Finance & Management

May 2003 Issue 99 Price: £4.00

The monthly newsletter for members, with news, views and updates on current topics.

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Faculty of Finance and Management

'GRACE IS GIVEN OF GOD, BUT KNOWLEDGE IS BOUGHT IN THE MARKET ' – Arthur Hugh Clough

Annual report

The Faculty's annual report for 2002 is published in this issue, including the chairman's statement, financial statement, AGM notice and more (see the pull-out section following page 8).

FORTHCOMING EVENT ...

Value and values

7 May – In this Faculty evening lecture in Birmingham, consultant Malcolm Lewis will argue that linking value with values is the key to long term corporate, financial and personal success.

For further details – see page 15

IN THIS MONTH'S MAILING ...

Management Quarterly

Issue 19

Strategy
Putting VBM into practice

Marketing
The case for a new driver

Human resources
Do human resources really add value to a business?

Finance
Getting the equation right

Information technology
New ways to extract value from systems

FINANCE AND IT

Now the 'digital business reporting' revolution

Finance directors may have heard of 'eXtensible business reporting language' (XBRL), the technology that promises to improve the way that companies report their business performance, but they may still be hazy about its implications. Here **Chris Rodgers** of KPMG reveals how XBRL is likely to impact the activities of businesses in the UK and some of the milestones that will be passed this year.

Digital business reporting means that disparate systems will be able to exchange complex and structured information about business performance efficiently without losing context and meaning. The idea is not all that new, but moving from idea to reality has not been straightforward. No one said reporting business performance electronically would be simple.

To work, it needs to be able to take into account the myriad differences in corporate disclosures, as well as the similarities. Making a reality of digital reporting has waited on the development of internationally agreed technical standards and internationally and nationally agreed definitions that map accounting concepts using those technical standards.

Agreement takes time and takes sponsorship but with these early hurdles crossed, digital reporting is now accelerating at an extraordinary pace.

SEE ALSO
'A MAJOR INNOVATION FOR INVESTOR RELATIONS' BY ALISON JONES
ON PAGE 4

What is the problem that digital reporting addresses?

Moving reporting information between users, whether it be from an operating division of a company to the finance director's office, or across the world to a bank, a customer, the stock exchange, a ratings agency, or the regulators, has always involved huge amounts of effort on the part of the people producing the report, and similar levels of work and manual re-entry by the consumers of that report. In short, it's expensive. But more significant perhaps, far more time goes into producing the information than into its analysis.

We are all peripherally aware of the problems. The City analyst waits for

continued on page 2

Tel: 020 7920 8486 Fax: 020 7920 8784

ISSN 1471-1818

XBRL – *from page 1*

Chris Rodgers, a partner at KPMG, is the founding chairman of XBRL-UK, the UK arm of the not-for-profit XBRL International consortium that leads the development of the freely licensed standards. The views expressed in this article are his own and not necessarily the opinion of KPMG. E-mail: chris.rodgers@kpmg.co.uk

an earnings release to appear on a Bloomberg or Reuters screen, only to retype that information into a spreadsheet or database of his/her own. The bank officer takes the faxed financial statements of a corporate customer and types them into an analysis package in order to determine the ongoing credit-worthiness of that client. The FD's staff slave for weeks to acquire countless spreadsheets and consolidation reports from different parts of the company and then pull them together like so many tangled shoelaces. All these groups struggle with the fact that it is extremely difficult and expensive to move information from system to system, and even when it is possible, it's difficult to reconcile the subtly, but importantly different definitions that have gone into the mix.

The efforts of the XBRL consortium (see box below) have brought together both the technical standards and the support of the accounting profession to ensure that reporting concepts get mapped into a new language that allows information and its supporting definitions to jump from system to system without loss of meaning. XBRL works a lot like bar codes do, providing an unambiguous label for each item that appears in a set of financial statements, regulatory, taxation related or other kind of business report.

Coding or 'tagging' a piece of reported data with XBRL makes it possible for systems other than the one which created the information in the first place to identify the data in context. Which is to say that XBRL makes clear what a reported fact represents, for which company, or part of a company. It can define the reporting period, the relationship of that item to others in the report, and its definition, including the relevant accounting policy or authoritative accounting standard. An entire set of financial statements can be tagged in this way.

The standards are important for the economy because they make it possible to move business reporting information around the various users of this information without building proprietary interchange systems, or worse (and far more commonly) rekeying the information that appears in a printed report.

Because XBRL is based on core internet technologies, it is possible to search across XBRL documents and extract individual concepts that might be needed for particular types of analysis. It is also possible to transform XBRL reports into literally any other kind of format, including human readable ones like HTML and Adobe Acrobat (PDF) files.

How will the arrival of digital reporting benefit companies?
However, it is businesses themselves that are likely to benefit the most

XBRL-UK consortium members

- Credence Software Ltd
- Croner.CCH Ltd
- Deloitte & Touche
- Fitch Ratings Ltd
- Inland Revenue
- IBM Business Consulting Services
- ICAEW
- International Accounting Standards Board
- KPMG
- PricewaterhouseCoopers
- Department of Accounting and Finance, University of Birmingham
- DecisionSoft Ltd

A list of the 170 international members is at www.xbrl.org. See also www.xbrl-uk.org.

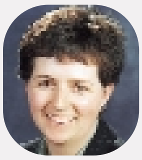
THE FACULTY OF FINANCE AND MANAGEMENT

Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ

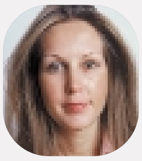
Main contact numbers
Tel: 020 7920 8486
Fax: 020 7920 8784
Web site: www.icaew.co.uk/fmfac

Comments and suggestions should be addressed to Chris Jackson (see below).

Chris Jackson
Head of Faculty
Tel: 020 7920 8525
chris.jackson@icaew.co.uk



Judith Shackleton
Technical manager
020 7920 8426
judith.shackleton@icaew.co.uk



Jo Kinlochan
Services manager
Tel: 020 7920 8508
jo.kinlochan@icaew.co.uk

Debbie Came
Administrator (job share)
Tel: 020 7920 8486
debbie.came@icaew.co.uk

Aurora Jay
Administrator (job share)
Tel: 020 7920 8486
aurora.jay@icaew.co.uk

THE FACULTY COMMITTEE

Christopher Pearce
(Chairman)

Charles Bartholomew	**Helen Jesson**
Ruth Bender	**Geoff Seeff**
Lois Bentley	**Douglas Shanks**
Kevin Bounds	**Professor Bob Sweeting**
Peter Franklin	**John Tranter**
Mark Garratt	**Colin Whipp**

All Faculty membership enquries should be addressed to Jo Kinlochan (details above) from digital reporting in terms of sheer scale. XBRL will allow companies to move information from system to system inside their own organisations. It will allow companies to develop a far more complete understanding of their reporting processes, the bottlenecks, the problems and the inconsistencies that exist inside those processes, and a set of tools for overcoming the weaknesses. XBRL provides a framework technology, and set of processes for sorting out the 'tangles' in the reporting mechanisms that exist in so many places.

This does not have to mean that companies will need to embark on new, expensive enterprise resource planning (ERP) systems implementations, nor become experts in the XBRL technology themselves. Over the next two to three years, we can look forward to more and more systems vendors simply building XBRL support into their own environments, providing the platform for reporting system interoperability that is missing today, making it simpler to bring about these kinds of improvements.

Equally, the benefits for listed companies, in using XBRL to help their investor relations efforts are clear. Companies seek to differentiate their activities from their competitors' in their reporting in myriad ways. XBRL provides new ways to convey the key factors that make a company stand out. As well as reducing the time that it takes for the analyst community to understand the business drivers that are important for individual companies, XBRL allows those companies to target their messaging in a very specific fashion. By producing unique 'extensions' to the XBRL definitions developed to meet disclosure requirements set out in the accounting literature, companies can directly draw attention to those particular aspects of their businesses that are distinctive.

XBRL has been built to cope with the diversity that exists in the way that individual companies report. It will not act like a straightjacket forcing all companies to comply with a chart of accounts. In practice, companies will be able to extend the core disclosure obligations set out in accounting standards to reflect their individual circumstances just as they do today.

Future XBRL applications will make the process of identifying and dealing with these extensions a routine exercise.

Where will we see change first?

Over the last few months there has been a flurry of announcements about regulators moving to adopt the XBRL standards, from the Inland Revenue, for corporate tax filings, to the US banking regulators for the quarterly regulatory reports they receive from the nearly 9000 US banks, to the Japanese tax authorities, the Tokyo Stock Exchange and the Danish companies authority. All these projects follow the lead of the Australian regulators that implemented their XBRL enabled systems over a year ago.

