our size tests. But we do believe there are disclosure considerations appropriate to all corporate reports arising from:

- (a) The need to make such reports conform to the characteristics of relevance, understandability, reliability, completeness, objectiveness, timeliness and comparability discussed earlier in paragraphs 3.3 to 3.10.
- (b) Practical considerations including the need to balance user needs and interests.

3.14 If corporate reports are to possess the characteristics listed above it follows that they should give recognition to economic substance in preference to legal and technical form, should not contain irrelevant information or be unreliable, misleading, incomplete, biased, inconsistent or out of date.

3.15 Practical considerations which call for judgement to be exercised include cost and confidentiality. The interests of users in general will not be served if costs are incurred in the collection and dissemination of information which are out of proportion to the likely benefits to users. Likewise the interests of users in general are unlikely to be served if information is published which is against the national interest or seriously prejudicial to the continued existence of the reporting entity.

Summary of section three

3.16 In our view **the fundamental objective of corporate reports is to communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.** To fulfil this objective we conclude that corporate reports should be relevant, understandable, reliable, complete, objective, timely and comparable.

3.17 This fundamental objective will apply to all corporate reports, whoever the reporting entity and whatever the reason for publication. However, the degree of disclosure appropriate in each particular case will be limited by practical considerations of cost and confidentiality and by the need to arrive at a balance which will imbue corporate reports with the desired characteristics outlined above and the need to serve, as far as possible, the general interests of all users.

Section four

Review of the present state of corporate reporting

The conventional view

4.1 The conventional view of the aim of published financial reports was expressed in Recommendation N15 issued by the Institute of Chartered Accountants in England and Wales in 1952 (withdrawn in 1974). This stated: 'The primary purpose of the annual accounts of a business is to present information to the proprietors, showing how their funds have been utilised and the profits derived from such use.'

4.2 This statement was no doubt correct at its time of issue, but with the passage of time it has become increasingly clear that it is incomplete and unsympathetic to modern needs. The object of this discussion paper is to suggest the general concepts which should underlie modern financial reporting and to point the new directions in which we think corporate reports should be developing.

Features of corporate reports of companies

4.3 At the time the working party started work in October 1974, published financial statements of UK Companies had five principal features. These were:

- (a) They consisted essentially of a directors' report, balance sheet, profit and loss account, and notes thereto. Apart from the Accounting Standards Steering Committee's proposal (since approved) that sources and application of funds statements should be published, this format had been virtually unchanged for a quarter of a century.
- (b) They were based generally on historical cost figures even though the effects of inflation invalidated the use, over time, of unadjusted pounds as a standard unit of measurement. Some companies periodically updated the balance sheet value of fixed assets such as property to current market values, although this was not a universal practice. The 1967 Companies Act introduced a requirement that the directors' report should note the market value of interests in land where these, in the opinion of the directors, differed substantially and significantly from the balance sheet figure.
- (c) They were concerned almost wholly with items and events which could be quantified in financial terms.
- (d) They were concerned with quantifying and highlighting distributable profit for the year as one identifiable and absolute amount. Although recent business liquidity problems had re-focused

users' attention on the balance sheet, that statement comprised balances which were largely the residue of profit calculations.
(e) They were concerned first and foremost with the financial claims of shareholders and creditors.

4.4 Annual corporate reports, which include financial statements, had the following additional characteristics:

- (a) They were produced in many forms. There was virtually no limit to the quantity of information which could be disclosed if so wished by the reporting organisation and few rules concerning presentation. Corporate reports may or may not have contained narrative explanations of activities, including a chairman's report to shareholders, and supplementary pictorial or diagrammatical information.
- (b) They contained both audited and unaudited information which often was not clearly segregated (although the auditor's report would have referred only to specific sections and pages of the report). The tendency over recent years had been for an increase in the quantity of unaudited information presented.
- (c) They were the most comprehensive and widely circulated documents published by listed companies.

4.5 The features of financial statements we have described arose largely as the result of legal requirements imposed in response to changing needs in the business sector. The law lays down minimum reporting requirements and, until recently, most companies have chosen not to go beyond these. Within the last few years however the work of the Accounting Standards Steering Committee has resulted in advances in accounting and disclosure practices.

4.6 The additional features of annual corporate reports have developed more recently as the public relations value of such reports has become recognised.

Corporate reports of entities other than companies

4.7 At the present time not all entities are compelled (or choose) to publish corporate reports or financial statements. The requirement to publish stems from the legal constitution of reporting entities rather than from any consideration of their size or activity. For example, business enterprises are not required to publish financial statements unless they have sought the legal protection of limited liability. In most cases existing law links the right to information to a direct interest or property right in the reporting entity.

4.8 Types of entities which are required to publish reports in some form include (other than limited companies) commercially orientated public sector organisations, government departments (which report to Parliament), local authorities, charities, trade and professional organisations, trade unions and building and friendly societies. In general the financial statements of such entities (which may or may not be presented as an integral part of a corporate report) tend to be:

- (a) Concerned with reporting income and expenditure (although not profit except in the case of commercially orientated organisations) and financial position.
- (b) Based on historical cost figures.
- (c) Concerned with items and events which can be quantified in financial terms.

4.9 It is not unusual for public sector entities to publish budgets and forecasts (although these are not always subsequently compared in published reports with the outcome of actual events). Public sector entities also tend to rely more than their private sector counterparts on the Press for the dissemination of financial statement information, (for example by admitting the Press and the public to meetings) rather than direct circulation of printed statements to users.

4.10 In both private and public sectors minimum reporting requirements are specified by law.

Company Law

4.11 Company law as it affects business enterprises has been concerned overwhelmingly with the protection of shareholders' and creditors' rights and property. For example, in 1965 the Institute of Chartered Accountants in England and Wales was given counsel's opinion that in law the object of annual accounts is to assist shareholders in exercising their control of the company by enabling them to judge how its affairs have been conducted. Whilst this may be an accurate representation of the legal position our discussion paper deals with wider issues.

4.12 The main reporting requirements of the Companies Acts are that directors lay before members in general meetings the balance sheet, profit and loss account and directors' report and auditor's report (each containing the information specified by statute) and that copies of the same be annexed to the annual returns that must be filed with the Registrar of Companies.

4.13 In general the law has required a lesser degree of disclosure for smaller concerns. For example, the 1967 Companies Act which abandoned the concept of exempt private companies, refrained from requiring the smallest companies to disclose turnover, directors' remuneration and employee information.

Other private sector entities

4.14 The trustees of pension schemes, and charitable and other trusts are generally required to apply their assets and to report in accordance with the terms of the trust. Under general trust law trustees have an obligation to the beneficiaries of their trust who may require an account of the conduct of the trust. Trustees of charities have an obligation to report, in the prescribed form, to the Charity Commissioners at their request or, in certain circumstances, annually.

4.15 Most other types of economic entity, for example trade and professional associations, trade unions and friendly societies have a legal obligation to report to their members. Many are required to file accounts with appropriate government agencies.

Local authorities

4.16 Local authorities are required to make available for inspection by the public abstracts of audited accounts. In addition each local authority levying rates must give, on every rate demand, specified information including an analysis of the rate in the pound levied.

4.17 In addition, any local government elector has the right to inspect documents, including minutes of meetings of his authority. Moreover, the Public Bodies (Admission to Meetings) Act 1960 as amended lays down the principle that meetings of local authorities, water authorities, regional health authorities, area health authorities and community health councils shall be open to the public and to reporters. Newspapers and news agencies have statutory rights to receive advance copies of the agenda for meetings and supporting documents.

Central government

4.18 For central government the Treasury is required to prepare for each financial year accounts of the transactions of the Consolidated Fund and of the National Loans Fund, together with statements of additional information regarding the transactions, assets and liabilities of the two funds. Both sets of information are presented to Parliament. Additionally there are services outside the 'supply' (ordinary annual

expenditure) system and in such cases, Parliament may establish a statutory fund whose accounts are presented to Parliament as 'White Paper' accounts. Instances are the National Insurance Fund and the Redundancy Fund. Appropriate organisations, such as the Royal Ordnance Factories, may be accorded 'Trading Fund' status and commercial accounting practices adopted.

Other public sector organisations

4.19 For each of the commercially oriented public sector organisations such as electricity, gas, passenger transport and water, the general statutory requirement is to prepare in respect of each financial year a statement of accounts in a form prescribed by the appropriate Minister. This statement, together with the auditor's report, must be sent to the Minister, a copy laid before Parliament, and copies made available to the public at a reasonable price.

4.20 Much more detailed requirements are imposed on the constituent bodies of the health service, which is wholly financed by the central government, and on the New Town Development Corporations, although the degree of public reporting by these organisations is limited. In the health service, annual financial reports (including accounts and unit costs) must be made to the Secretary of State. New Town Development Corporations are required to keep accounts and records in prescribed form and a detailed management accounting system is in operation.

Social and industrial developments

4.21 A dramatic increase in economic activity combined with a period of technological innovation and change has occurred during the last 30 years. The complexity of modern business enterprises and public utility services has brought a growing awareness of the mutual inter-dependence of all sections of the community and is reflected by a change in balance between the owners of businesses, employees and to a lesser extent customers and the public acting as members of organised groups. Government, through legislation, through nationalised industries and because of its growing economic power, has come to take a more active role in business affairs. Not all these developments are yet reflected fully in legal reporting requirements and accounting practices.

4.22 Despite improving means of communication there is much misunderstanding of the role business enterprises play in modern

society and particularly of the function of profits. There is a growing need to find new ways of expressing the importance and communicating the contribution of business operations to the economy.

4.23 The company law assumption that individual shareholders jointly exercise effective control over their company does not always obtain in practice. Individuals increasingly tend to own interests in companies through investments in pension funds, insurance and investment schemes and other such newer organisational groupings of potential power. Except on rare occasions such as take-overs individual shareholders tend to exercise control, if at all, at second hand through decisions to buy, hold or sell investments.

Enterprise objectives

4.24 It is a long held view that the objective of business enterprises is to earn profits. In the past the emphasis has been placed upon earning profits for the benefit of owners.

4.25 As noted, in law business enterprises which are incorporated as limited liability companies are expected to have regard primarily to the interests of their members. But in practice business enterprises currently recognise wider responsibilities.

4.26 A CBI report 'The responsibilities of the British Public Company', published in 1973, stated: 'We think that the government might consider, as part of their doctrine of wider disclosure, a general legislative encouragement for companies: "to recognise duties and obligations (within the context of the objects for which the company was established) arising from the company's relationship with creditors, suppliers, customers, employees and society at large; and in so doing to exercise their best judgement to strike a balance between the interests of the aforementioned groups and between the interests of those groups and the interests of the proprietors of the company".'

4.27 We have conducted a survey of corporate objectives amongst the chairmen of 300 of the largest United Kingdom listed companies. Of the 166 replies, 58% linked primary objectives to profits. 23% of the total number of respondents (and included in the 58% above) narrowed this to profits available for distribution to shareholders. The majority of companies recognised a responsibility to employees (71%), to shareholders (69%) and to customers (53%) (see appendix 4).

4.28 The majority view of those replying to the survey was that their primary objective was to make a profit for the benefit of a number of groups and that this could only be achieved if due attention was paid to the particular interests of each of these groups. It was not the majority view that the maximisation of shareholders' profit was the primary objective.

Need for additional performance indicators

4.29 Business enterprises can survive only with the approval of the community in which they operate and they have an interest in revealing information which displays how differing interests are being balanced for the benefit of the whole community.

4.30 Because neither business organisations nor the public regard the maximisation of owners' profit as the only legitimate aim of business, distributable profit can no longer be regarded as the sole or premier indicator of performance. This would be so even if accountants were able to agree that 'profit' is one certain figure which can be measured with precision. That this is not the case will be argued in section seven.

