Tax Research

Accountancy Briefing

Who are the users of accounts?

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Accounts – or financial statements to use the technically correct current terminology – are for the purposes this briefing the reports produced by limited liability companies and other entities that have a duty, imposed on them by law, to report to people other than their management, usually on an annual basis, that customarily include a profit and loss account, a balance show, a cash flow and sufficient notes to make sense of the financial position of the organisation that has issued the report.

The entity perspective

Historically it was assumed that accounts were produced for the benefit of the owners of the entity and no one else. This was because it was considered that the owners, and the owners alone, had a contractual right to that data.

This perspective is no longer considered relevant. It is now recognised that a limited liability entity required to produce annual accounts has a duty to a wider interest group.

The International Accounting Standards Board (IASB), who are responsible for setting accounting standards for much of the world describe this as reporting from the "entity perspective"[1]. They say this means:

> *"Financial reports reflect the perspective of the entity rather than the perspective of the entity's equity investors, a particular group of its equity investors or any other group of capital providers."*

This is important. It says three things. The first is that the entity exists independently of its owners. The second is that it has a duty to a wider group than its owners. Third it says that the interest in the organisation extends beyond those who provide it was capital, in other words beyond the owners, its bankers, those who make loans to it and those to whom it owes money.

[1] See http://www.iasb.org/NR/rdonlyres/464C50D6-00FD-4BE7-A6FF-1BEAD353CD97/0/conceptual_framework_exposure_draft.pdf

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The International Accounting Standards Board perspective

Despite having reached this seemingly obvious conclusion the IASB claims that:

> *"The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Capital providers are the primary users of financial reporting."*

As a result they have stated that unless information is of use to capital providers it need not be included in financial statements.

Are capital providers really the only users of accounts?

As the IASB made clear when formulating their opinion, this was a decision on their part. In other words, they recognised that other positions were possible and chose not to adopt them.

This is in marked contrast with some of their forebears. For example, as long ago as 1975 the UK's Accounting Standards Steering Committee, a body that can be seen as a precursor of the current International Accounting Standards Board, published a seminal document entitled the Corporate Report[2]. That report said that published accounts should enable a user to appraise information on:

1. The performance of the entity;

2. Its effectiveness in achieving stated objectives;

3. Evaluating management performance, including on employment, investment and profit distribution;

4. The company's directors;

5. The economic stability of the entity;

6. The liquidity of the entity;

7. Assessing the capacity of the entity to make future reallocations of its resources for either economic or social purposes or both;

8. Estimating the future prospects of the entity;

[2] http://www.ion.icaew.com/ClientFiles/6f45ef7e-1eff-41ff-909e-24eeb6e9ed15//The%20Corporate%20Report2.pdf

9. Assessing the performance of individual companies within a group;

10. 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;

11. The compliance of the entity with taxation regulations, company law, contractual and other legal obligations and requirements (particularly when independently identified);

12. The entity's business and products;

13. Comparative performance of the entity;

14. The value of the user's own or other user's present or prospective interests in or claims on the entity;

15. Ascertaining the ownership and control of the entity.

It can, quite reasonably, be argued that very little has changed since 1975 in this regard. These are still a reasonable summary of the needs of the users of published financial statements.

Those with interest in financial statements have almost certainly not changed much since either. The Corporate Report identified these in 1975 as:

- The equity investor group (shareholders)
- The loan creditor group (banks and bondholders)
- The analyst-adviser group who advise the above groups
- Employees
- The business contact group
- The government
- The public.

It is curious to note that UNCTAD in their 2008 report entitled “Guidance on Corporate Responsibility Indicators in Annual Reports”[3] said that in their opinion financial statements might be used by:

- Investors and financial institutions;
- Business partners;
- Consumers;
- Employees;
- Surrounding community;
- Civil society organizations; and

[3] http://www.unctad.org/en/docs/iteteb20076_en.pdf

- Governments and their institutions.

The groups are defined slightly differently in each case, but the overlap is almost identical and only differs in emphasis. It seems there may be widespread agreement on this issue.

As, indeed, there appears to be on the part of the International Accounting Standards Committee Foundation (IASCF[4]) which is the trustee oversight body for the International Accounting Standards Board. According to the IASC Foundation constitution its objectives are*:*

> (a) to develop, ***in the public interest*, a *single*** set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets ***and other users make economic decisions***;
> (b) to promote the use and rigorous application of those standards;
> (c) in fulfilling the objectives associated with (a) and (b), ***to take account of, as appropriate, the special needs of ….emerging economies***; and
> (d) …."

Abbreviation has taken placed and emphasis added but it should be noted that:

1. The IASB is required to act in the public interest, not in the interest of capital markets alone;

2. The needs of other users are not considered supplementary to, or subordinate to the needs of the world's capital markets. The phraseology used by the IASC Foundation is specific. The single set of financial statements that the IASB must promote must meet the needs of the world's capital markets **and** the needs of other users who make economic decisions based on corporate accounting data.

3. The special needs of developing and emerging economies (which by definition will be country based) must be a particular concern when setting IFRS.

Conclusion

In the circumstances the IASB's claim that the data needs of the providers of capital to companies are paramount when assessing the benefits of information supplied in financial statements would appear to be wrong, and is recognised as being so in their own constitution.

The benefits other users derive from financial statements must also be considered both in the process of setting International Financial Reporting Standards and in preparing financial statements, and that consideration must take into account use in capacities other than as providers of capital, of which there are many.

[4] http://www.iasb.org/The+organisation/IASCF+and+IASB.htm

As a result the single set of accounts that International Financial Reporting Standards must result in must meet the information needs of all who make economic decisions based on the activities of corporations, and supply them with the “high quality, transparent and comparable information” they need to do so. And that means the International Accounting Standards Board must take into consideration in its work the needs of employees, the business contact group of the reporting entity, governments and the public and in the process must consider the whole spectrum of their needs, as the UK's Accounting Standards Steering Committee did some thirty five years ago.