> Accounting professionals need to be ready for this

All seek to take advantage of a standard for corporate reporting that will allow them to receive more accurate and more relevant information at the same time as reducing the burden that their requirements impose on the business community. As accounting system vendors start to get serious about incorporating XBRL capabilities into their offerings, the benefits for regulators indisputably accrue.

So what should you do?

Does all of this mean that FDs should turn their organisations inside out, start new reporting projects, or reshape their investor relations platform? Not necessarily. Monitoring XBRL and recognising where its application could alter existing strategies should definitely be on the agenda. For some companies, the early adoption of the technology will make a positive statement about the transparency of their operations. For others the application of the technology will bring about business benefits that can't be passed up, notwithstanding the immaturity of the supporting tools available today.

The amount of time that it takes for a standard of this nature, one that will only take complete hold once entire supply chains adopt it, is difficult to predict. How long did it take for bar codes to revolutionise retailing and logistics? Nearly 10 years. How long did it take for internet browsers and the HTML standard to turn information dissemination upside down? About four years. How long will it take for XBRL to become the corporate reporting platform? No one knows. But this year will see a range of milestones that will help companies make their plans.

Significant milestones

The first stage of the Inland Revenue Corporate Tax e-Filings project was launched in March, with the XBRL specific aspects to be released later this year. This will allow companies to file both the CT600 form and the tax specific computations that reconcile the contents of the form with their accounts electronically, the latter in XBRL form. Later on the Inland Revenue will accept the financial statements themselves in XBRL format. This project should help simplify and streamline the tax filings process for tax payer and tax authority alike.

The international XBRL community will gather in Amsterdam this month for the 7th International XBRL conference. At that conference the next set of improvements in the standard itself will be released, together with the announcement of a range of related initiatives covering the creation of the XBRL accounting dictionaries ('taxonomies', in the jargon) and assurance over XBRL information, a vital step in ensuring the integrity of reports that appear in this format.

In late February, a much anticipated announcement was made by Microsoft which has decided to provide an XBRL add-in module to the next versions of Excel and Word. These should be available around the same time as Office 2003 is released and will allow authors of financial statements, or other kinds of business reports, to tag their information with XBRL, right inside their familiar Office environment. And leading up to the Amsterdam conference, we can expect to see a number of other announcements from major vendors.

Suffice to say that the turning point, ie the moment in time in which the adoption of an idea moves from a crawl to a sprint, seems to be nearly upon us. Accounting professionals need to be ready for it. F&M

XBRL – a major innovation for investor relations

XBRL is not only transforming how businesses provide information to investors, markets and regulators, it is also enhancing analysis and related decisions. **Alison Jones** explains.

Alison M Jones is assurance partner and UK XBRL leader, at PricewaterhouseCoopers.
E-mail: alison.jones@uk.pwcglobal.com
For XBRL in action, see www.nasdaq.com/xbrl

Today's corporate reporting involves greater complexity and more compliance with regulation than ever, and can result in investor confusion.

Moreover, compliance with the existing regulatory reporting model alone is no longer enough. To attract investor capital, companies need to communicate applicable and reliable information to a variety of stakeholder groups. However, with the range and volume of information companies produce, there is a constant challenge to keep messages relevant and consistent and to ensure information is accurate.

Adding to this complexity are high reporting costs due to internal systems that require manual interfaces and human intervention to aggregate the information from disparate sources before it can be used for communications.

More requirements

Standard setters and market regulators are also creating new reporting requirements to meet demands for greater corporate transparency and accountability – international accounting standards (IAS), Basel II reporting in the financial services sector and Sarbanes-Oxley compliance for SEC registrants to name a few.

Companies are also increasingly presenting new forms of information, such as on sustainability, providing company-specific information of interest to stakeholders. But, as the demand for variety and volume of information increases so do production and distribution costs.

Investors make decisions on third party summaries

The result can be confusion. Investors, or information consumers, receive all of this information from a variety of sources (the good news), but it is in a wide range of formats (the bad news), making analysis, and therefore, informed decision making, a costly and time consuming process. The high cost of consuming reported information also leads to practical restrictions on the number of companies analysts can cover.

Faced with high costs for gathering and preparing information, and limited institutional coverage, investors often turn to distributors and/or aggregators who repackage reported information for resale.

Today most investors make critical decisions based on third-party summaries rather than information supplied directly by companies. Thus, there are technological barriers to direct report usage creating rifts between management and investors.

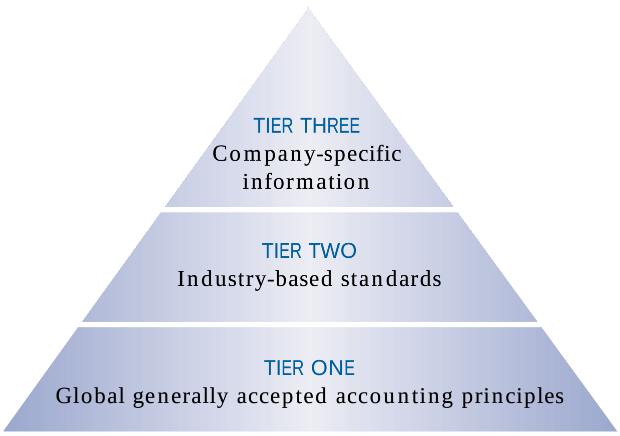
A proposal for the future

A solution for improving direct usage of the information reported by companies involves two main strands – a blueprint for heightened reporting transparency and a means of leveraging the internet to improve business information exchange.

PricewaterhouseCoopers has its own proposed solution to the corporate transparency challenge, in a framework developed after years of research involving investors, analysts and executives. This is a practical tool for companies to use in enhancing communications with investors and other stakeholders.

Second, enabling technologies, such as XBRL, built on open standards,

Figure 3 The three tier model of corporate transparency



Source: DiPiazza, Samuel A Jr and Eccles, Robert G, 'Building public trust', John Wiley & Sons, Inc, 2002 improves automation of the reporting process throughout the corporate reporting supply chain.

Today, companies have the opportunity to deploy XBRL to enhance the speed, efficiency and reliability of their reporting process and, at the same time, to present reports to investors in such a way that the information can be more readily accessed and used for analysis.

Corporate transparency – the 'three tier' model

The 'three tier' model of corporate transparency, illustrated in Figure 1 (opposite) and described below, offers one vision of the future of corporate reporting:

- *tier one* – at the bottom of the illustration, is a single, global GAAP that is principles-based rather than rules-based;
- *tier two* – in the middle, offers industry-specific standards for measuring and reporting performance; and
- *tier three* – at the top, is company-specific information, such as value drivers that are unique to a company.

By communicating information in each of the three tiers in an integrated fashion, management can present a comprehensive and convincing picture of corporate performance, opportunities and strategies.

Principles and methods of tying the three tiers of information together are embodied in a framework, which PricewaterhouseCoopers calls ValueReporting™.

Increasing transparency

The ValueReporting framework creates a bridge between the information that management uses to run a company and the information investors believe is critical to understanding value creation. This is not about assigning values to all intangible assets on the balance sheet, or about forecasting profit or future cash flows.

Rather, ValueReporting is about providing more comprehensive and comprehensible historical information, as well as metrics for areas of business activity, which both management and investors know are leading indicators of financial performance.

Outside stakeholders aren't the only ones who will benefit from more balanced information: management will be better able to spot early signs of problems in key value-creating activities and utilise the broader context of information to support investor relations strategies.

Enabling technologies – XBRL

Enabling technologies, such as XBRL, can be used today to tag information so that it has context from the beginning. Once tagged, information, whether numeric or text, can be automatically routed from its source to an unlimited number of electronic documents. By reducing the need for human intervention in moving information from one system or software application to another, XBRL redefines the business information supply chain.

Heightened connectivity between various operating areas of a single company, between business partners, and between businesses and any other organisation means XBRL will redefine how the business information supply chain works.

> Investors can immediately analyse information

Because XBRL is an open standard and is platform and application neutral, recipients of business information provided in the XBRL format will be able to leverage tools to analyse and use reported information instantly, with no need to re-key or convert to other formats. This provides investors with immediate analysis capabilities on reported information.

XBRL in practice – a demonstration of the Excel Investors Assistant tool

Microsoft, NASDAQ and PricewaterhouseCoopers have collaboratively developed a publicly available demonstration showing the benefits of XBRL in action, available at: www.nasdaq.com/xbrl.