4.31 Other types of organisation also need the approval of the community in which they operate. Although there are no simple equivalents to indicators of performance for non commercially orientated concerns (such as profit or value added in the case of business enterprises) there is promising scope for the development of non-monetary indicators to supplement expenditure figures as measures of output.

4.32 If the success of entities in fulfilling multiple responsibilities is to be measured and given due recognition it follows that information on progress towards the achievement of such objectives should be published. It is to the advantage of users and the reporting entity that information relating to the fulfilment of these responsibilities should be published.

4.33 It is important to keep in mind the pervasive influence of reporting practices on management attitudes. Managements naturally respond to those indicators by which they consider their performance is judged, and strive to achieve and present results accordingly. Special attention is bound to be given to those areas where the spotlight falls. Our view is that management attitudes and objectives can be profoundly affected by changes in reporting practices. In a national context the corporate report therefore assumes special importance, since it offers a means of directing attention to and promoting action in connection with alleged weaknesses or limitations.

4.34 The additional information that we believe should be reported would give an insight into the reporting entity's employment policies, use of human resources and contribution to national efficiency. For instance, in the UK concern is often expressed about levels of economic performance, inflation, productivity and investment, and rates of return on capital. We consider that financial reports should be presented in such a way as to take cognisance of these factors and assist in making comparisons and judgements on such matters, and we have kept this general social objective in mind in the suggestions which follow.

New legislation

4.35 Recognition of changing public attitudes was given in the 1973 Companies Bill (which lapsed following a change in government). Clause 53 of the Bill stated: 'The matters to which the directors of a company are entitled to have regard in exercising their powers shall include the interests of the company's employees generally as well as the interests of its members.'

4.36 The White Paper which preceded the Bill stated: 'For public and large private companies these powers (of disclosure) will be used by the government to give shareholders and the public the chance to judge companies' behaviour by social as well as financial criteria.'

4.37 There is a trend in recent proposed and actual legislation towards the imposition of disclosure requirements not directly linked to the needs of shareholders. Examples include: The 1971 Industrial Relations Act, (repealed in 1974) which included provisions for companies to disclose more information to employees and their representatives; The 1975 Industry Bill which provides for manufacturing undertakings to give information about specified activities to the appropriate government Minister and, except in certain specified circumstances, to the trade unions recognised by the undertaking; The 1975 Employment Protection Bill, which proposes to place a general duty on employers to disclose information necessary for collective bargaining purposes to the representatives of trade unions recognised by that employer; The 1974 Health and Safety at Work Act which requires the disclosure by some companies of information concerning the arrangements for securing the health, safety and welfare at work of employees and for protecting other persons against risk to health or safety arising out of or in connection with the activities at work of these employees.

4.38 The European Communities have an elaborate programme for the harmonisation of European company law based on Article 54(3)(g) of the Treaty of Rome. This calls for "co-ordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by member states of companies or firms with a view to making such safeguards equivalent throughout the Community".

4.39 These proposals are likely to lead to a greater recognition in company law of the rights of employees. For example, the Proposed Fifth Directive published by the EEC Commission in October 1972 includes proposals for two-tier boards of directors for all companies with more than 500 employees. Employees of such companies would have one third representation on supervisory boards. There are plainly implications as regards the provision of information to employees.

Summary of section four

4.40 In reviewing the relevance of the conventional view of the aim of published financial reports to current conditions and attitudes, we note the trend towards the acceptance by business enterprises of multiple responsibilities and conclude that distributable profit is no longer the sole or premier indicator of performance in the corporate reports of such entities. We recognise the trend in new and proposed legislation towards the recognition of the rights to information of a growing number of groups including employees and the public. We suggest there is a need for additional indicators of performance in the corporate reports of all entities.

Part II
Measurement and method

Section five

Communication, publication, frequency and distribution

Communication and publication

5.1 In our fundamental objective (paragraph 3.2) we stated that corporate reports should communicate economic measurements and information. An important aspect of communication is that the means of transmission and the form and presentation of the information transmitted must be selected as being relevant to the receiver. In particular the information transmitted must be understandable.

5.2 Ways of publishing information include the use of the written and spoken word, telecommunications, press announcements and direct mail. At the present time economic entities usually fulfil their reporting responsibilities by publishing printed reports. It is likely that new means of communication will become practical alternatives in the future but we have not examined these possibilities in detail.

5.3 When viewed as a means of communication it is clear that corporate reports must be concerned with all possible ways of describing economic activities. Such ways must include financial and quantitative measurements and descriptive and explanatory narrative statements.

5.4 We recommend that improvements in the means of communicating corporate report information be made wherever possible. Such means will include the use of imaginative presentation within printed reports wherever understandability can be improved.

5.5 In this paper we have not limited our discussions and recommendations to matters concerning only financial statements. We have considered the overall requirements of report users and the means of fulfilling these requirements by providing financial, quantitative and descriptive information.

5.6 While the accounting profession can claim special expertise regarding the provision of financial information the working party acknowledges the equal and in some cases superior qualifications and competence of other groups to comment on some aspects of corporate reports.

Frequency

5.7 An important aspect of communication and publication is the question of frequency and method of distribution.

5.8 It is usual practice for business enterprises to produce corporate reports annually. Whilst this accords with existing legislation such as the Companies Acts, it is clear that the practice presents accounting difficulties for some businesses. For example, businesses in the shipbuilding and civil engineering industries where projects have lives extending over several years, may have considerable difficulty in drawing up meaningful financial statements for periods as short as twelve months. Nevertheless, the majority of businesses do not have such difficulties and for many it would be possible to produce financial reports on a more frequent basis than at present.

5.9 The emphasis throughout this paper has been on the rights of users to receive information which will enable judgements to be made as to the reporting entity's fulfilment of its responsibilities. Since users are aided in forming judgements by the regular release of information, we support the view that corporate reports should be timely and be presented at intervals of appropriate frequency – certainly not less than annually.

5.10 However, we recognise that corporate reports are expensive to produce in terms of cash, time and effort. We do not believe that the benefit to be derived from producing such detailed reports on a basis more frequently than annually is sufficient to warrant the extra costs involved. At the same time we consider entities should satisfy their annual reporting obligation within six months, at most, of the relevant accounting date.

5.11 Whilst this discussion paper is concerned only with the annual corporate report, the comprehensive package of information both financial and non-financial describing the activities of an economic entity, we recognise the need for listed companies to publish interim statements of results. Although Stock Exchange requirements call on companies to publish half-yearly results, there is some evidence of a demand for UK listed companies to follow the American example and publish quarterly results.

Distribution

5.12 In view of the wide range of user groups we have identified and the nature of the responsibilities which we consider economic entities

should recognise towards them, we believe that corporate reports should be made as widely available as possible.

5.13 It would be impractical to suggest that copies of the corporate report be sent each year to each member of each user group, for example to every potential investor or every member of the public. Such a practice would be prohibitively expensive and grossly wasteful. However, we do consider that corporate reports of those economic entities falling within our tests of significance should be available to any employee, customer, supplier or any other member of the public on request. Further, we consider that, besides sending a copy of the report to each shareholder, the reporting entity should inform employees on the day of publication that a corporate report has been published, is available free on request and how copies may be obtained. In the case of wholly owned subsidiaries, this recommendation should relate to group accounts only. In the case of limited companies and some other types of organisation, accounts are required to be filed with registrars or similar government agents. The date of filing often follows the date of publication but in any case filing accounts alone does not meet our recommendation.

5.14 We strongly support the production of simplified versions and special interest extracts of corporate reports for the information of user groups. However, we believe the information contained in such versions and extracts should be derived completely from the full corporate report and should contain no significant new information. Further, we consider such versions or extracts should always contain a reference to the fact that they are wholly derived from the corporate report, that this report is freely available on request and to whom this request should be made. Any extract or simplified version produced should either form an integral part of the full corporate report or should be provided as a matter of course to all shareholders and all others provided with copies of the report on request.

Summary of section five

5.15 We believe that corporate reports should be concerned with all possible ways of effectively describing economic activities and recommend that ways of improving the means of communicating corporate report information should be actively explored.

5.16 We support the view that corporate reports should be timely and be presented frequently and regularly. However we recognise that corporate reports are expensive to produce and do not believe the

benefits to be derived from producing such reports on a basis more frequently than annually is sufficient to warrant the extra costs involved.

5.17 We consider that the corporate report of those economic entities falling within our tests of significance should, besides being sent to each shareholder, be generally available free on request. We strongly support the production of simplified versions and special interest extracts of corporate reports.

Section six

The scope and content of corporate reports

Drawbacks of current reporting practices

6.1 Current reporting practices do not fully meet all the needs of the user groups identified in section two. At the present time corporate reports of business enterprises are concerned mainly with providing measurements and information of use to shareholders and creditors. Since each enterprise has responsibilities towards many more groups with wider needs it follows that there is a need for corporate reports to disclose more than at present.

6.2 Drawbacks concerning the current scope and content of published financial statements of business enterprises include:

- (a) The maximisation of short term profit is not the sole aim of modern business enterprises although by making the profit figure the keynote figure of financial reports, users are encouraged to believe that it is the sole aim.
- (b) The figure of audited profit for the year is presented as being definitive although it is well known to be subject to many uncertainties.
- (c) As noted, users are encouraged to appraise the results of business enterprises on the basis of short term results. Management, consequently, may tend to concentrate on short term results rather than the longer view.
- (d) The format implies that proprietors are the dominant interest and masks acknowledged responsibilities to other user groups.

Need for additional statements

6.3 The reporting of profit and loss and balance sheet figures only will be insufficient to impart a comprehensive picture of economic activities. Additional information and statements are needed which will assist the understanding of financial statements and reveal more fully how resources have been utilised.

6.4 We recognise that means of fulfilling the information needs of all user groups are not yet available and may never be available in a corporate report format. However we believe corporate reports could be made more comprehensive and recommend that, where appropriate, corporate reports contain, in addition to those statements currently presented (i.e. profit and loss accounts, balance sheets and – for the future – source and application of funds statements) the statements

outlined in paragraph 6.5 below. We regard it as appropriate for all entities falling within our tests of significance to publish each statement if it is relevant to the activities of the entity. We suggest which statements should be published by which type of entity in appendix 2.

6.5 We recommend that, where appropriate, corporate reports contain the following statements in addition to those now current:

- (a) A statement of value added, showing how the benefits of the efforts of an enterprise are shared between employees, providers of capital, the state and reinvestment. This statement will assist users to evaluate the economic performance of the entity.
- (b) An employment report, showing the size and composition of the workforce relying on the enterprise for its livelihood, the work contribution of employees and the benefits earned. This report will assist users in assessing the performance of the entity, evaluating its economic function and performance in relation to society, assessing its capacity to make reallocations of resources and evaluating managerial performance, efficiency and objectives.
- (c) A statement of money exchanges with government, showing the financial relationship between the enterprise and the state. This statement will assist users to assess the economic function of the entity in relation to society.
- (d) A statement of transactions in foreign currency showing the direct cash dealings of the reporting entity between this country and abroad. This statement will assist users to judge the economic functions and performance of the entity in relation to society and the national interest. It may also provide information of assistance in assessing the stability and vulnerability of the reporting entity and in estimating its capacity to make future cash payments.
- (e) A statement of future prospects, showing likely future profit, employment and investment levels. This statement will assist users evaluate the future prospects of the entity and to assess managerial performance.
- (f) A statement of corporate objectives showing management policy and medium term strategic targets. This statement will assist users to evaluate managerial performance, efficiency and objectives.

6.6 These proposals for additional statements, which are discussed further below, are by no means exhaustive. They are regarded merely as a first phase in a period of transition during which it is hoped published financial reports will come to provide a complete and rounded picture of the activities of economic entities. Such a picture should include information on the use of all resources, whether financial, material or

human and whether owned by the reporting entity or by the community. Such a picture should also include a more precise description of the use of financial assets.

Value added statement

6.7 The simplest and most immediate way of putting profit into proper perspective vis-a-vis the whole enterprise as a collective effort by capital, management and employees is by presentation of a statement of value added (that is, sales income less materials and services purchased). Value added is the wealth the reporting entity has been able to create by its own and its employees' efforts. This statement would show how value added has been used to pay those contributing to its creation. It usefully elaborates on the profit and loss account and in time may come to be regarded as a preferable way of describing performance.

6.8 There is evidence that the meaning and significance of profits are widely misunderstood. It is not the purpose of this report to attempt to justify the profit concept. We accept the proposition that profits are an essential part of any market economy, and that in consequence their positive and creative function should be clearly recognised and presented. But profit is a part only of value added. From value added must come wages, dividends and interest, taxes and funds for new investment. The interdependence of each is made more apparent by a statement of value added.

6.9 We recommend that business enterprises and where appropriate other economic entities, within our tests of significance include as a part of their corporate reports and in a prominent position, a statement of value added containing as a minimum the following information:

- (a) Turnover
- (b) Bought-in materials and services.
- (c) Employees' wages and benefits.
- (d) Dividends and interest payable.
- (e) Tax payable.
- (f) Amount retained for reinvestment.

6.10 The statement of value added provides a useful measure to help in gauging performance and activity. The figure of value added can be a pointer to the net output of the firm, and by relating other key figures (for example, capital employed and employee costs) significant

indicators of performance may be obtained. A simple illustration of the type of statement envisaged is given below:

Illustration

A manufacturing company Statement of value added

	Year to 31 Dec 1974 £M	Preceding Year £M
Turnover	103.9	102.3
Bought-in materials and services	67.6	72.1
Value added	<u>£36.3</u>	<u>£30.2</u>
Applied the following way		
To pay employees		
wages, pensions and fringe benefits	25.9	17.3
To pay providers of capital		
interest on loans	0.8	0.6
dividends to shareholders	0.9	0.9
	<u>1.7</u>	<u>1.5</u>
To pay government		
corporation tax payable	3.9	3.1
To provide for maintenance and expansion of assets		
depreciation	2.0	1.8
retained profits	2.8	6.5
	<u>4.8</u>	<u>8.3</u>
Value added	<u>£36.3</u>	<u>£30.2</u>

6.11 The above statement is to be regarded as illustrative only. The basic information required is already available in every enterprise and the concept is neither new nor original. It must be appreciated that the presentation of value added statements involves overcoming many of the problems also associated with the presentation of profit and loss accounts, for example the treatment of extraordinary profits and losses.

Employment report

6.12 Nothing illustrates more vividly the nineteenth century origin of British company law than the way in which employees are almost totally ignored in the present Companies Acts and in corporate reports. The 1967 Companies Act introduced a requirement for companies with more than 100 employees to state in the directors' report the average number of employees per week and the aggregate remuneration paid. This modest requirement barely does justice to the role of companies as the life support systems for millions of people.

6.13 Economic entities are concerned with the use of monetary, material and human resources. As employers they are accorded a position of trust by their employees who look to the entity for employment security and prospects. In our view this relationship carries with it a responsibility to report to and about employees.

6.14 Employment prospects affect whole communities and society looks to employers (and employees) to maintain certain standards of conduct. Economic entities therefore also have a general responsibility to report employment information to the community at large.

6.15 One method of reporting employment information is termed human asset accounting. In essence human asset accounting relates to the quantification in money terms (e.g. by calculating a capital value) of the human resources employed by an organisation. Its purpose is to provide information relevant to decisions involving employees.

6.16 The basis of valuation used may be capitalisation and amortisation of recruitment and training expenditure as pioneered by the R. G. Barry Corporation in the USA. An alternative basis suggested by a joint working party of the Institute of Personnel Management and the Institute of Cost and Management Accountants would be to apply an appropriate multiplier to remuneration.

6.17 Although human asset accounting may have merit in explaining the goodwill of a business enterprise (i.e. the difference between its market value and the value of assets recorded in its books), it has not been developed to such a stage that its general application can be advocated. We recognise a possible central failing in the fact that employees are not 'owned' by employers and may regard human asset accounting as an implication that they are being so treated.

6.18 However, significant information about the workforce can presently be given by simple and readily available means. We

recommend that the general reporting responsibility as regards employment information be met by the publication of employment reports concerned primarily with information about time worked and numbers employed rather than money values. (These have the added advantage of being more stable units of measurement than unadjusted money values). The publication of such reports will fulfil an immediate need and may present a long-term solution which could prove preferable to human asset accounting. They will not contain information for the purpose of collective bargaining at group or plant level which can more appropriately be supplied by other means.

6.19 We recommend economic entities within our tests of significance should present, as part of their corporate reports, employment reports containing the following information:

- (a) Numbers employed, average for the financial year and actual on the first and last day.
- (b) Broad reasons for changes in the numbers employed.
- (c) The age distribution and sex of employees.
- (d) The functions of employees.
- (e) The geographical location of major employment centres.
- (f) Major plant and site closures, disposals and acquisitions during the past year.
- (g) The hours scheduled and worked by employees giving as much detail as possible concerning differences between groups of employees.
- (h) Employment costs including fringe benefits.
- (i) The costs and benefits associated with pension schemes and the ability of such schemes to meet future commitments.
- (j) The cost and time spent on training.
- (k) The names of unions recognised by the entity for the purpose of collective bargaining and membership figures where available or the fact that this information has not been made available by the unions concerned.
- (l) Information concerning safety and health including the frequency and severity of accidents and occupational diseases.
- (m) Selected ratios relating to employment.

6.20 An example of the type of report envisaged which will meet a general stewardship responsibility to report on employment is included in appendix 3. It should be regarded as illustrative only.

6.21 The basic information required is or should be already available in every enterprise and its presentation, in view of the requirements of the Industry Bill and the Employment Protection Bill and for statistics

required by government departments, should not be onerous. The report will make available information of use not only in judging efficiency and productivity but will also provide significant information concerning the workforce of the reporting entity, its personnel policies and industrial relations record.

Statement of money exchanges with government

6.22 All types of organisations have a close and continuing economic relationship with government. They make use of and benefit from government provided community facilities and services. Besides these tangible and intangible benefits (the effects of which are difficult to measure) organisations have direct financial dealings with government. They pay and collect taxes, they may receive grants and subsidies.

6.23 The full extent to which business enterprises collect and pay taxes is not reflected by current reporting practices. For example, PAYE collected for the government is not shown separately but is grouped with employment costs. The amounts involved are substantial and indicate the importance of economic entities to central government and to the community as a whole.

6.24 It is recommended that economic entities, within the size tests previously set, include in their corporate reports a statement of money exchanges with local and central government (distinguishing where appropriate between home and overseas governments). Such statements should include the following information (which should be reconcilable to the funds flow statement and should distinguish between amounts collected and paid over in the capacity of agent and those directly borne by or benefiting the entity).

- (a) PAYE collected and paid over.
- (b) VAT collected and paid over.
- (c) Corporation tax and similar taxes paid over and borne by the entity.
- (d) Rates and similar levies paid over to local authorities and borne by the entity.
- (e) Other sums paid to government departments and agencies including social security, training levies and duties.
- (f) Money receipts from government including grants and subsidies.

6.25 The purpose of the statement of money exchanges with government is to present the direct flow of money between enterprises and government with the object of demonstrating the degree of

interdependence between the enterprise and the state. It does not purport to reflect the full extent of the direct and indirect benefits derived by entities from social services and public facilities provided by government.

Statement of transactions in foreign currency

6.26 National prosperity is linked to the ability of individual concerns to earn net foreign exchange abroad through direct exports and overseas operations and investment.

6.27 The extent to which entities contribute to balance of payment figures is therefore an aspect of their economic function and performance in relation to society and the national interest.

6.28 Fluctuations in exchange rates, political developments and national and international events and restrictions will affect those involved in overseas dealings. In that the degree of risk and uncertainty attached to such dealings may be significantly different from that attached to U.K. operations, figures relating to transactions in foreign currency may assist users to assess the stability and vulnerability of the reporting entity.

6.29 At the present time corporate reports contain limited information concerning transactions in foreign currency. For example, the 1967 Companies Act generally requires direct exports to be reported while making no such stipulation in relation to imports.

6.30 We recommend that economic entities within our tests of significance should present, as part of their corporate reports, a statement of cash transactions in foreign currency during the reporting period containing at least the following information :

- (a) U.K. cash receipts for direct exports of goods and services.
- (b) Cash payments from the U.K. to overseas concerns for direct imports distinguishing between imports of a capital nature (e.g. plant and machinery for use rather than resale) and those of a revenue nature (e.g. raw materials and services).
- (c) Overseas borrowings remitted to or repaid from the U.K.
- (d) Overseas investments and loans made from or repaid to the U.K.
- (e) Overseas dividends, interest or similar payments received in the U.K. or U.K. dividends, interest or similar payments remitted overseas.

6.31 Entities may wish, in addition, to provide information on indirect imports and exports (although we recognise that there may

be substantial difficulties in compiling such information), and on export turnover and import costs included in income and expenditure statements where these are materially different from cash flow figures.

Statement of future prospects

6.32 Corporate reports deal only with a relatively short period within the overall life of an economic entity. If such reports are to enable users to make meaningful judgements concerning performance the results of one accounting period must be placed firmly in context. This need is already partially met by the provision of previous period comparative figures. It could be satisfied to a greater degree by the additional provision of information concerning future prospects.

6.33 A recurrent, almost dominant theme of section two was the concern of users to assess an entity's future prospects. It is true that everybody wishes to know the future: it is also true that it is not vouchsafed to them. There is no doubt that many users would like to see forecasts included in the corporate report. Some organisations (for instance, local authorities) already publish detailed projections. Business enterprises prepare projections for internal management use, but usually they are published only in the special circumstance of a securities issue or takeover. Company chairmen often give a broad, unquantified indication of future prospects in their annual statement: but there is a strong resistance by many to the regular issue of forecasts as standard practice in corporate reports.

6.34 It is important to recall that forecasts are projections rather than predictions. They do not so much predict the future as set out, in a logical and systematic manner, the future implications of past and present known facts adjusted by reference to estimates of likely future developments. Such projections may be judged to have different degrees of probability attached to them; but rarely is their probability so sure that they could be termed predictions. It is the certainty of uncertainty that makes entities unwilling to make public projections, though all those acquainted with such exercises are perfectly familiar with the limits on reliability which are inherent in them. The fear is that those less instructed will misunderstand and be misled.

6.35 As noted in section two many users are more concerned with the future prospects of entities than with past results. Investors, employees and creditors are examples of such user groups. And yet published financial reports, other than prospectuses and take-over circulars, rarely contain precisely qualified forecasts.

6.36 The objections to publishing such forecasts include:

- (a) Forecasts are concerned with the future and are therefore inherently uncertain. But unless carefully presented, users may regard forecasts as presenting facts rather than best estimates.
- (b) Management will be judged by how well it has met its forecasts and may be encouraged to lower its targets by publishing only conservative forecasts which it knows are wholly attainable and to accept results which meet those forecasts.
- (c) The provision of forecasts by enterprises suffering from financial difficulties may result in the withdrawal of support and thus precipitate an otherwise avoidable collapse.

6.37 While we would encourage the publication of more information about projections, we regard it as unrealistic to suggest that the publication of precisely quantified forecasts could form a standard part of corporate reports at the present time. Our recommendation is that corporate reports as a minimum include a statement of future prospects for the year following the balance sheet date. Such a statement should include information concerning:

- (a) Future profit levels.
- (b) Future employment levels and prospects.
- (c) Future investment levels.

It should also include a note of the major assumptions on which the statement has been based.