The demonstration provides a basic, working example of how the business reporting supply chain is being transformed by the internet, XBRL and related web service tools incorporated into the latest software applications.

These enable investors to receive currently reported information in a significantly more effective, instantly useable manner.

Benefits for consumers and producers

Information consumers will have faster and richer content with which to work; information producers will be able to gather and disseminate more information much more quickly than today;

The benefits of XBRL and related web service technologies

For information producers

- **Cheaper** – reduce the cost of preparing and publishing information.
- **Better** – increase the speed and efficiency of decisions; enhance distribution to all stakeholders.
- **Faster** – automate the last stage from accounting systems to business reports.
- **Smarter** – improve the range and quality of internal reporting.

For information consumers

- **Cheaper** – enhance access and reduce cost of analysing business information.
- **Better** – deepen analysis to component level, reduce margin for manual errors.
- **Faster** – increase speed of use and related decisions.
- **Smarter** – pave the way for new concepts in using business information.

and regulators are more likely to obtain the level of transparency they require, more quickly and with less effort.

In short, the speed, efficiency and reliability of reporting will improve exponentially with the increasingly widespread adoption of XBRL (see box, left).

Adaptability

Any company considering its total reporting needs will be able to leverage XBRL to achieve significant improvements from more efficiently integrated systems, reduced error rates and enhanced analysis. XBRL is also flexible, so that it can accommodate future reporting needs, whether these arise internally from management or externally from investors, regulators and other authorities.

A company can implement XBRL now with the confidence that a solution will be scaleable and will be able to address new reporting requirements.

Significance for investor relations

XBRL automates the time-consuming, manual, error-prone tasks of translating corporate information from whatever format it is provided in to whatever format an information consumer wishes to employ.

Information can be tagged once at its source, and then be reused for an unlimited number of reports, which better ensures information accuracy and, very crucially, enhances the control environment.

> Information can be tagged at its source

Tagging at the source means that there is a trail from the origin of information to the final reports in which it appears, which is crucial to executives who face legal sanctions for incorrectly reported information. It also means that if information changes at the source, 'downstream' reports can be updated at the touch of a button, maintaining not only consistency, but a verification trail.

The upshot is that investor relations can significantly reduce efforts to search for information to ensure accuracy and consistency and can focus on its crucial tasks of communicating company strategies and messages.

XBRL makes information free from time and place constraints, as stakeholders anywhere in the world need only an internet connection to gain access to company information. So there is also the prospect of a move to a demand-pull type of environment where the information end-users decide for themselves which view they wish to take and then pull down that information easily and quickly.

As illustrated by the Nasdaq-Microsoft-PricewaterhouseCoopers pilot, an analyst could run specific queries, driven by tags, in a tool based on automated access to the complete population of relevant information on the internet.

Complementary technologies

The benefits of using XBRL for information production and dissemination will be complemented by other initiatives. For instance, related to XBRL is the extensible public relations language, which is being developed by the XPRL.org consortium.

The goal is to create standards for automating the public relation processes focusing on production of information in the form of press releases, applying tags, which, in turn, will form the basis for feedback from a cutting service, captured electronically. Better information on usage will help to present messages, drive content and evaluate channels.

There are also other efforts underway to automate financial information, which dovetail with the growth of XBRL and the adoption of web services technologies. Two of the most notable include research information exchange markup language (RiXML), to make investment and financial research easier to categorise and use, and market data definition language (MDDL), for financial markets all over the world.

The widespread adoption of XBRL is a question of 'when' not 'if'

Across the world there are more and more examples of regulators adopting XBRL. In the forefront are the Australian Prudential Regulatory Authority, the UK Inland Revenue and the US Federal Deposit Insurance Corporation. Leading edge companies, such as Microsoft, Reuters and Morgan Stanley have already begun publishing financial information in XBRL.

> Regulators around the world are adopting XBRL

Many other companies are engaged in projects using XBRL for transfer of information between systems, enhanced corporate reporting and specific business processes. Systems vendors are also embracing XBRL, and the range of taxonomies for reporting, such as IAS GAAP, is steadily increasing and is being extended to address industry specific requirements.

The new, inter-operative business information supply chain

What would be different about today's capital market if investors did not have to manually dig through the mountains of company reports?

Companies would have a more effective way to communicate with their stakeholders. Investors would have a more efficient way to analyse companies. The transparency of the corporate reporting environment would be enhanced.

We would have a reporting platform for more efficient capital allocation in an environment of greater integrity and trust, no small feat in today's markets, where investor confidence has fallen.

Where do you stand?

Are you using XBRL to enhance your corporate reporting processes and the related control environment? Are you enabling a more effective communications process with your investors? Where do you stand on using XBRL? F&M

Assessing the impact of the OFR on companies

Nigel Sleigh-Johnson is the Institute's head of financial reporting
E-mail: nigel.sleigh-johnson@icaew.co.uk

The importance of the operating and financial review (OFR) as a component of the annual financial reporting package has grown significantly, and not only for listed companies. **Nigel Sleigh-Johnson** provides some ideas on how the usefulness of OFR disclosures might be enhanced.

Recent developments regarding the OFR include a revised version of the Accounting Standards Board (ASB) Statement on the OFR content, published in January. The scope of the revised statement continues to be listed companies and other public interest entities. It sets out high level principles on content, supplemented by recommendations on their application, and emphasises the importance of an even-handed approach and of commentary on strategy, strengths and resources. Also, a recent white paper proposes requiring publication of an OFR by listed and private companies that satisfy two of the criteria (above, right).

Draft legislation is expected later this year. This statutory OFR would set out an informed assessment of the company's operations, its financial position and its future strategies and prospects. Directors would need to determine whether other specified matters should be addressed, including environmental and social issues.

In addition, a separate European Union (EU) initiative – potentially applicable to all UK companies – will lead to a new requirement to disclose OFR-type information in the annual report, for example non-financial key performance indicators.

The white paper criteria

	Turnover (£ million)	*Balance sheet total (£ million)*	*Employees*
Public company	more than 50	more than 25	more than 500
Private company	more than 500	more than 250	more than 5,000

Help from the Institute

The Institute has a number of initiatives designed, inter alia, to assist directors in the preparation of an OFR. These include:

- *'Preparing an operating and financial review. Interim process guidance for UK directors'* – (available on the Institute web site) sets out principles and guidance for gathering information;
- *'Prospective financial information (PFI)'* – guidance on the preparation of all types of PFI (to be published by the Summer); and
- *'Smaller quoted companies (SQCs)'* – a project is underway to evaluate reporting by the SQC sector and set out good practice. An interim report will be published by the end of the year.

Improving OFR information content from 'standard' to 'premium'

Unfortunately, the persuasive – rather than mandatory – force of the ASB statement is reflected in the uneven quality and quantity of OFR disclosures to date. Institute-sponsored research found much variation and noted that major areas of 'disclosure deficit' included 'forward-looking, quantified disclosures (both financial and non-financial)'.*

How might current practice be improved? A primary objective must be avoiding 'box-ticking' compliance. The draft legislation contains a worrying level of detail. With this caveat, there is considerable scope for companies to improve their OFRs as sources of information for investors, and some ways in which the Institute is seeking to facilitate this process are listed in the box (left).

Three areas where users might particularly welcome some improvement in the content of the OFR are:

1) more extensive discussion of the main factors likely to affect future success – financial statements focus on historical results, which are only one indicator of the potential for creation of economic value;
2) a more wide-ranging discussion by the reporting entity of each of its existing businesses – including greater disclosure of relevant information for each material business segment and the markets in which they operate, drivers of future value and performance and current initiatives, plans and prospects; and
3) additional commentary on financial and non-financial measures – disclosure in annual reports of relevant measures and supporting detail is generally sparse, but can add to users' understanding.

One key concern is over commercial sensitivity. There is no specific exemption from disclosing commercially sensitive information in the new ASB statement or in the white paper. It is hoped that the proposed new legislation will permit the standard setter to address this important issue. F&M

* *'Through the eyes of management: a study of narrative disclosures', Vivien Beattie, Bill McInnes and Stella Fearnley, 2002.*

Corporate governance – the continuing story

Jonathan Hunt is the Institute's head of corporate governance. The views expressed in this article are his own. E-mail: JDFHunt@icaew.co.uk

Jonathan Hunt describes areas of the Higgs and Smith reports likely to cause concern inside – and outside – the boardroom.