6.38 Should these assumptions become invalidated or the reliability of the statement subsequently affected by some other event, we consider it desirable that updated information be published as soon as possible.

6.39 Since performance in relation to forecasts will provide an important basis of judgement as to managerial performance, forecasts which are quantified should be presented in such a way as to enable future comparisons with actual results to be made. Further, it is desirable that differences between results and forecasts be explained.

Statement of corporate objectives

6.40 It has already been argued that users need to assess the effectiveness of the reporting entity in achieving objectives established previously by its management. If such judgements are to be made, and if users are to be able to judge how management objectives differ from their own (see paragraph 2.40 (c)), it follows that corporate objectives should be published.

6.41 We believe there are two distinct components to such objectives. These comprise general management philosophy or policy and medium term strategic targets set as steps towards implementing management philosophy or policy.

6.42 We recommend that corporate reports of entities falling within our tests of significance should include a statement of corporate objectives including a statement of general philosophy or policy and information concerning strategic targets in the following policy areas:

- (a) Sales.
- (b) Added value.
- (c) Profitability.
- (d) Investment and finance.
- (e) Dividends.
- (f) Employment.
- (g) Consumer issues.
- (h) Environmental matters.
- (i) Other relevant social issues.

As with forecasts, the more specific the statement, the more useful it is likely to be. We recommend that strategic targets should be quantified wherever possible.

Social accounting

6.43 Through legislation, society is imposing duties on business enterprises to comply with anti-pollution, safety and health and other socially beneficial requirements. Legislation of this type seems likely to increase in the future.

6.44 Such regulations impose new costs, formerly borne by the community generally, on individual enterprises. There is good reason therefore for requesting such compulsory expenditure to be reported. Equally good arguments can be put forward for disclosing expenditure of this nature undertaken voluntarily.

6.45 It is tempting to propose that entities disclose information which will show their impact on, and their endeavours to protect society, its amenities and environment. In our opinion such a proposal would be impractical at the present time since the necessary generally agreed measurement techniques are not available.

6.46 We believe that social accounting (the reporting of those costs and benefits, which may or may not be quantifiable in money terms, arising from economic activities and substantially borne or received

by the community at large or particular groups not holding a direct relationship with the reporting entity) will be an area of growing concern to the accounting profession and one in which it has an opportunity to help develop practical reporting techniques.

6.47 We recommend that further study be conducted into methods of social accounting but that no obligation to report on social and environmental issues be imposed until acceptable, objective and verifiable measurement techniques have been developed which will reveal an unbiased view of both the positive and negative impact of economic activities. Individual enterprises, as hitherto, will show the way. Where expenditure can be identified as relating primarily to projects undertaken to protect the environment or to benefit society it is likely that entities will wish to disclose the amounts involved for public relations purposes.

Disclosure and disaggregation

6.48 This section has been concerned primarily with proposals for additional statements designed to contribute to user needs rather than with discussing the degree of disclosure desirable in statements already generally included in corporate reports. We have not, for example, dealt with directors' reports, statements of accounting policies, auditors' reports or statements of changes in retained earnings. However, we recognise that such statements contribute to user needs and that directors' reports and auditors' reports are the primary means of contributing to some user needs (in particular those identified in paragraphs 2.40(d), (k), (l) and (o)).

6.49 The problem of disaggregation (i.e. the analysis of general corporate information between separate divisions or classes of business which are individually of economic significance, sometimes called segment or site reporting (see paragraph 2.40 (i)) arises in the context of the degree of disclosure appropriate in basic financial statements. The problem is found at its most extreme in organisations of vast size and spread such as nationalised industries and multinational companies.

6.50 While the 1967 Companies Act requires companies to disclose the profit and turnover of substantially different classes of business, the manner in which this provision has been interpreted and applied by individual companies varies and gives room for improvement. Stock Exchange disaggregation disclosure requirements relating to geographical divisions have proved less difficult to implement.

6.51 We approve of the concept of disaggregation while recognising the difficulties that any comprehensive system would impose on large organisations. We believe that an important step forward in this area would be improved implementation of the relevant provisions of the 1967 Companies Act, but that further research is needed to arrive at a generally applicable and practical basis for disaggregation.

6.52 Our suggestion is that the basis of division of activities selected should be the one which in the opinion of the management will most fairly represent the range and significance of the entity's activities. The division could be based on groups of products or services, group companies, operating or geographic divisions, markets served or any combination of these items which would assist fair presentation. The basis of division used for internal management reporting purposes and for external special purpose reports, for example to the Price Commission, will provide a useful guide to appropriate bases of division.

6.53 We consider it desirable that the following information (the preparation of which may involve some arbitrary apportionments) should be disclosed about each main class of activity:

- (a) Turnover.
- (b) Valued added.
- (c) Profits or losses before tax.
- (d) Capital employed.
- (e) Employment information.

The basis of division into classes of activity should be stated as should, where appropriate, other bases used for internal and special purpose reporting. There should also be disclosed, insofar as they will assist in forming a view of the entity's financial position and will not be damaging to its interests, significant changes during the year in principal products, services or markets as classified in the corporate report.

Other statements

6.54 Although not required by law or competent authority, corporate reports usually contain a statement by the chairman or chief officer of the reporting entity. We believe this to be a desirable practice which should be encouraged. The statements of chairmen or chief officers are often the only narrative description and interpretation of corporate activities included in reports and this we consider to be an essential feature.

6.55 Likewise, many concerns choose to publish summaries of results of previous years, typically a "ten year summary". We consider such statements to be valuable as a means of placing results in perspective. We recommend that corporate reports include appropriate summaries of income and expenditure, financial position and flow of funds statements for at least the previous five years.

Summary of section six

6.56 As current reporting practices do not fully meet the needs of users identified earlier, we conclude there is a need for additional statements to be published and suggest the following:

- (a) A statement of value added.
- (b) An employment report.
- (c) A statement of money exchanges with government.
- (d) A statement of transactions in foreign currency.
- (e) A statement of future prospects.
- (f) A statement of corporate objectives.

We believe that social accounting will be an area of growing concern to corporate report users and recommend further study into methods of social accounting.

6.57 While not attempting to consider detailed disclosure in basic financial statements we approve the concept of disaggregation and recommend further research in this area. Our suggestion is that a basis of division of activities should be selected which, in the opinion of management fairly represents the range and significance of activities, and that disaggregated information be given in respect of turnover, value added, profits or losses before tax, capital employed and employees.

6.58 We believe descriptive and interpretive statements by chairman or chief officers to be an essential feature of corporate reports and that their publication should be encouraged. We also recommend that corporate reports include appropriate summaries of income and expenditure, financial position and flow of funds statements for at least the previous five years.

Section seven

Concepts and measurements in financial statements

Basic statements

7.1 We have defined 'basic financial statements' as those concerned primarily with reporting financial transactions and position (paragraph 0.2). The concepts of profit or loss and asset value are central to such statements. In this section we survey some of the problems of calculating profit and asset values.

7.2 Essentially there are three main types of financial statement which are included in corporate reports. These are concerned with:

- (a) The income and expenditure attributable to activities undertaken by the reporting entity during the period (i.e. the profit and loss account).
- (b) The financial position of the reporting entity at a point in time (i.e. the balance sheet).
- (c) The flow of funds arising from activities of the reporting entity during the period under review (i.e. statement of source and application of funds).

7.3 Financial statements of business enterprises in the U.K. (and generally in the developed world) have almost invariably been produced on the historical cost basis of asset and profit measurement (i.e. at the monetary amount sacrificed or laid out at the time assets are acquired). This practice stems from the fact that the basic inputs of accounting records are made up of items stated in monetary amounts as at the date of each transaction. The system has the advantage of being essentially factual and despite criticisms, was generally considered adequate for reporting purposes by accountants so long as money was a reasonably stable unit of measurement from one year to another. But the relevance of historical cost based financial statements to modern needs and conditions has been increasingly called into question as inflationary pressures have become more evident. However financial records of transactions are and are likely to continue to be recorded initially in historical cost figures, and this basis of measurement therefore retains some inherent practical advantages.

Income statements

7.4 Income statements (currently profit and loss accounts in the case of business enterprises although statements of value added may take over this role in the future) should be concerned with the measurement of performance although they may also be used in the measurement of capital maintenance and income distributability. It is important to appreciate that these are distinct aspects. If perfect measures of wealth were available these aspects could be easily combined. As it is however the element of risk and uncertainty in the treatment of incomplete transactions in income calculations (see below) makes this impossible and in practice the dual purpose of income statements (measurement of performance and of maintenance of capital) often leads to conflict in the application of accounting concepts.

7.5 Insofar as income statements are able to meet both purposes ('performance' and 'capital maintenance') they are likely to contribute significantly to user needs in :

- (a) Evaluating the performance of the reporting entity.
- (b) Assessing the effectiveness of the entity in achieving objectives established previously by its management, its members or owners or by society. This includes, but is by no means limited to, compliance with stewardship obligations.
- (c) Evaluating managerial performance efficiency and objectives including investment and profit distribution plans.
- (d) Assessing the economic stability and vulnerability of the reporting entity.
- (e) Estimating the capacity of the reporting entity to pay dividends.
- (f) Making economic comparisons.
- (g) Estimating the value of present and prospective interests in or claims on the entity.

Insofar as past performance can be a guide to the future, income statements can also be of use in estimating the future prospects of the entity.

Financial position statements

7.6 Financial position statements (balance sheets) should be concerned with disclosing the amount and sources of capital employed and an appropriate analysis of its disposition. Measurement of capital employed is not without considerable difficulty, but insofar as it can be achieved, it contributes, by the calculation of return on capital, to an evaluation of the efficient use of

resources and may also enable economic comparisons to be made. An estimate of total capital employed may have some use in assisting an understanding of the stability and vulnerability of the reporting entity, but this interest is more likely to be met by analysis of the detail contained within the financial position statement.

7.7 Financial position statements are therefore likely to contribute significantly to user needs in:

- (a) Evaluating the performance of the entity.
- (b) Assessing the effectiveness of the entity in achieving objectives established previously by its management, its members or owners or by society. This includes but is by no means limited to, compliance with stewardship obligations.
- (c) Evaluating managerial performance efficiency and objectives including investment and profit distribution plans.
- (d) Assessing the economic stability and vulnerability of the reporting entity.
- (e) Assessing the liquidity of the entity, its present or future requirements for additional fixed and working capital, and its ability to raise long and short term finance.
- (f) Assessing the capacity of the entity to make future reallocations of resources.
- (g) Making economic comparisons.
- (h) Estimating the value of present and prospective interests in or claims on the entity.

Flow of funds statements

7.8 Flow of funds statements (statements of sources and application of funds) should be concerned with distinguishing between funds generated or released by different means and the uses to which such funds are put. Flow of funds statements, by providing information on the activities of the reporting entity and its ability to generate funds, form an important means of fulfilling a general responsibility to report. Insofar as past flow of funds can be an indicator for the future, such statements will be of assistance in judging the future prospects of the entity, particularly its capacity for instance to make new investments and pay remuneration and dividends.

7.9 By showing the manner in which funds are generated and the extent to which they are locked into or released from fixed and working

capital, the information contained in flow of funds statements is likely to contribute significantly to user needs in:

- (a) Assessing the effectiveness of the entity in achieving objectives established previously by its management, its members or owners or by society. This includes, but is by no means limited to, compliance with stewardship obligations.
- (b) Assessing the economic stability and vulnerability of the entity.
- (c) Assessing the capacity of the entity to make future reallocations of its resources.
- (d) Estimating the future prospects of the entity, including its capacity to pay dividends, remuneration and other cash outflows and predicting future levels of production and employment.
- (e) Estimating the value of present or prospective interests in or claims on the entity.

Profit concepts

7.10 The concept of profit has been discussed frequently by economists. Our own thinking has been influenced by the definition propounded by Professor Sir John Hicks in his work 'Value and capital', which in this context may be paraphrased as the maximum value which an entity can dispose of during an accounting period and still expect to be as well off at the end of the period as it was at the beginning. This definition implies that a wholly satisfactory measurement of wealth would enable wholly satisfactory measurements of profit to be made by deducting the total wealth of an entity at the outset of a reporting period from the total wealth at its close, after adjusting for capital introductions and withdrawals.

7.11 Conventionally profit has not been calculated this way in financial statements. It has been calculated by reference to the transactions current during a period. The dynamic nature of the entity implies that at any moment of time there will be incomplete transactions which represent effort by the entity to which income could be related (or matched).

7.12 In measuring business income accountants have formulated basic rules for overcoming the problem of depicting a static view of dynamic entities and estimating the outcome of partly fulfilled transactions. Two of the most important are the 'accruals' concept and the 'prudence' concept. These are defined in the U.K. and Irish accountancy bodies' Statement of Standard Accounting Practice No. 2 as follows:

- (a) *The 'accruals' concept:* revenue and costs are accrued (that is,

recognised as they are earned or incurred, not as money is received or paid), matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they relate; provided that where the accruals concept is inconsistent with the 'prudence' concept . . . the latter prevails. The accruals concept implies that the profit and loss account reflects changes in the amount of net assets that arise out of the transactions of the relevant period (other than distributions or subscriptions of capital and unrealised surpluses arising on revaluation of fixed assets). Revenue and profits dealt with in the profit and loss account are matched with associated costs and expenses by including in the same account the costs incurred in earning them (so far as these are material and identifiable);

(b) *The concept of 'prudence'*: revenue and profits are not anticipated, but are recognised by inclusion in the profit and loss account only when realised in the form either of cash or of other assets the ultimate cash realisation of which can be assessed with reasonable certainty; provision is made for all known liabilities (expenses and losses) whether the amount of these is known with certainty or is a best estimate in the light of the information available.

7.13 The application of the concept of prudence is clearly useful to those users concerned with assessing economic stability and vulnerability (for example loan creditors). It is likely to be less useful to those users concerned with the measurement of performance (for instance equity investors) although this will depend on the nature of the entity.

7.14 The accruals concept deals with the attribution of cost to income and requires that revenue and costs are 'matched' with one another so far as their relationship can be established or justifiably assumed. As noted, there is, however, the important proviso that where the accruals concept is inconsistent with the prudence concept the latter prevails. It may reasonably be predicted that users concerned with security of capital would be better served by a more rigorous application of the prudence concept to cost attribution, whilst those concerned with performance would find useful the added dimension of income reports in which costs were matched as closely as possible with revenue, with the result that realities were not distorted by the need to observe cautious accounting precepts. While the concept of 'matching' can be

simply stated, it involves numerous problems of judgement, and a variety of conventions and practices have been evolved for handling them.

Bases of measurement

7.15 The usefulness of financial statements in fulfilling user needs is restricted at the present time because of the defects of the basis of measurement generally used. Historical cost accounting fails, in times of rapidly changing prices and values, to ensure that sufficient provision is made for capital maintenance. When reported figures are not related to current values there may be over- or understatement of performance as measured by profits and return on assets.

7.16 A further deficiency at the present time is that money, the unit of measurement used in financial statements, is not constant in value but fluctuates from year to year. In inflationary conditions the lack of a standard unit of measurement means that financial reports are not comparable over time (even over short periods) and can be seriously misleading. It is in our view essential that, whatever basis of historic cost or current value measurement is used, financial statements should express amounts in terms of a standard unit of measurement. The most obvious way in which this can be done is by means of adjusting figures by an appropriate index derived from fluctuations in the general purchasing power of money.

7.17 Methods of income measurement can be broadly divided into two main schools: historical cost systems (historical cost and CPP adjusted historical cost bases) and current value systems (replacement cost, net realisable value, net present value and value to the firm).

7.18 In the paragraphs which follow we briefly survey each of the six major bases of measurement currently accorded a reasonable level of practical or theoretical recognition. Our descriptions are confined to the essentials: we have not attempted to detail the numerous variants and elaborations surrounding each system.

Historical cost bases

Historical cost

7.19 Under the historical cost method assets are carried in the balance sheet on the basis of actual or allocated sacrifices incurred at their date of acquisition, and are limited to items expected with a high degree of

probability to produce future benefits. In the pure form of this system no recognition is given to post acquisition changes in asset values unless there is a permanent diminution in their value or until they are realised. In practice some entities revalue some fixed assets upwards from time to time and entities are expected to reduce the figure of current assets to net realisable value if this has fallen below original cost. Profit equals the net difference between realised revenues and the expired historical cost of inputs (essentially expenses) valued at acquisition prices.

7.20 The historical cost basis of measurement is generally agreed to be easier to apply than other bases and there will be no difficulty in reconciling basic accounting records with financial statements. Given stable currency values the actual or allocated sacrifice (cost) of acquisition may remain a useful measure for the determination of profit. Furthermore, given stability of prices of specific assets, acquisition cost may remain, in the short term at least, a reasonable indicator of replacement cost and net realisable value, both of which are current value measures.

7.21 Historical cost accounting is often said also to have the advantage of objectivity. However, this claim is weakened by the controversies attached to the practical application of this method which often requires considerable discretion to be exercised in the allocation of income and expenditure over time and between capital and revenue accounts. (See, for instance, the discussion about 'matching' in paragraph 7.14 above.)

7.22 Historical cost accounting has proved unsatisfactory in meeting user needs, especially in inflationary conditions. As a consequence there has developed a growing practice of substituting current market valuation figures in place of historical cost figures for fixed assets in company balance sheets. For example, in the case of property the Institute of Chartered Accountants in England and Wales in conjunction with the Royal Institution of Chartered Surveyors has recommended that directors consider the advisability of having independent valuations carried out regularly and frequently. Again, the accountancy bodies have already recognised the need at least to supplement historical cost figures in Provisional Statement of Standard Accounting Practice No. 7 dealing with accounting for changes in the purchasing power of money (although this deals primarily with income statements and is not designed to produce current valuation figures).

CPP basis

7.23 The CPP (Current Purchasing Power) basis involves an adjustment to take account of inflation, (i.e. general changes in the purchasing power of money). The CPP basis is usually taken to relate to an adjustment to the prevailing historical cost basis of measurement and it is only in this context that it is considered here. In the CPP historical cost form all items in the financial statements are measured on the historical cost basis adjusted for changes in the general price index since acquisition. Profit equals the difference between CPP revenue and CPP expenses, plus/less net gains/losses on monetary items.

7.24 The adoption of the current purchasing power basis of measurement means that historical cost figures are adjusted into a standard unit of measurement although not a comparable basis from year to year until the previous year's figures have been updated for the inflation that has occurred since the previous year-end.

7.25 Critics of CPP accounting claim that the application of a general price index to results may have little relevance to many undertakings (those for example trading in specific commodities whose prices vary significantly from changes in current purchasing power). However, CPP accounting is concerned with the maintenance of purchasing power invested in the enterprise.

7.26 CPP accounting has been demonstrated to be a workable basis of accounting (which some of the other bases of accounting have not, at least to date) and as such represents, in our view, a desirable initial move away from pure historical cost accounting. But insofar as CPP accounting is especially (though not uniquely) concerned with the point of view of investors its application may not, by itself, completely fulfil the fundamental objectives of corporate reports.

Current value bases

Replacement cost

7.27 Under the replacement cost method assets are valued on the basis of the current sacrifice which would be incurred in replacing the future service potential or capacity represented by the asset. Estimates of such sacrifices may be employed through direct pricing or through the use of specific price indices. Profit is the difference between realised revenues and the current cost of expense inputs adjusted, in some variants, by increases in the replacement cost of

assets employed. Provision may also be made to include losses and gains in monetary items and to eliminate the fictitious (purchasing power) element of realised and unrealised changes in the replacement cost of assets employed.

7.28 The term replacement cost accounting in fact covers a family of techniques which may be taken to include placing values on assets by reference to the cost of replacement by:

- (a) Identical assets of the same age and condition.
- (b) Assets of identical manufacturing or service capacity.
- (c) Assets of identical profit capacity.

7.29 Replacement cost accounting is concerned with the maintenance of a given level of physical assets or operating capacity. As such the application of the basis can provide useful measurements for external users and for internal management. Moreover replacement cost accounting has been used successfully by a number of companies, notably in Holland. There are, however, many divergencies in the application of the replacement cost basis (just as there are in the application of the historical cost basis) and its use requires well developed accounting and managerial resources.

Net realisable value

7.30 Under the net realisable value basis assets are valued at their opportunity cost in terms of the current cash equivalent of the benefits obtainable in an orderly programme of asset disposal in current market conditions. Use of this method is not taken to imply an intention to liquidate. Profit is equivalent to the change in the net worth of successive balance sheets (after accounting for capital introductions and withdrawals). The conventional breakdown between revenue and expenses is not normally employed.

7.31 Net realisable value measures of wealth would be useful in contributing to users' needs in assessing the capacity of the reporting entity to make future reallocations of its resources. In that they take into account the alternative uses to which assets may be put, they may also be of assistance in evaluating the entity's effectiveness in using resources and estimating the value of interests in or claims on the entity.

7.32 The use of net realisable value as a practical measurement technique depends on assumptions about whether the sale is to be forced or orderly, on the availability of willing buyers and on the continuance of existing market conditions.

7.33 The principal drawback to this basis lies in the problem of practicality. Use of net realisable value implies that an arm's length market is available against which assets can be valued. In the case of specialised assets in particular such a ready market will rarely exist in practice (though it does exist, for instance, for undertakings holding portfolios of listed securities, such as unit or investment trusts). As regards assets held for resale, valuation at net realisable value is conceptually possible for finished goods, but presents obvious room for manipulation by increasing or reducing inventory levels.

Net present value

7.34 Under the net present value basis assets, or groups of assets or the enterprise as a whole, are valued at the present value of the expected future stream of net cash flows attributable thereto, applying discount rates reflecting prime interest costs and enterprise risks. Profit is equal to the change in net worth as represented by successive balance sheets (after accounting for capital introductions and withdrawals), with periodic revision of expectations and yields. The conventional breakdown into revenues and expenses is not employed.

7.35 The technique of evaluating assets by reference to future cash receipts has attractions in that it comes close to reconciling reported values to an economic definition of wealth. The application of this basis does, however, appear to present insurmountable practical difficulties. These centre on the uncertain amount and timing of future cash flows and their partial dependence on future decisions and as yet unsuspected external factors. The selection of a suitable discount factor would necessarily be subjective and would involve taking a view as to the degree of risk and uncertainty attached to expected future cash flows. The application of the net present value basis to individual assets is complicated by the problem of dividing and allocating cash flows attributable to groups of assets.

Value to the firm

7.36 The value to the firm basis involves the use of a combination of the three current value measurement bases outlined above – replacement cost, net realisable value and net present value. In this system assets are valued at their opportunity value, namely the least costly sacrifice avoided by owning the asset. This will usually be the lower of replacement cost or net realisable value in the case of fixed or current assets held for resale or the lower of replacement cost or net

present value in the case of assets held for use. Profit is computed on a basis similar to the replacement cost basis outlined above.

7.37 Value to the firm has the advantage that it is designed to exploit the best features of the various current value systems. This flexibility gives it merit. Relying on multiple bases of accounting, the system is subtle in concept and requires accounting and management resources not always readily available at present in many of the entities of the economic size with which we are concerned. But the theoretical merits of the basis are undeniable and its possibilities as a practical system have been demonstrated by a number of companies. We recommend further study of this system.