Corporate governance issues continue to feature in the media. Since 20 January most of the debate has been on the proposals in Derek Higgs' substantial report on the role and effectiveness of non-executive directors. Whilst there is significant consensus around much of the report, a number of issues have hit the headlines.

At the time of writing (late March) many commentators are focusing on the role of the senior independent non-executive director and some are concerned about how the new proposals will affect the role of the chairman. Other issues include the size of boards and how listed companies (especially smaller ones) will find their extra non-executive directors.

So why the controversy? Apart from the issues mentioned above, another reason must be the proposed significant increase in the size of the revised Combined Code. Section 1 of the existing code's 45 provisions will increase to 82, even ignoring the extra 'quasi-provisions' in the Smith report (see later). Don't forget that boards of listed companies have to either comply with code provisions or give reasons for their non-compliance. For some, full compliance will probably be a challenge particularly as the proposed introduction date is currently for accounting periods commencing on or after 1 July 2003.

In the short term, we may well see an increase in the number of non-compliance/explanation disclosures, especially for smaller companies. Even though this number will decrease over time as action is taken by boards to make the necessary changes, concerns have been voiced about the effect that a significant number of non-compliance/explanation statements in a company's annual report will have on the attitude of some investors and commentators towards that company.

Turning to the other report issued on 20 January and with the same proposed implementation timetable, the Smith report (named after its chairman, Sir Robert Smith) on audit committees has not had as much publicity. Yet for many Faculty members, this report may be more relevant.

> The Smith report codifies best practice for audit committees and adds more

In many respects, the Smith report codifies existing best practice for audit committees, but it also brings some new developments. Codifying best practice includes, for example, the committee's main role and responsibilities which are now:

- to monitor the integrity of the financial statements;
- to review the internal financial control system and, unless dealt with by a risk committee or the board, risk management systems (ie the wider aspects of internal control);
- to monitor and review the effectiveness of the internal audit function; and
- to manage the relationship with the external auditor including dealing with issues of engagement, remuneration, independence, and non-audit services.

One of the new developments is that audit committees will now have to provide, as a separate section in the directors' report, a report on their role, responsibilities and activities. Another new development, apart from the mention of whistleblowing in paragraph 5.9, is that, if there is a dispute between the board and the committee, the latter should have the right to report the matter to shareholders in its activities report.

The Smith report introduces a formal requirement (paragraph 3.16) that at least one member of the committee should have 'significant, recent and relevant financial experience'. This is likely to create expectations of that person. As a finance director or an internal auditor, you may be subjected to more detailed questioning.

One thing that you must bear in mind is that the Smith report includes certain paragraphs in bold text. These are classified as essential requirements that every audit committee should meet, and compliance with these is necessary for compliance with the Code. Yet when you look at the related proposals in the code, not all the bold type wording is included as new provisions, albeit there is reference in the code to the bold type in the Smith report. So watch out for these additional 'quasi-provisions'.

There may be some interesting times ahead before the new Combined code is finalised. So watch the press – and *F&M* – for developments. F&M

Web sources

The Higgs report – www.dti.gov.uk/cld/non_exec_review
The Smith report – www.frc.org.uk/publications/content/ACReport.pdf
The Combined Code – www.fsa.gov.uk/pubs/ukla/lr_comcode.pdf

ANNUAL REPORT TO FACULTY MEMBERS

2002

ANNUAL GENERAL MEETING 2003

Notice is hereby given that the ninth Annual General Meeting of the Faculty of Finance and Management will be held at **1.20pm** on **Thursday 12 June 2003** at Chartered Accountants' Hall, Moorgate Place, London EC2, for the following purposes:

1. To receive the annual report and financial statement of the Faculty of Finance and Management, for the year ended 31 December 2002.

2. To receive a report on Faculty Committee membership changes from 28 May 2002 to 11 June 2003.

3. To receive a report of the results of the elections to the Faculty Committee in 2003.

4. To answer questions about the activities of the Faculty of Finance and Management.

A lecture will precede the formal proceedings, and a buffet will be available afterwards to enable members to meet each other and members of the Faculty Committee in an informal setting.

CHRISTOPHER D JACKSON
Head of Faculty
Direct Dial 020 7920 8525

Notes: A member of the Faculty is entitled to attend the meeting and, on a poll, vote in person, or may vote by proxy. The instrument appointing to a proxy must be received by the Head of Faculty of the Faculty of Finance and Management at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ by noon on Friday 6 June 2003. A form of proxy may be obtained from Jo Kinlochan at the same address. A member who thereby lodges a form of proxy will not be debarred from attending in person and voting, but must inform the Head of Faculty before the meeting of his or her intention to vote in person.

CHAIRMAN'S STATEMENT

Review of the Year
In 2002, Faculty membership remained above 10,000 as we continued to offer you, our members, the management and technical information that keep you up to date professionally and help you in your business careers.

We continue to research how you feel about our output and the 2002 survey corroborated the findings of 2001. Some 73% of you feel that the Faculty does a 'good', 'very good' or 'excellent' job in satisfying your needs, compared with 72% in the last survey – and 86% of you rate the Faculty as 'good value for money'.

We know that the majority of you rely on our publications as the principal means of receiving information from the Faculty. We changed the format of all our journals to full colour, which was well received. The topics we covered in 2002 included 'Corporate social responsibility', 'Shareholder value', 'IAS', 'Intellectual capital', 'Customer profitability analysis' and ' The real value of e-business' – a fuller list is shown on page iv of this report. In 2003 we have introduced a new *Executive Summary* publication which we hope will combat the information overload that we all face.

We have continued our series of monthly events, providing members with information and an opportunity to meet with fellow business members. We plan to expand the number of events we hold in 2003, in particular concentrating on Birmingham and Manchester. If these plans for regional events are a success we hope to extend our programme to more regional centres in 2004. We continue to make recordings of many London events available to those who cannot attend.

Financially the Faculty is in a sound position with revenue in excess of expenditure. It is not our intention to continue to maintain the reserves at their current level and we are reviewing how these reserves can be best applied for the benefit of members. The Institute continues to fund the technical work we undertake which benefits all members of the Institute.

People
I should like to thank all members of the Faculty Committee for their time and the high quality of expertise they bring to the Faculty. In particular, I wish to pay tribute to John Edwards who stepped down in June 2002 after four years as chairman and nine years on the committee. John made a great impression on everyone with whom he worked and was held in high regard by his fellow committee members, members of Council and the Institute staff. He made a major contribution to the Faculty and we are proud to be continuing the path he led.

We are grateful also to the members of the Faculty team – Chris Jackson, Judith Shackleton, Debbie Came and Kirsten Fairhurst (who left us in December). I would like to welcome Jo Kinlochan who joined in March to replace Kirsten and Aurora Jay who has also joined the team.

Looking forward
Having taken over the chairmanship from John Edwards in June 2002, I believe we provide an excellent package of benefits for members, especially the publications. We continue to look for ways to improve our services to you and, with our strong financial position, we have the funds to make improvements. We undertook a member needs survey in 2002 to help us identify the information you need to do your jobs better and we will update that survey in 2003 to maintain the relevance of our output.

We in the Faculty are very conscious that Chartered Accountants in business are faced constantly with new challenges and demands – particularly today with new accounting standards and new corporate governance requirements. As a result, the requirement for good professional accounting standards has never been higher, which reinforces the value of the Chartered Accountant qualification.

We continue to believe that the Faculty can bring benefits to many more Chartered Accountants than are currently members and one of our tasks is to persuade them that we can add value to their businesses and to their careers.

CHRISTOPHER PEARCE
March 2003

FINANCIAL STATEMENT

Year ended 31 December 2002

	Note	2002	2001
		£'000	*£'000*
Income			
Faculty subscriptions		647	608
Notional interest on funds held		19	29
Miscellaneous income		11	49
Total Income		677	686
Expenditure			
Staff costs		169	167
Publications and web site	1	215	225
Costs of mailing		88	107
Marketing and PR		55	60
Internal recharges	2	61	66
Events		28	73
Miscellaneous		42	25
Defrayment of costs by Institute for Faculty activities which benefit all Institute members		(89)	(74)
Total expenditure		569	649
Surplus for the year		108	37
Surplus brought forward from previous year		305	268
Surplus carried forward		413	305

C T Pearce
Chairman
12 March 2003

Notes: 1 - Included in the cost of publications is a payment of £1,975 (2001 £5,850) to Ruth Bender, an elected member of the committee, in respect of her work on *Management Quarterly* and *MQ Online*.
2 - Institute recharges for accommodation and common office services.