The future

7.38 From our review of the main available systems of performance and position measurement we conclude that no one system is capable of meeting all the user needs we have identified. The problem is illustrated by our own assessment of the bases considered (included in matrix form in appendix 5). This suggests that financial statements might use a number of appropriate measurement bases designed to meet different user needs and might give more than one figure for profit/performance and more than one figure for financial position, using for example a multi-column presentation.

7.39 However, such an approach would involve an enormous change in accounting practice and assumes a higher level of user comprehension than at present exists (although a step in this direction has already been made by the introduction of supplementary inflation-adjusted profit statements). While undoubtedly providing a more rounded picture of economic activities, multi-column reports would be highly complex and will fail the test of usefulness if they are not understandable.

7.40 We recommend that a programme of research be conducted into the feasibility of multi-column reporting and in particular the problem of presentation. One of the objectives of such research should be to narrow the number of presentations compatible with fulfilling user needs and maintaining understandability. Should multi-column reporting prove to be the solution it will only achieve its purpose if accompanied by an extensive educational programme for users.

7.41 We consider that original inputs into accounting records will continue to be expressed in historic cost terms for the foreseeable

future. We are aware of no other system that is so universally available, understandable and practical for recording basic data. But the historic cost system is demonstrably defective when it comes to the measurement of results and financial position in periodic financial reports, particularly in the context of significant changes in the purchasing power of money.

7.42 The defects of the historic cost system under inflationary conditions can be ameliorated by the use of general index-adjustment techniques. We recommend that at least for the present, historic cost figures should be adjusted for the effects of inflation in the manner recommended in Provisional Statement of Standard Accounting Practice No. 7, but that the inflation adjusted financial statements should be reported not as supplementary statements but should be accorded equal status.

7.43 Beyond this, we believe that current value methods of measurement, accompanied by the use of a general index adjustment, will in time prove to offer superior means of measuring performance and position. We recommend a practically-orientated programme of research and testing to develop a workable and standardised system of current value accounting capable of general application.

Summary of section seven

7.44 Having considered the types of statements published and the user information needs that these satisfy we conclude income statements (profit and loss accounts in the case of business enterprises) should be concerned with the measurement of performance, although they may also be used in the measurement of capital maintenance and income distributability; position statements (balance sheets) should be concerned with measuring the resources owned by the reporting entity; flow of funds statements (sources and application of funds statements) should be concerned with showing the generation and disposition of funds. However, there are inherent conflicts in the application of accounting concepts in arriving at a dual purpose measure of performance and capital maintenance.

7.45 We consider that whatever basis of measurement prevails, financial statements should be expressed in terms of a standard unit of measurement. We regard this as fundamental.

7.46 We conclude that no one system of measurement is capable of meeting the user needs we have identified. However, the use of a

number of appropriate measurement bases designed to meet different user needs (using for example a multi-column presentation) would involve an enormous change in accounting practice and may fail the test of usefulness if understandability is impaired. We recommend that a programme of research be conducted into the feasibility of multi-column reporting and in particular the problem of presentation.

7.47 The fact that virtually every economic entity maintains its records on a historical cost basis dictates that for the present, at least, financial statements must be largely based upon historical cost figures. However we believe that historical cost figures alone are inadequate and that the thrust of development should now be towards the adoption of current value systems. Until a workable and standardised system of current value accounting is developed we recommend that historic cost figures should be adjusted for the effects of inflation in the manner recommended in Provisional Statement of Standard Accounting Practice No. 7, but that the inflation adjusted financial statements should be reported not as supplementary statements but should be accorded equal status.

7.48 We recommend a practically-orientated programme of research and testing to develop a workable and standardised system of current value accounting capable of general application.

Part III
Summary

Section eight

Summary of this discussion paper

Section one

8.1 Our basic approach has been that corporate reports should seek to satisfy, as far as possible, the information needs of users. We believe there is an implicit responsibility to report incumbent on every economic entity whose size or format renders it significant. This responsibility arises from the custodial role played in the community by economic entities. Although we believe this principle of public accountability to be applicable to every type of entity we have not attempted to consider in detail non-commercial public sector reporting. We recommend further study in this area.

8.2 We define users as those having a reasonable right to information concerning the reporting entity arising from the public accountability of the entity. We have assembled a list of user groups which we identify as the equity investor group, the loan creditor group, the employee group, the analyst-adviser group, the business contact group, the government and the public. Although corporate reports should seek to satisfy as far as possible the information needs of these user groups it is impractical to suggest all needs of all users could be entirely met by such general-purpose reports.

Section two

8.3 Having reviewed the rights and needs of user groups we conclude that corporate reports may be able to contribute to user information needs in:

- (a) Evaluating the performance of the entity.
- (b) Assessing the effectiveness of the entity in achieving objectives established previously by its management, its members or owners or by society. This includes but is by no means limited to, compliance with stewardship obligations.
- (c) Evaluating managerial performance, efficiency and objectives, including employment, investment and profit distribution plans.
- (d) Ascertaining the experience and background of company directors and officials including details of other directorships or official positions.
- (e) Assessing the economic stability and vulnerability of the reporting entity.

- (f) Assessing the liquidity of the entity, its present or future requirements for additional fixed and working capital, and its ability to raise long and short term finance.
- (g) Assessing the capacity of the entity to make future reallocations of its resources, for either economic or social purposes or for both.
- (h) Estimating the future prospects of the entity, including its capacity to pay dividends, remuneration and other cash outflows and predicting future levels of investment, production and employment.
- (i) Assessing the performance, position and prospects of individual establishments and companies within a group.
- (j) Evaluating the economic function and performance of the entity in relation to society and the national interest and the social costs and benefits attributable to the entity.
- (k) Attesting to compliance with taxation regulations, company law, contractual and other legal obligations and requirements (particularly when independently verified).
- (l) Ascertaining the nature of the entity's business and products.
- (m) Making economic comparisons, either for the given entity over a period of time or with other entities.
- (n) Estimating the value of users' own or other users' present or prospective interests in or claims on the entity.
- (o) Ascertaining the ownership and control of the entity.

Section three

8.4 In our view **the fundamental objective of corporate reports is to communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.**

To fulfil this objective we conclude that corporate reports should be relevant, understandable, reliable, complete, objective, timely and comparable.

8.5 This fundamental objective will apply to all corporate reports, whoever the reporting entity and whatever the reason for publication. However, the degree of disclosure appropriate in each particular case will be limited by practical considerations of cost and confidentiality and by the need to arrive at a balance which will imbue corporate reports with the desired characteristics outlined above and the need to serve, as far as possible, the general interests of all users.

Section four

8.6 In reviewing the relevance of the conventional view of the aim of published financial reports to current conditions and attitudes we note the trend towards the acceptance by business enterprises of multiple responsibilities and conclude that distributable profit is no longer the sole or premier indicator of performance in the corporate reports of such entities. We recognise the trend in new and proposed legislation towards the recognition of the rights to information of a growing number of groups including employees and the public. We suggest there is a need for additional indicators of performance in the corporate reports of all entities.

Section five

8.7 We believe that corporate reports should be concerned with all possible ways of effectively describing economic activities and recommend that ways of improving the means of communicating corporate report information should be actively explored.

8.8 We support the view that corporate reports should be timely and be presented frequently and regularly. However we recognise that corporate reports are expensive to produce and do not believe the benefits to be derived from producing such reports on a basis more frequently than annually is sufficient to warrant the extra costs involved.

8.9 We consider that the corporate report of those economic entities falling within our tests of significance should, besides being sent to each shareholder, be generally available free on request. We strongly support the production of simplified versions and special interest extracts of corporate reports.

Section six

8.10 As current reporting practices do not fully meet the needs of users identified earlier, we conclude there is a need for additional statements to be published and suggest the following:

- (a) A statement of value added.
- (b) An employment report.
- (c) A statement of money exchanges with government.
- (d) A statement of transactions in foreign currency.
- (e) A statement of future prospects.
- (f) A statement of corporate objectives.

We believe that social accounting will be an area of growing concern to corporate report users and recommend further study into methods of social accounting.

8.11 While not attempting to consider detailed disclosure in basic financial statements we approve the concept of disaggregation and recommend further research in this area. Our suggestion is that a basis of division of activities should be selected which, in the opinion of management fairly represents the range and significance of activities, and that disaggregated information be given in respect of turnover, value added, profits or losses before tax, capital employed and employees.

8.12 We believe descriptive and interpretive statements by chairmen or chief officers to be an essential feature of corporate reports and that their publication should be encouraged. We also recommend that corporate reports include appropriate summaries of income and expenditure, financial position and flow of funds statements for at least the previous five years.

Section seven

8.13 Having considered the types of statements published and the user information needs that these satisfy we conclude income statements (profit and loss accounts in the case of business enterprises) should be concerned with the measurement of performance, although they may also be used in the measurement of capital maintenance and income distributability; position statements (balance sheets) should be concerned with measuring the resources owned by the reporting entity; flow of funds statements (sources and application of funds statements) should be concerned with showing the generation and disposition of funds. However, there are inherent conflicts in the application of accounting concepts in arriving at a dual purpose measure of performance and capital maintenance.

8.14 We consider that whatever basis of measurement prevails, financial statements should be expressed in terms of a standard unit of measurement. We regard this as fundamental.

8.15 We conclude that no one system of measurement is capable of meeting all the user needs we have identified. However the use of a number of appropriate measurement bases designed to meet different user needs (using for example a multi-column presentation) would involve an enormous change in accounting practice and may fail the test of usefulness if understandability is impaired. We recommend that a programme of research be conducted into the feasibility of multi-column reporting and in particular the problem of presentation.

8.16 The fact that virtually every economic entity maintains its records on a historical cost basis dictates that for the present, at least, financial statements must be largely based upon historical cost figures. However, we believe that historical cost figures alone are inadequate and that the thrust of development should now be towards the adoption of current value systems. Until a workable and standardised system of current value accounting is developed, we recommend that historic cost figures should be adjusted for the effects of inflation in the manner recommended in Provisional Statement of Standard Accounting Practice No. 7, but that the inflation adjusted financial statements should be reported not as supplementary statements but should be accorded equal status.

8.17 We recommend a practically-orientated programme of research and testing to develop a workable and standardised system of current value accounting capable of general application.

Appendices

Appendix 1

Suggested tests of economic significance

We consider there is an implicit responsibility to report (whether or not required by law or regulation) incumbent on every economic entity whose size or format renders it significant.

The definition of what constitutes 'significant' must be a matter of arbitrary and largely subjective judgement. But by relating size criteria to numbers employed it is possible to establish parameters which seem likely to command general acceptance. For instance, to fix the size threshold at a workforce exceeding one thousand persons would seem to exclude a significant number of the one thousand largest British companies. On the other hand there are some precedents to suggest that a workforce of 250-350 persons marks a natural break between the organisationally simple and economically modest undertaking and the organisationally complex and economically significant undertaking. In fact (and admittedly arbitrarily) we suggest a threshold slightly above these minima.

We consider all listed companies to be significant and therefore to have a responsibility to publish corporate reports. We consider other economic entities to be significant and have a responsibility to publish corporate reports if, on a consolidated basis, they:

- (a) Have, on average, more than 500 employees during a reporting period, or
 - (b) Have, on average, capital employed (including loan capital and bank overdrafts) of over £2 million during a reporting period, or
 - (c) Have annual gross turnover or revenues in excess of £5 million.
- (All money amounts should be inflation adjusted in future years.)

Once falling within the scope of these size tests we think entities should be expected to continue to publish financial reports as suggested unless they fall below the test limits for five consecutive years.