ACCOUNTANTS' REPORT TO THE MEMBERS OF THE FINANCE AND MANAGEMENT FACULTY

We have examined the financial information for the year ended 31 December 2002 set out above and tested, on a sample basis, items of income and expenditure shown therein.

This financial information has been properly extracted from the books and records of the Institute of Chartered Accountants in England and Wales, of which we are auditors and on whose financial statements we have issued an unqualified audit opinion on 18 March 2003.

RSM Robson Rhodes
Chartered Accountants and Registered Auditor
18 March 2003

FACULTY COMMITTEE

Executive Committee Members

Christopher Pearce*
(Chairman) (c)*
Formerly Rentokil Plc

Charles Bartholomew
C Bartholomew Associates Ltd

Ruth Bender
Cranfield School of Management

Lois Bentley
Bridges Freelance Ltd

Kevin Bounds
Briefcase Consulting Ltd

Mark Garratt
Reed Health Group Plc

Peter Franklin
Pangray Ltd

Dr Geoff Seeff
Currie & Brown Group

Douglas Shanks
Numerica Group

Professor Bob Sweeting*
Manchester Metropolitan University

John Tranter
Eaton Williams Group Ltd

Colin Whipp
Amersham Business Management Ltd

* Co-opted
(c) Member of Council

FACULTY STAFF

Chris Jackson
Head of the Faculty

Judith Shackleton
Technical manager (part time)

Jo Kinlochan
Services manager

Debbie Came
Administrator (job share)

Aurora Jay
Administrator (job share)

REPORT ON ACTIVITIES 2002

Publications

Topics covered in our publications in 2002 include:

Finance & Management:	Balanced scorecard Activity based costing The role of the CFO in 2010 The real value of e-business Pensions Banking relationships Performance measurement in the public sector IAS Strategic enterprise management Risk management for SMEs Intellectual capital Outsourcing
Management Quarterly:	Strategic management accounting Psychometric testing Supply chain Managing a downturn Corporate social responsibility Shared service centres
Manager Update:	Culture and commitment Business to business marketing Options on strategic positioning Life after Enron When HRM reaches across borders Changing business cultures Rejuvenating strategic planning
Good Practice Guideline:	Customer profitability analysis Shareholder value How to control marketing Real options techniques

Events

Title	*Speakers*
Beyond budgeting (Manchester/Birmingham)	*Jeremy Hope*
People management – valuing people as assets	*Andrew Mayo*
Enterprise planning systems	*Dennis Keeling*
Leadership unplugged – a new role for FDs	*Steve Sonsino*
Pay for performance – directors' remuneration	*Ruth Bender*
Strategic enterprise management	*Martin Fahy*
Performance measurement in the public sector	*Anthony Dart*
The ValueReporting revolution	*David Phillips*
A framework for marketing accountability	*Robert Shaw*
Reputation and stakeholder relationships	*Keith McMillan*

Faculty membership

Number of members at 31 December 2002 – 10,160 (2001 – 10,080)

International activities

Representation on the International Federation of Accountants Financial and Management Accounting Committee.

The role of the finance function post Enron

After Enron and WorldCom, the role of the finance function is under scrutiny. **Graham Harvey** looks at the factors which may have caused finance – knowingly or otherwise – to contribute to these disasters, and outlines a model to prevent or mitigate such things happening again.

Graham Harvey is a principal consultant with Atos KPMG Consulting, working within its world class finance division.
E-mail:
graham.harvey@atoskpmgconsulting.co.uk

Enron, WorldCom... these names are now taken by some as synonymous with corporate failure, corruption, self interest and lost livelihoods. The events and characters involved in these spectacular corporate collapses have been commented on, far and wide, impacting on already depressed financial markets.

Who cares?
The scale of interest and outrage following these corporate collapses has been intensive. This reflects the ever-growing number of people standing to gain or lose depending on the success or failure of corporations and their share prices. Savings, pensions, endowments have all been adversely affected. Last, but no means least, livelihoods have been destroyed for company employees as well as, in the case of Enron, the employees of its auditor, Arthur Andersen.

Investors and regulators are also intensifying their corporate scrutiny. Delivering the statutory minimum on disclosure requirements is no longer acceptable, certainly if this does not reflect a fair picture of underlying performance or can't be used as a reliable indicator of future performance.

In all these scenarios, the fundamentals come back to the ability to generate profits, deliver positive cashflow and manage the balance between short term and long term increases in shareholder value. Those with vested interests in corporate performance need information to justify current investment decisions and to inform future ones. And the finance function has a fundamental responsibility for delivering on this. So what has gone wrong? Has finance lost sight of its basic responsibilities to the degree that gross mismanagement can go unchecked until too late? Is this a US phenomenon or is it just a matter of time until the UK and European scandals break through? Has the eagerness of finance to become and be seen to be a 'business partner' silenced the voice of reason and conscience?

Finance under the spotlight
If Enron is used as a defining point in time, then the focus on the finance function post Enron has intensified. This shift in focus has been generated for a variety of reasons both internal and external to the business (see Figure 1, 'Pressures on the finance function', on page 10).

> Finance has more time to devote to the business

The pressures on the finance function have increased. Externally, stakeholders, regulators and the general public (as private investors) are increasingly looking for someone in the business they can trust and rely on – someone who is making the challenge, verifying the facts, figures and opinions.

Within the business, the demand is for timely and accurate management information, informed decision support and financial processes which meet, not frustrate, business needs.

Finally, the finance director (FD) or chief financial officer (CFO) may be looking to exert greater control and financial discipline across the organisation at optimum cost.

These demands are not new. They have historically formed the bedrock of what the finance function does. What has changed, however, is the relative emphasis being put on these roles. In addition, the ultimate customers for these services and reporting lines are changing.

Transforming the finance function
Primarily through IT developments, the time needed to record and report transactional activity has declined. Thus finance has been able to devote more resources and energy to the needs of the business ('the business' here refers to operational functions and other back office departments which exist outside finance). This has generated the 'business partner model' – the 'holy grail' of finance for the past 10 to 15 years.

This involves finance 'adding value' to the organisation (integrating with it, becoming first a 'business partner' and then an 'e-business partner'), so introducing new, interesting and challenging roles. Finance wanted, and needed, to move away from the traditional 'bean counter' role and from being the department that always said 'no' (see Figure 2, 'The finance value chain', on page 11).

Failure of the 'business partner' model
Post Enron, however, the business partner model has come under significant pressure. The view is that finance has now become too close to the business. In its quest to add value, finance has begun to get integrally involved in areas such as sales strategy, marketing campaigns and operational decisions. And in cases where finance personnel report and

are accountable directly to operational management, finance can lose its independent voice, compromising the ability and willingness to challenge the business view.

From an external stakeholder perspective this spells danger. The failure to deliver the 'true and fair' view, the failure to deliver the challenge, means the voice of finance is not being heard and its role is being questioned. Either finance's views are stifled by the business, or finance becomes so close to the business that its objectivity is lost.

This scenario can be described as the 'biased business partner' model. When taken too far the business partner model can act to destroy value in an organisation as demonstrated by recent events.

The pendulum moving away from the traditional scorekeeper role has swung too far. Sometimes finance loses sight of the basics; namely prudent financial management and delivering a 'true and fair view'

The independent business partner
So, it could be argued, the concept of the business partner is over. Having lost sight of its governance role and failed to protect shareholder and public interest, it is perhaps time for finance to get back in its box. The demands today are for rigorous financial controls and discipline, and delivery of the traditional true and fair view. This could take our pendulum back to where finance began – the bean counter.

This view is somewhat of an overreaction. Finance needs to continue to strive to add value under a business partner type model. The key is getting the balance right between providing business support as well as the independent view and challenge.

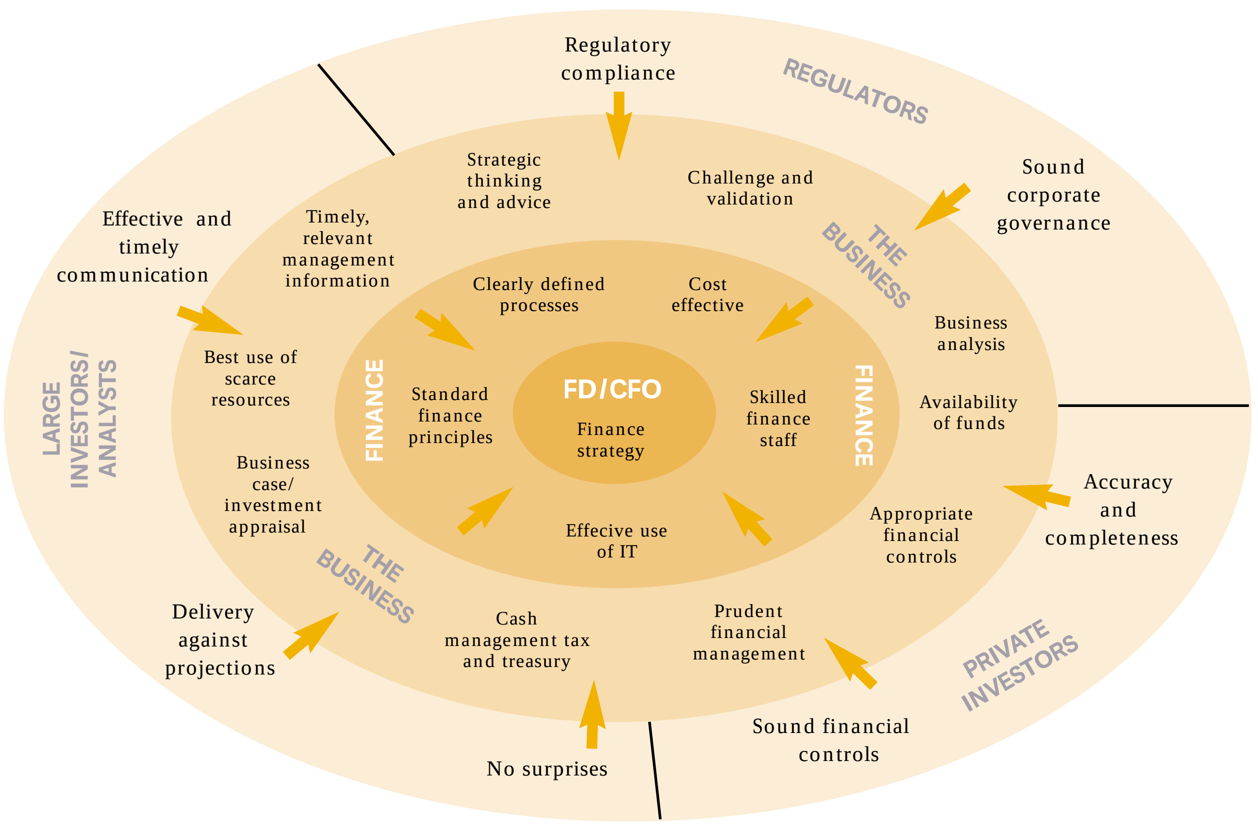
The model where this balance is achieved is described as the 'independent business partner' model (see Figure 3 'The finance swing-o-meter', opposite)

Being an effective finance function means never forgetting the basics – effective controls (accurate, preventative, complete), effective and appropriate reporting (using appropriate policies, timely, relevant, reliable) and safeguarding corporate assets. These must always be the initial focus and foundation for any finance function.

In the desire to move to the business partner model, these basics need to be in place, and cannot be lost. The well publicised financial failures over the last 12 months could be characterised as a situation whereby these core finance building blocks were missing (see Figure 4, 'Building blocks for finance', on page 12).

Along with having the basics in place, the terms 'business partner' and 'value added role' require clarification.

Figure 1 Pressures on the finance function



‘Adding value’, for finance, is not about ‘value creation’. The strategy, ideas and opportunities all need to be created by the business. Finance’s role as a business partner is to assess and validate them where appropriate. It is about finance providing an objective financial assessment of business ideas on the basis of appropriate and rigorous challenge. When working properly this is done in a manner which gains the trust and respect of the business.

So in addition to ensuring the basics are in place, finance should be working with the business to maximise shareholder value by:

- ensuring that business plans and strategy which drive investment and operational performance are subject to independent challenge and review;
- carrying out an independent review of actual performance that is rigorous and appropriate. This should incorporate challenging over-performance as much as under-performance – to minimise the risks of fraud or misstatement; and
- providing independent financial expertise that supports and complements business management’s skill sets.

Consequently, the CFO should be responsible for explaining corporate performance. This should cover historic results as well as the expected financial implications of future plans and strategic initiatives.

The CFO is not there to sell the merits of the strategy itself – this should be left to the chief executive officer (CEO) and operational executives.

Finance needs to be seen, both internally and externally, as the independent ‘voice of conscience’. It is the function that asks the tough questions, helps ensure decisions and evaluations are based on robust analysis and fact, as well as raising the red flag when required. By delivering on this role, finance will

Figure 2 The finance value chain

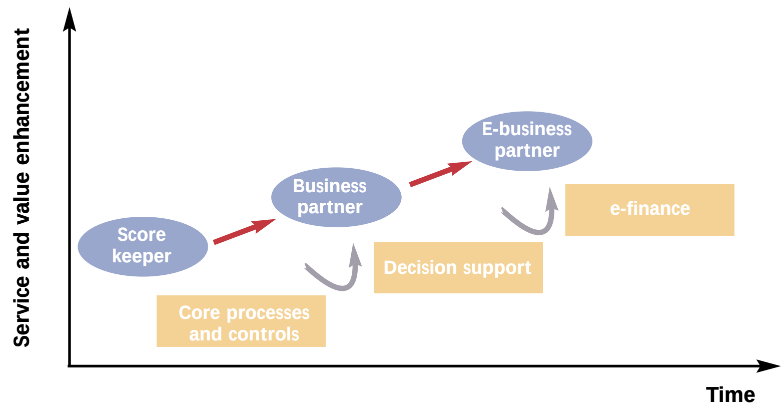
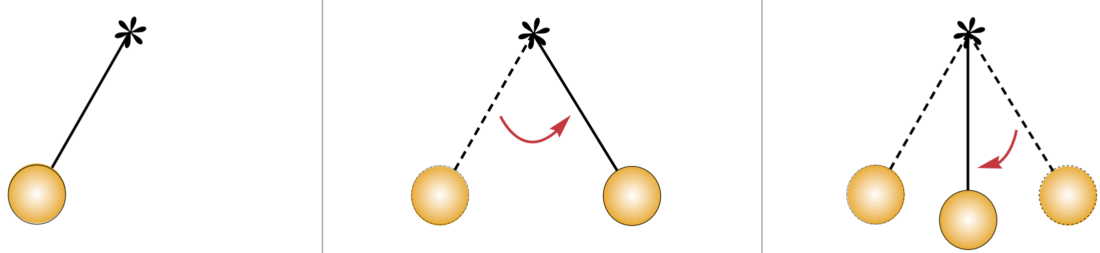


Figure 3 The finance swing-o-meter

TRADITIONAL SCORE KEEPER | BIASED BUSINESS PARTNER | INDEPENDENT BUSINESS PARTNER



TRADITIONAL SCORE KEEPER

Strengths
- Focus on financial controls
- Stringent financial management
- Strict segregation of duties

Weaknesses
- Limited commercial understanding
- Limited interaction with the business
- Limited interaction with external stakeholders
- Little value being added

BIASED BUSINESS PARTNER

Strengths
- Commercial approach
- Strong interaction with the business
- Action orientated

Weaknesses
- Loss of independence
- Diversion from delivering basic controls and safeguards
- Business view = Finance view

INDEPENDENT BUSINESS PARTNER

Strengths
- Strong financial controls
- Independent view providing appropriate challenge
- Commercial approach
- Appropriate interaction with the business
- Direct links with external stakeholders

ensure the business increases its chances of successfully implementing corporate strategy and maximising shareholder value.

Critically, finance should be in a position to take this 'voice of conscience' directly to the external markets – shareholders, analysts, pension funds etc. Clearly the CFO and CEO need to present a unified business view. However, communication to the markets should reinforce the distinct CEO and CFO roles and responsibilities.