Appendix 2

The contents of corporate reports

The package of information contained in the annual corporate reports of business enterprises should contain at least the following statements (in which all pound figures have been price level adjusted):

	Suggested relevant classes of undertakings
1 Chairman's, president's or chief executive's statement	A, B, C, D, E, F, G
2 Directors' (or Management) report	A, B, C, D, E, F, G
3 Statement of accounting policies	A, B, C, D, E, F, G
4 Auditor's report	A, B, C, D, E, F, G
5 Profit and loss (or income and expenditure) account	A, B, C, D, E, F, G
6 Statement of changes in retained earnings	A, B, C, F, G
*7 Statement of value added	A, B, C
8 Source and application of funds statement	A, B, C, D, E, F, G
9 Balance sheet (or statement of financial position)	A, B, C, E, F, G
*10 Employment report	A, B, C, D, E, F, G
*11 Statement of money exchanges with government	A, B, C, E, F, G
*12 Statement of transactions in foreign currency	A, B, C, E, F
*13 Statement of future prospects	A, B, C, D, E, F
*14 Statement of corporate objectives	A, B, C, D, E, F, G
15 Summary, for at least the previous five years, of:	
(a) Profit and loss (or income and expenditure) account	A, B, C, D, E, F, G
(b) Balance sheet (or statement of financial position)	A, B, C, E, F, G
*(c) Source or application of funds statement	A, B, C, D, E, F, G

Key to classes of undertakings and organisations :

- A Companies
- B Commercially oriented public sector bodies (e.g. nationalised industries)
- C Unincorporated firms (e.g. partnerships)
- D Non-commercially oriented central government departments and agencies
- E Local authorities
- F Trade unions and trade and professional associations
- G Pension schemes, charitable and other trusts and non-profit seeking organisations.
- * Indicates information additional to the normal contents of corporate reports at the time of writing.

Appendix 3

Example employment report

A Manufacturing Company

Employment Report Year to December 31 1974

1 Number employed (including overseas)		as at year end		average
(a) total employees		male	female	during
				year*
			total	total
total full time	7000	2500	9500	9000
total part time		1000	1000	1000
total temporary	1000	1000	2000	500
	<u>8000</u>	<u>4500</u>	<u>12500</u>	<u>10500</u>
(b) Functions of employees				
Production				8750
Other				1750
Total				<u>10500</u>
(c) Total permanent employees at commencement of year				9500
(d) Net increase in permanent staff during year				1000
(e) Comprising:				2500
	recruitments			1500
	separations (including 100 redundancies)			<u>1000</u>

2 Location of Employment

At the year end the company operated three major employment units in the U.K. These were at Birmingham (1500), Liverpool (2000) and London (2000). In addition there were 10 minor employment units (employing in total 1000).

Overseas the company operated three major employment units. These were in South Africa (2000), Zambia (500) and the U.S.A. (1500).

*Full time equivalent

3 Age distribution of permanent workforce at the year-end

	Overseas	U.K.	Total
Under 20 years	100	2100	2200
20-29	1000	1800	2800
30-39	1200	1100	2300
40-49	1000	700	1700
50-59	600	400	1000
Over 60	100	400	500
Total	<u>4000</u>	<u>6500</u>	<u>10500</u>

4 Hours worked during year

	Overseas (Million hours)	UK (Million hours)	Total (Million hours)
Paid hours			
Total paid at normal rates	7.7	10.7	18.4
Total paid at overtime rates	0.6	1.6	2.2
Total paid hours	<u>8.3</u>	<u>12.3</u>	<u>20.6</u>
Unpaid lost hours	0.3	1.3	1.6
Total required hours	<u>8.6</u>	<u>13.6</u>	<u>22.2</u>
Less: Paid lost hours:			
Sick leave	0.2	0.2	0.4
Industrial accidents	0.1	0.1	0.2
Lay-offs	-	0.1	0.1
Industrial disputes (external)	0.2	0.1	0.3
Unpaid lost hours:	<u>8.1</u>	<u>13.1</u>	<u>21.2</u>
Lay-offs	0.1	0.1	0.2
Industrial disputes: Internal	0.2	1.1	1.3
External	-	0.1	0.1
Total hours worked	<u>7.8</u>	<u>11.8</u>	<u>19.6</u>
Average required hours per week per employee	43.0	41.8	42.2
Average hours worked per week per employee	39.1	36.3	37.3
Average paid holiday hours per annum per employee	75	77	76

5 Employee costs

	Overseas (£000)	UK (£000)	Total (£000)
Total wages and salaries	7,400	16,300	23,700
Total cost of fringe benefits	300	1,900	2,200
	<u>£7,700</u>	<u>£18,200</u>	<u>£25,900</u>
Average benefit per week per employee	£37	£54	£47

6 Pension

At the year end 6000 employees were members of the company pension scheme to which the company contributed £1,420,000 during the year and employees contributed £702,000. The scheme, which is underwritten by the XYZ Life Assurance Company, is open to all full time employees over the age of 25 earning in excess of £1,200 p.a. Employee contributions amount to 5% of basic salary or wage. Benefits are calculated by reference to the number of years service and average salary for the last five years of service up to a maximum of 40/60ths of this average.

7 Education and training (U.K. only)

	Total (000 hours)
Total employee hours spent in training during year within the company (but excluding on-the-job training)	220
External training courses	135
	<u>355</u>
Cost of training	Total (£000)
Cost of training department	70
Wages of trainees during training	360
Training Board levy	190
External Courses	540
	<u>1,160</u>
Less training board grant	95
Total	<u>£1,065</u>

8 Recognised trade unions

During the year the company recognised the following trade unions for the purposes of collective bargaining: AICE, VIE, OET AICE informed the company that 4000 of its members were employed by the company. The other two unions have not provided information on numbers of members employed.

9 Additional Information

(a) Number of formal complaints lodged with Race Relations Board	25
(b) Number found to be justified	5
(c) Frequency of industrial accidents (accidents per 1000 hours worked)	0.4
(d) Severity of industrial accidents (hours lost through accidents as a percentage of hours worked)	0.8%
(e) Number of registered disabled persons employed	500
(f) Number of employees confirmed to be suffering permanent disease or injury through conduct of their work	25
(g) Number granted compensation for occupational disease or injury	15

10 Employment Ratios

	Overseas	U.K.	Total
	£	£	£
Average sales per employee	9600	10100	9860
Average value added per employee	3650	3300	3450
Average pre-tax profit per employee	900	690	720
Average remuneration per employee	1925	2800	2470
Average net earnings per employee	1650	2050	1980
Investment in plant per employee	3250	5300	4650
Average exports per (U.K.) employee		1000	1000
Employee costs as a percentage of sales	23%	26%	25%
Employee costs as a percentage of value added	63%	74%	71%
Labour turnover (number of leavers during year as a percentage of average number employed)	13%	15%	14%

Appendix 4

Survey of business objectives: Analysis of results

1 At a meeting of the Scope and Aims working party held on 25 January, 1975 it was agreed the Technical Directorate of the Institute of Chartered Accountants in England and Wales should undertake a survey of the primary business goals of enterprises. To implement this decision the chairman of the working party wrote to the largest 300 of the 'Times 1000' companies asking for a brief statement of company objectives.

2 In reply 166 such statements were received (a response rate of 55%). Although some companies questioned the need for such a survey, the chairman's request was generally well received.

3 Of the replies, a majority of 58% linked primary objectives to profits. Of these 23% narrowed this to profits available for distribution to shareholders. The majority of companies stated that they recognised a responsibility to employees (71%) to shareholders (69%) and to customers (53%).

Survey of business objectives – the results

Primary objectives stated to be related to:	Number	%
profits	58	35
profits (measured in terms of shareholder return)	39	23
<hr/>	<hr/>	<hr/>
total related to profit	97	58
survival	16	10
service offered	31	19
other	22	13
	<hr/>	<hr/>
	166	100
	<hr/>	<hr/>
Responsibilities stated to be recognised towards:		
Employees	119	71
Shareholders	114	69
Customers	88	53
Community	47	28
Environment	11	7
Suppliers	10	6
The Nation	7	4
Governments	5	3
Balance of payments/exports	5	3

Primary objectives relating to profits

Number relating primary objective to:	Number	% of total replies
Shareholders return only	16	10
Shareholders return plus a responsibility towards employees and/or other groups	23	13
Profits only	14	9
Profits plus a responsibility towards specified groups (e.g. employees, customers, etc.)	44	26
	<u>97</u>	<u>58</u>

- 4** Only 10% of the replies received expressed the extreme view that the primary objective of the company was to earn profits only for the benefit of shareholders. Typical replies of this kind were:
- 5** "To make profits through which our shareholders will obtain satisfactory and continuing rewards for their investment."
- 6** "To earn profits for the shareholders by the use of the skills of management and employees alike."
- 7** A further 13% of the replies received, while putting the interests of shareholders first (or at least measuring success in terms of shareholder return) also stated that the company recognised responsibilities to other groups. Typical replies in this category were:
- 8** "To increase the value of shareholders' equity in the long term while providing standards of employment considered to accord with the best practices in the industry."
- 9** "To maximise over the years the wealth of its shareholders working within the usual legal and ethical constraints. The company has subsidiary social objectives of which the three most important are:
- (a) To treat all those who work for the firm fairly both during and after their employment.
 - (b) To give our varied customers as good a deal as possible, and never to take advantage of our position as a supplier.
 - (c) To be a good citizen in the various communities within which we operate."

10 "To increase net earnings per share at an average rate of 15% p.a in real terms. We fully realise that unless we pursue adequate social and employment policies we would suffer from obvious constraints in trying to meet our objective."

11 Of the 58 replies relating objectives to profits, 14 replies did not link objectives to particular groups. Examples of replies falling into this category are:

- 12 "To make profits which represent an efficient level of return on the resources used in the business both capital and human."
- 13 "To make a profit."
- 14 "To make the maximum possible return on capital employed."
- 15 The remaining 44 replies relating primary objectives to profits all stated that these were to be earned for the benefit of a number of groups. Examples of such replies are:
- 16 "To maintain a satisfactory profit growth in the interests respectively of our shareholders, employees and customers."
- 17 "To secure as remunerative a use of the capital we employ as is consistent with good service to customers and a rewarding career for employees."
- 18 Not every company relating primary objectives to profits sets out to 'maximise' profits or shareholder return. While 19 replies did state maximisation of profit to be the company objective, 23 replies qualified the amount of profit sought by such words as 'proper' and 'fair', 'reasonable', 'sufficient' and 'adequate'.
Examples of such replies are:
- 19 "To be an efficient, economic company making profits with decency whilst also being a good citizen of the countries in which we operate."
- 20 "To make a fair profit."

Primary objective relating to service offered

- 21 Just under one fifth of the replies received related primary objectives to service offered. Examples of such replies are:
- 22 "To give the best possible service."
- 23 "To provide a service to customers which is better than that of its competitors."
- 24 "To manufacture and market goods designed to meet the requirements of users, at prices they can afford, whilst giving a satisfactory return on capital."

Primary objectives related to survival

- 25 One tenth of the replies related primary objectives to survival. Examples of such replies are:
- 26 "To survive without having to go to government for financial help."
- 27 "To preserve and develop itself so as to remain an outgoing and profitable concern; and that it will best achieve that objective if continually aims to observe four independent sets of interest—the interests of its customers, of investors and lenders, of employers, and of society at large; and to hold the balance between them as fairly as it can."

Other stated primary objectives

28 Twenty two of the replies related primary objectives to goals other than those noted above. The most common of these related objectives to achieving or fulfilling:

- (a) multiple goals and responsibilities of equal priority (12 replies)
- (b) growth (6 replies)

Examples of (a) are:

29 "To improve the quality of life, in the long term, of our customers, employees, shareholders, and the public at large and to do so without lowering the quality of life of anyone who lives near our factories."

30 "We do not direct the business for the particular benefit of any one segment of the community. Rather we endeavour to direct profitably the business of the company whilst recognising the interests of all those directly and indirectly participating in our affairs; namely our shareholders; all the people who work in the business; our customers (the public as well as our distributors); our suppliers; the local communities where we have manufacturing interests; local governments and of course, national governments both at home and abroad."