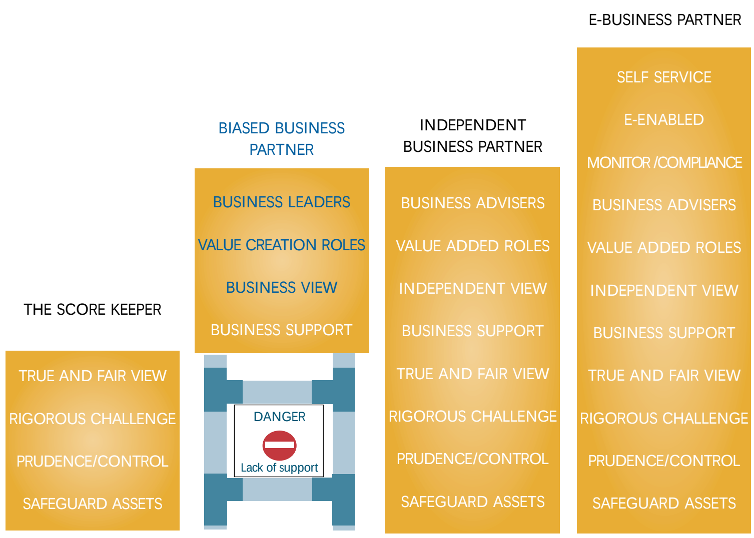
Conclusions
From a finance function perspective the problems and criticisms associated with recent corporate collapses partly stem from two core issues:

- finance losing sight of the basics. (Prior to moving to the business partner role the basics need to be in place and institutionalised); and
- finance not understanding its business partner role and how it can 'add value'.

The focus for finance must, first and foremost, be to get the basics right, ie effective controls, timely reporting, accurate reporting, safeguarding of assets. Only when this is in place should the aspiration of becoming a business partner be considered.

Subsequent delivery of this role is about validating the value creation ideas identified within the business and assessing actual performance in light of approved plans.

Figure 4 Building blocks for finance



As the 'voice of conscience' finance provides independent challenge and assessment, promoting viable projects, rejecting others, flagging and seeking explanation for variances. It is necessary for CFOs, audit committees and non-executive directors alike to evaluate critically:

- whether the basics are being achieved by their finance function;
- where finance sits along the score-keeper-to-business-partner value chain;
- whether finance is adopting the right operating model: and
- whether finance, if applying the business partner model, has a clear and appropriate understanding of its role and how it can add value (creating value vs independent assessment and validation).

The answers to these questions will help the CFO understand how his or her finance function interacts with the rest of the business and external stakeholders.

This can be used as the first step to identifying actions which need to be taken to restore confidence in corporate reporting and inform better decision making across the organisation. F&M

The key issues for accountants in business – IFAC survey

What are the most important technical or professional issues facing accountants in business? According to a recent survey by the International Federation of Accountants (IFAC) of member bodies active in this area, the top issues are:

- ethics;
- corporate governance;
- orporate performance transparency;
- business/external reporting;
- image of the profession;
- professional education; and
- risk management.

The survey was conducted toward the end of 2002 by IFAC's Financial and Management Accounting Committee (FMAC) and the Accountants in Business Task Force. Twenty-eight member bodies, representing over 650,000 accountants in business from 16 countries worldwide, responded to the survey. The purpose was to 'identify current technical and/or professional priorities of member bodies for accountants in business, to determine global issues facing this constituency, and to ascertain how willing member bodies would be to collaborate with other bodies on FMAC-led projects'.

Initial findings show that the majority of those surveyed are willing to collaborate on projects – some member bodies are already doing this – as well as to share information. FMAC says that it will conduct additional research among member bodies on this subject. F&M

TAX

Is this the end for employee share schemes?

In his latest Tax Update, **Frank Haskew** looks at the complexities of the tax position relating to employee share schemes.

Frank Haskew is head of the Institute's Faculty of Taxation.
E-mail: frank.haskew@icaew.co.uk

The recent furore over the tax treatment of unapproved share options following the Court of Appeal case tax position Mansworth (HMIT) vs Jelley has once again highlighted the complexities surrounding the tax position of employee share schemes. This case concerned what was the base cost of shares for capital gains tax for an employee who acquired shares under an unapproved share options scheme. The two possibilities were:

- the market value of the shares at the date of exercise (as contended by the taxpayer); or
- the value of the consideration given for the option plus the price paid for the shares (as contended by the Revenue).

Before the decision in this case, the Revenue's view of the capital gains tax treatment was that the base cost of the shares comprised two elements:

- the actual price paid for the option and the shares; and
- the amount charged to income tax in respect of the exercise, being the difference between the exercise price and the market value of the shares at the time of exercise.

Surely these two calculations would give the same result? Well, in 90% of cases they would, but not where, for example, there is no income tax charge. Enter Mr Jelley, who was not resident in the UK at the time of the grant and was not liable to an income tax charge when the share options were exercised.

Thus, the Revenue argued, the base cost of his shares should be the exercise price and not the market value of the shares at the date of exercise. The court agreed with the taxpayer that it was the market value.

Revenue note makes employers potentially CGT-liable

Following this decision in December 2002, on 8 January 2003 the Inland Revenue published a note on the implications of Mansworth vs Jelley. Sadly, this note has raised further problems. Most attention has been focused on the effect on employees exercising unapproved share options.

The Revenue has stated that for capital gains tax (CGT) purposes the base cost of the shares is their market value at the time of exercise plus any amount charged to income tax on the exercise.

The result of this surprising statement is that for CGT purposes, the base cost is likely to be higher than the sale price and employees exercising unapproved share options and disposing of the shares will realise an allowable CGT loss.

> Employers will need to review all share schemes

Whilst this statement may produce unexpected windfalls for employees, it is the other side of the coin which produces problems. The impact of the case extends beyond the employee to cover the person who transfers existing shares to the employee to satisfy the option – for example, an employee benefit trust. Post Mansworth, these transfers are treated as made at market value. Transferors are therefore faced with a market value disposal and a possible CGT charge where none existed before.

The Revenue's statement is a strangely ill-considered affair, giving rise to capricious results and redistributing tax liabilities at the expense (ultimately) of the employer. It remains to be seen whether the Chancellor will seek to reverse the Mansworth decision.

Will the ASB kick share schemes into touch?

Whatever the Chancellor may decide, the fate of UK employee share schemes may be out of his hands. Changes in accounting standards may spell the end of employee share schemes as we know them. On 7 November 2002, the International Accounting Standards Board (IASB) issued exposure draft (ED) 2, 'Share-based payment'.

The ED proposes that all entities should be required to recognise an expense, measured at fair value, whenever a share-based payment is made. In other words, any discount as compared with the real value of the shares issued must be expensed through the profit and loss account.

In a show of solidarity, on the same day the Accounting Standards Board (ASB) announced that it supported the basic principles underlying the draft standard in ED 2 and proposed, in financial reporting exposure draft (FRED) 31, 'Share-based payment', that the standard should be implemented as a UK standard for accounting periods beginning on or after 1 January 2004. Further, the proposed standard will cover all entities (both listed and unlisted) and all share-based payments (including Inland Revenue approved share schemes).

Post Enron, it now appears inevitable that the new standard will be implemented. Employers will need to review all their share schemes, both unapproved and approved and decide whether they remain a cost-effective way to incentivise staff. F&M

FINANCIAL REPORTING

Revenue recognition and business combinations

David Chopping is the technical partner of Moore Stephens, London. He is a member of the technical and practical auditing committee of the Audit and Assurance Faculty. E-mail: david.chopping@moorestephens.com

In his latest Update, **David Chopping** looks at the ASB's compromise solution for alterations to revenue recognition practices without a new standard, and at its scant enthusiasm for the IASB proposals on business combinations.

With 2005 looming, the Accounting Standards Board (ASB) has already stated that it will no longer issue new standards that do not take account of international practice, whether current or, if international changes are expected, proposed.

At the same time, there have been issues with revenue recognition that mean the ASB feels that something needs to be done. As a compromise, therefore, it has issued a draft application note to financial reporting standard (FRS) 5. This enables the ASB to amend revenue recognition practices in areas where it believes change is due, without the need for a full standard.

The draft deals with the general issue of revenue recognition, but mainly with five specific issues. In summary:

1) it clarifies that income on long term contracts should be recognised as services are provided, which is not necessarily the same as when costs are incurred;
2) it discusses the issue of separating and linking contractual arrangements. This depends on whether elements are separable, and whether fair values can be attributed to unprovided elements;
3) it provides tests for determining whether a sale should be recorded in a bill and hold situation;
4) it states that, normally, sales should be recognised where there is a right of return, but that an estimate should be made of returns and the turnover reduced accordingly; and
5) it deals with principals and agents, stating that an entity will normally have to account as principal where it bears risks associated with selling price or stock holding.

Business combinations

The ASB has also published a consultation paper on business combinations, impairment and intangibles. This is a copy of proposals published by the IASB, and not proposals that have been generated by the ASB. Indeed, it is clear that the ASB does not support the proposals, and in the preface it states that it is not convinced that the proposals would represent an improvement in the UK.