31 "To preserve a balance between the interests of all employees, shareholders, customers and the community."

Examples of (b) are:

32 "To be a successful growth public company, providing reputable goods and services, and fulfilling in an honourable fashion its responsibilities to its shareholders, employees, customers, suppliers and the communities and countries in which it operates."

33 "To establish and maintain a growth company for the benefit of our shareholders, staff and customers."

Subsidiary objectives/responsibilities

34 Of the 166 companies replying to the survey only 32 chose not to state subsidiary social objectives or recognise responsibilities to a number of groups. The majority of companies recognised a responsibility towards shareholders, employees and customers.

An example of the minority view is:

35 "To maximise the return on the money entrusted to it by its shareholders. The directors are in what one could call a quasi-fiduciary position which I would have thought normally debarred them from departing very far from this principle."

An example of the majority view is:

36 "To operate a well managed, efficient and profitable business; one which yields a proper return to shareholders; serves consumers well by offering fairly priced products of the highest quality

designed to meet their specific wants and needs ; and pays careful attention to the wishes of the employees, customers, suppliers and the community."

Conclusion

37 The majority view of those replying to the survey seems to be that their primary objective is to make a profit for the benefit of a number of groups and that this can only be achieved if due attention is paid to the particular interests of each of these groups. It is not the majority view that the maximisation of shareholders' profit is the primary objective.

38 A statement of company purpose published by one company comes close to encapsulating the majority view. It is included below :

Our purpose in business

Our purpose in business is to create wealth, to make money. For this to be possible we must please our customers and enjoy the confidence of our shareholders and employees. We must make good profits, so that after providing for taxes and dividends (and in present conditions financing inflation) there is available enough money to keep our factories and equipment modern and to enable us to grow in strength and maintain or improve our market position. We endeavour to provide good, satisfying employment for our people. Creating wealth and building a better company is our contribution to better standards of living.



Appendix 5

Assessment of measurement bases

We have completed the following matrix by entering an assessment of the degree to which each criterion could be met by the measurement basis heading each column. (a) is the high-point of the scale representing a very-high degree of compliance. (e) represents very low utility or compliance. This assessment represents the collective opinion of the members of the Working Party and is not based upon the results of extensive research. We believe that the inclusion of this assessment may be useful as a starting point for discussion and research. While each basis has variants (for example, replacement cost accounting will involve some reduction where replacement cost is seen to be an unrealistically high value) we are concerned here with the essence rather than the precise technical form of each and our assessment is of present attainable potential. We have however assumed that current value bases (columns (iii) to (vi)) include the use of a general price level adjustment.

- Criteria to be met
- (1) **Theoretical acceptability**
 (a) Consistent with economic concepts of value and income
 (b) Consistent with SSAP 2 concepts:
 (i) Going concern
 (ii) Accruals
 (iii) Prudence
- (2) **Utility: Relevance to user needs in**
 (a) Assessing stability
 (b) Assessing vulnerability
 (c) Evaluating liquidity
 (d) Evaluating performance
 (e) Judging future prospects

Criteria to be met	Measurement Basis					
	Historic Cost		Current Value			
	HC (i)	CPP (ii)	RC (iii)	NRV (iv)	VF (v)	NPV (vi)
(1) Theoretical acceptability						
(a) Consistent with economic concepts of value and income	e	c	b	b	a	a
(b) Consistent with SSAP 2 concepts:						
(i) Going concern	a	a	a	d	a	b
(ii) Accruals	a	a	a	c	a	c
(iii) Prudence	c	b	b	a	b	c
(2) Utility: Relevance to user needs in						
(a) Assessing stability	c	c	b	b	b	d
(b) Assessing vulnerability	d	c	b	a	b	d
(c) Evaluating liquidity	e	b	b	a	b	e
(d) Evaluating performance	d	c	b	d	b	d
(e) Judging future prospects	e	c	b	c	b	c

Criteria to be met	Measurement Basis					
	Historic Cost		Current Value			
	HC (i)	CPP, (ii)	RC (iii)	NRV (iv)	VF (v)	NPV (vi)
(f) Evaluating management	d	c	b	c	b	d
(g) Making comparisons over time	d	b	b	c	b	d
(h) Making comparisons with other entities	c	b	b	c	b	c
(i) Assessing achievement of goals	e	c	c	d	b	c
(j) Assessing compliance with stewardship	b	b	c	d	c	d
(k) Evaluating social costs and benefits	*	*	*	*	*	*
(l) Assessing compliance with regulations	*	*	*	*	*	*
(m) Estimating value of owner and creditor interests	e	c	c	b	b	c
(n) Assessing capacity to adapt	d	c	c	a	c	d
(o) Estimating likely levels of employment and production	*	*	*	*	*	*
(p) Neutrality	b	b	c	c	c	d
(3) Practicality						
(a) Verifiability of raw data	a	a	c	c	d	e
(b) Feasibility of measurements:						
(i) Availability of data	a	a	c	d	d	e
(ii) Costliness of system required	a	b	c	d	d	e
(iii) Objectivity of measurements	a	b	d	d	d	e
(iv) Susceptibility to double entry procedures	a	b	b	b	b	e

Bases of Measurement :

- (i) Historical cost
- (ii) Current purchasing power
- (iii) Replacement cost
- (iv) Net realisable value
- (v) Value to the firm
- (vi) Net present value

These terms are defined in section seven. The assessment allocated to each measurement basis under each heading is the median of the range of the assessments of individual working party members.

*In our opinion this user need cannot be met by measurement methods used in basic financial statements though it may be assisted by other statements contained within the corporate report, including, for instance, the audit report and proposed employment report.

Appendix 6

Suggestions for further research

During our study we have encountered problems too large to be solved in the time allotted us or too specialised to be tackled except by a study group with relevant specialist knowledge. While trying to provide general pointers in these areas we recommend that positive steps be taken towards solving these important issues. In particular we recommend that, as a matter of urgency, research and studies be conducted in the following areas:

- (a) Public sector accounting (see paragraph 1.7)
- (b) Social accounting (see paragraph 6.47)
- (c) Disaggregation (see paragraph 6.51)
- (d) Multi-column reporting in basic financial statements (see paragraph 7.40)
- (e) Current value accounting (see paragraph 7.43)

In addition we consider there are many improvements that can be made relating to the degree of disclosure in income and expenditure and position statements and the additional statements we have recommended remain to be developed.

Appendix 7

Individuals and organisations contributing views, comments and ideas to the study

- 1 G. H. Ackroyd, The British Petroleum Co. Ltd.
- 2 John Arnold, University of Manchester
- 3 Association of Investment Trust Companies
- 4 Association of Irish Chartered Accountants in London
- 5 Association of Unit Trust Managers
- 6 Australian Accounting Standards Committee
- 7 Australian Accounting Research Committee
- 8 Bank of England
- 9 Professor Barback, University of Hull
- 10 Beds. Bucks and Herts District Society of Chartered Accountants
- 11 Professor Bird, University of Kent
- 12 Professor Brealey, London Graduate School of Business Studies
- 13 Birmingham and West Midlands Society of Chartered Accountants
- 14 Bruce Bower
- 15 Professor Briston, University of Strathclyde
- 16 British Institute of Management
- 17 British Insurance Association
- 18 British Leyland Motor Corporation Ltd.
- 19 Professor Bromwich, University of Wales Institute of Science and Technology
- 20 R. A. Brooks
- 21 J. A. Cannon, The Charterhouse Group Ltd.
- 22 Professor Carsberg, University of Manchester
- 23 Professor Chambers, The University of Sydney
- 24 City Capital Markets Committee
- 25 Commercial Union Assurance Company Ltd.
- 26 John Cope M.P.
- 27 Committee of London Clearing Banks
- 28 Department of Industry, Accountancy Services Division
- 29 J. P. Dornon
- 30 Dun and Bradstreet Ltd.
- 31 Professor Edey, London School of Economics and Political Science
- 32 Exeter and District Society of Chartered Accountants
- 33 Extel Statistical Services Ltd.
- 34 S. F. Fagan, Dun and Bradstreet Ltd.
- 35 E. Frye, The Plessey Co. Ltd.
- 36 M. B. Gifford-Gifford, University of Exeter
- 37 H. P. Gold

- 38 A. S. Gresty, J. Bibby & Sons Ltd.
- 39 D. W. Hardy, Tate & Lyle Ltd.
- 40 B. G. Harrison, University of Aston
- 41 Michael Heseltine M.P.
- 42 H. J. H. C. Hildreth, Institute of Directors
- 43 F. J. K. Hillebrandt, Imperial Chemical Industries Ltd.
- 44 Anthony Hope, University of Manchester
- 45 B. T. P. Horton, Avon Rubber Co. Ltd.
- 46 Humberside and District Society of Chartered Accountants
- 47 M. J. T. Hunter
- 48 Robin Hutton, Director General, Financial Institutions and Fiscal Matters, Commission of the European Communities
- 49 Insolvency Practitioners Association
- 50 Institute of Chartered Secretaries and Administrators
- 51 G. R. James, Henry Ansbacher & Co. Ltd.
- 52 Professor Kitchen, The University College of Wales
- 53 B. J. Knightley, Babcock & Wilcox Ltd.
- 54 J. A. Lane
- 55 G. A. Lee, University of Nottingham
- 56 Professor T. A. Lee, University of Liverpool
- 57 R. H. Legge
- 58 Leicestershire and Northamptonshire Society of Chartered Accountants
- 59 Liverpool Society of Chartered Accountants
- 60 London and District Society of Chartered Accountants
- 61 David A. K. McAbe, Investment Bank of Ireland
- 62 Graeme Macdonald, University of Kent
- 63 Amandio da Silva Machado, British American Tobacco
- 64 D. B. Mackay
- 65 J. McKinnon
- 66 P. N. McMonnies, Institute of Chartered Accountants of Scotland
- 67 Matrix Consultants
- 68 S. A. Middleton
- 69 Monopolies and Mergers Commission accounting staff
- 70 Moodies Services Ltd.
- 71 Frank Morland
- 72 Len Murray, Trades Union Congress
- 73 National Association of Pension Funds
- 74 National Economic Development Office
- 75 National Institute of Economic and Social Research
- 76 Office of Fair Trading
- 77 Denis R. Newman
- 78 J. D. Nicholson

- 79 F. A. Noble
- 80 North West Society of Chartered Accountants
- 81 E. A. D'Cruz
- 82 B. D. G. Ogle, Imperial Chemical Industries Ltd.
- 83 Professor Perrin, University of Warwick
- 84 T. M. Phillips, The John Lewis Partnership
- 85 A. J. Platt, Pilkington Brothers Ltd.
- 86 Sean Poster, The Institute of Small Business
- 87 P. E. Randall, International Telephone & Telegraph Corporation
- 88 David F. Robinson
- 89 Paul J. Rutteman
- 90 J. S. Sadler, The John Lewis Partnership
- 91 S. D. Samwell
- 92 Professor Sizer, Loughborough University of Technology
- 93 K. A. Sherwood
- 94 Southern Society of Chartered Accountants
- 95 Professor Standish, London Graduate School of Business and
Harvard Graduate School of Business Administration
- 96 Martin Stevens, Annual Reports Ltd.
- 97 C. M. Stuart, International Computers Ltd.
- 98 Tate & Lyle Ltd.
- 99 Professor Thomas, University of Bath
- 100 A. P. Thompson, de Zoete & Bevan
- 101 Professor Tricker, Oxford Centre for Management Studies
- 102 H. Volten, Nederlands Instituut van Registeraccountants
- 103 Richard Wainwright, M.P.
- 104 Peter Walker, M.P.
- 105 T. R. Watts
- 106 F. P. Weavers, Brittanica Assurance Co. Ltd.
- 107 The Zambian Association of Accountants