There are numerous changes proposed in the IASB draft, including:

- the abolition of merger accounting;
- the elimination of guidance on business combinations;
- the abolition of amortisation of goodwill, and its replacement with a requirement for impairment testing on an annual basis;
- negative goodwill to be recognised as an immediate gain; and
- allowing various intangible assets acquired as part of a business acquisition to be recognised separately when, under current rules, they would be considered to be part of goodwill.

Some of the differences then create further ones. For example, the recognition of intangible assets that would currently not be recognised separately has a greater impact since the proposed rules for impairment tests on goodwill are not the same as those for intangible assets.

Probably the major change proposed is the elimination of amortisation of goodwill. This change, which has already taken place in the US, is supported by those who consider amortisation to be arbitrary. The ASB points out that there is a cost benefit issue here, with amortisation being a realistic commercial alternative to the complexities of impairment reviews.

The ASB also has serious concerns about the proposed impairment review itself. It considers the proposed approach weaker than that currently used in the UK, and feels that it blurs the distinction between purchased and unpurchased goodwill. The proposed test concentrates on whether a business has sufficient goodwill in total to support the carrying value; no real attempt is made to determine whether this is the goodwill that was acquired or the goodwill that has been built up by acquisition.

Even those who consider amortisation is arbitrary would be pressed to argue that the goodwill that has been acquired lasts forever. After a period of time, admittedly a period that varies widely and is difficult to determine, companies will have only goodwill they have generated themselves. In this case, companies that have made past acquisitions can carry a figure for goodwill, and those that have not will be prohibited from doing so.

Apart from disagreeing with the logic of some of the proposals, the ASB also notes that there are legal problems with some. In particular, those associated with goodwill. Amortisation is a requirement of current EU accounting directives, which can be breached only in exceptional circumstances.

The recognition of negative goodwill as a gain may also create problems, since EU rules allow only realised profits to be credited to the profit and loss account.

This one will run and run. F&M

FORTHCOMING FACULTY EVENTS

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to the services manager at the Faculty's address given on the bottom of the form.
If you have any queries relating to these or other events, please contact Jo Kinlochan on 020 7920 8486.

● 7 May
EVENING LECTURE
(Motor Cycle Museum, Solihull)

'LINKING VALUE WITH VALUES – THE BEHAVIOURAL ASPECTS OF FINANCE' – MALCOLM LEWIS, STRATEGIC VALUE PARTNERS

Consultant Malcolm Lewis will argue that linking value with values is the key to creating long term corporate, financial and personal success, ie having a vision that is based on 'what should be' rather than 'what is'. Registration 5.45pm; lecture 6.00pm; buffet and networking 7.00pm.

● 21 May
EVENING LECTURE
(Chartered Accountants' Hall, London)

'NEW ROLES FOR FINANCE – MAKING AN EFFECTIVE CONTRIBUTION IN YOUR EXECUTIVE TEAM' – SIMON COURT, VALUE PARTNERSHIP

Capital investment is in steep decline and business opportunities are limited. Simon Court, founding director of Value Partnership, says that focusing on good management and organisation is the imperative. Registration 5.45pm; lecture 6.00pm; buffet and networking 7.00pm.

● 12 June
LUNCHTIME AGM & LECTURE
(Chartered Accountants' Hall, London)

FACULTY ANNUAL GENERAL MEETING
plus lecture – 'BUSINESS VALUATION' – MAGGIE MULLEN, GRAVITAS PARTNERS

Maggie Mullen, chairman of Gravitas Partners, will discuss some of the valuation issues arising within current markets and how they impact upon business. The lecture will begin at 12.30pm and will last until 1.20pm. The AGM will take place over the next 10 minutes, followed by a buffet luncheon until 2.00pm. All Faculty members are welcome and the event is free to them.

● 24 June
EVENING LECTURE
(Golden Tulip Hotel, Manchester)

'THE FUTURE OF FINANCE' – SCOTT PARKER, ATOS KPMG CONSULTING

Scott Parker, managing director of Atos KPMG Consulting, will discuss the future of the finance function in an era of dramatic change for the CFO. He will consider the implications of recent and impending legislation and share insights from other companies on how they are responding to the new challenges. Registration 5.45pm; lecture 6.00pm; buffet and networking 7.00pm.

THERE WILL BE NO FACULTY EVENTS IN JULY AND AUGUST 2003

RECORDINGS OF FACULTY LECTURES IN 2002

The following lectures and conferences held by the Faculty in 2002 are available, in both **audio** and **video** format.

To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.

There is a charge of £5.00 for audio recordings and £10.00 for video.

18 SEP — HUMAN CAPITAL – MEASURING PEOPLE AS ASSETS
Andrew Mayo, a consultant on international human resource management, discusses how to balance people's cost with a quantitative measure of their value.

8 OCT — ENTERPRISE PLANNING (ERP) SYSTEMS – DO THEY MEASURE UP?
Dennis Keeling of BASDA, the international software standards body, explores the pros and cons of these systems and looks at software industry trends.

3 DEC — REALITY CHECK – STRATEGY'S ROLE IN CREATING WEALTH
Bob Gorzynski of Bristol University looks at what went wrong with 'new economy' companies and at the role of strategy.

22 JAN — LINKING VALUE WITH VALUES
Malcolm Lewis of Strategic Value Partners argues that the 'organisational soul' can affect a business's value creation.

Competing through capability

In a trailer for his forthcoming 'Masterclass' address (see page 15), **Cliff Bowman** of Cranfield says that an innovative approach to identifying strategic assets will improve management skills.

Professor Cliff Bowman of Cranfield School of Management is one of the speakers at a series of half day master-classes around the theme 'Developing a competitive edge' organised by the Institute's East England region. The events take place on 3 June and 3 July (see page 15). For further details contact Claire Harris on 01223 257873 or e-mail her at claire.harris@icaew.co.uk

Unfortunately a good deal of senior management time and effort is wasted on formalised planning processes that produce neither insight nor commitment. All that seems to emerge from these processes is a document, 'the plan', which serves primarily as a monitoring and control device.

Where firms have committed resources to scenario planning and other attempts to forecast the future, these educated guesses are expected to be incorporated into business unit plans. Often the planning process itself is kicked off by the setting of tough financial targets. But if these future scenarios are not believed by those writing the plans, and if the targets are not seen as credible either, then the 'plan' constructed in response to these inputs will not be believed, especially by those who have drafted it. If you don't really believe the plan you are unlikely to drive it through to implementation.

An alternative approach would be to start with a sophisticated understanding of the current situation facing the firm. This insight can be developed if we can identify the firm's strategic assets, assets that enable the business to outperform competitors on costs, or product value. They help the firm win profitable business. These assets are rarely obvious, even to those of us responsible for running the firm. But an insight into what really makes a difference for us out there in a competitive market is a sound basis to form a view about where the firm should be moving. No-one can predict the future anyway, so let's start from at least a proper understanding of where we are today.

Strategic assets are combined with entry assets, which can be found equivalently in competing firms. You need these to be in the game, but they don't win you business. What makes a difference is the strategic assets which can come in many forms. Generally, the most critical assets are the least well understood, and consequently they are vulnerable.

We are well aware of the importance of brands, but what may be more crucial are personal relationships with customers or suppliers. Tacit routines, the 'way we do things around here' may be vital in preserving the quality of service delivery. The know-how and reputations of specific individuals could be critical, and the way these people interact with colleagues in informal networks within a culture of supportive professionalism may be what makes the difference between winning and losing contracts.

If we understand these strategic assets we have a chance of protecting and leveraging them. If we understand them we may also be able to create new assets. So insight into these assets enables executives to engage confidently in the strategic management of their business. F&M

IN FUTURE ISSUES...

Finance & Management

- UK adopting the euro – for and against
- Spend control white paper
- Ways of controlling IT costs
- Supply chain management – with a case study

IN JUNE'S MAILING...

Good Practice Guideline

- 'Measuring human capital' – this GPG looks at people as assets (or liabilities) and asks whether better people-related measures would benefit a business. It looks at public reporting and at considerations for the finance function.

Finance & Management

... is edited and produced on behalf of the Faculty by Silverdart Ltd, Unit 211, Linton House, 164-180 Union Street, London SE1 0LH. Tel: 020 7928 7770; fax: 020 7928 7780; contact: Alex Murray, Gabrielle Liggett or Helen Fearnley.

www.icaew.co.uk/fmfac

The Faculty of Finance and Management,
The Institute of Chartered Accountants
in England and Wales,
Chartered Accountants' Hall,
PO Box 433,
Moorgate Place,
London EC2P 2BJ

Telephone: 020 7920 8486
Fax: 020 7920 8784

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

TECPLM1976