Stewardship versus economic decision making in financial reporting

The main objective of financial reporting according to the IASB's Preparation and Presentation of Financial Statements framework is that of providing adequate information in order to enable shareholders conduct economic decision making. This brought the debate of whether such objective neglected the importance of the stewardship assessment by the part of shareholders. In the past decade the IASB and the US FASB have been working on a joint project to develop a conceptual framework for financial reporting. Such conceptual framework has the aim of providing a base for developing harmonised, future accounting standards. In 2008, the boards issued an exposure draft of chapter one and chapter two of the conceptual framework with chapter one tackling the objectives of financial reporting.

In the exposure draft that has been lately issued by the two boards, it was identified that the objective of financial reporting should be that of catering for all the decisions that capital providers make, including both resource allocation decisions and decisions made to protect and enhance their investments. Furthermore on the underlying exposure draft there is stated that information about the stewardship of an entity's economic resources should be considered as decision-useful information. Hence in this exposure draft it is clear that the two boards shifted from focusing solely on economic decision making, to general decision making, with stewardship being included in such broader definition.

Although this move to focus on decision usefulness rather than specifically on economic decision making was a means to subsume stewardship in the objective of financial reporting, authors such as Andrew Lennard still argue that stewardship and decision usefulness should be recognised as separate objectives.

"…stewardship contributes an important dimension to financial reporting, which should be reflected by specific acknowledgement in the objectives of financial reporting."[1]

The majority of the authors who recognise stewardship as a fundamental objective in financial reporting, claim that financial statements should be prepared on the basis of historical costs. This ensures in providing a clear, factual account of the transactions that occurred during the year, over which management had control. Thus reporting on historical cost can aid shareholders accomplish their stewardship assessment needs better.

On the other hand, to cater for decision usefulness, especially in terms of economic decision making, financial reporting would focus more on the forecasting of future cash flows. Such objective would be better addressed with valuations based on market values, since they better reflect the timing and certainty of future cash flows. This is leading to the emergence of valuation techniques based on current values, such as fair value.

The adoption of fair value accounting is perhaps one of the most controversial issues currently being faced by the accountancy world. Both the IASB and the FASB have been working on this issue for the last couple years. Traditionally, financial reporting has been exclusively based on historical costs. The use of current values, such as fair value reporting emerged relatively recently, and was applied to only few selected areas. One of the areas where fair value had a major influence is in the measurement of financial instrument. Using market values to value Financial Instruments is deemed to be reliable (since markets in these items are well developed) and relevant (because the values of financial instruments can experience large fluctuations, thus historical costs depicts a very poor picture of current values). However, in the nearby future, fair value measurement is likely to be extended to other assets, especially in the light of the fact of the IASB's and FASB's perceived preference for fair value measurement even where the market is not well developed.

" The IASB believes that fair value measurement under IFRS and GAAP is already consistent. Also, the IASB and the FASB will continue to work together to ensure that applying fair value in an inactive market is accounted for consistently"[2].

Shareholders are divided into two main categories, private individuals and institutional investors. Although financial reporting is designed to cater for the needs of capital providers, due to the lack of knowledge commonly found within private individual shareholders, concerns may arise on what such private individual shareholders identify as useful, for their decision making.

Need for the study:

The dissertation's objective is to identify the current needs of private shareholders and what they identify as valuable information. The dissertation shall then examine to what extent the focus on decision usefulness and the forecasting of future cash flows through fair value accounting shall aid private shareholders in satisfying their requirements.

Research Methodology:

The dissertation will be of a qualitative nature. The aim of such dissertation is to achieve a deep understanding of what local private shareholders value as relevant information, and to examine whether the emerging concept of fair value accounting will be providing such users more relevant accounting information. The aim of the study is not to generalise findings but to obtain rich description on the underlying topic.

The method being taken into consideration to gather the qualitative data is the setting up of focus groups with shareholders. Such group discussions provide direct evidence about similarities and differences in participant's opinions. Participants are not required to answer for every question enabling them to build on one another's response. Furthermore by acting as a moderator I can ensure that the discussion is always kept on track.

Finally, focus groups can be considered as a more plausible solution when compared to open ended interviews with shareholders. The response rate of shareholders to a focus group is likely to be greater when compared to a personal one on one interview, since the latter is perceived as more intrusive. The main limitation of using focus groups is perhaps the risk that people influence each other's response. As a result the response of participants can be different than the response that would have been generated from a private one on one interview.

Shareholders from two local, listed companies are going to be considered as the population sample. These companies are Bank of Valletta and HSBC. The choice fell on these companies because due to the recent changes to IAS 39 and IFRS 7, fair value measurement had a considerable impact on the banking sector. Thereby, due to such fact shareholders can be even more concerned and affected with the underlying subject. Two focus groups are planned to be set, one with BOV shareholders and one with HSBC shareholders, with groups ranging from six to twelve members. Shareholder’s list can be obtained from the Malta Financial Services Authority. The sampled population will exclude overseas shareholders, trusts and investment companies, thus focusing solely on local private shareholders.

Chapters Overview:

Introduction: firstly the stewardship versus economic decision making debate will be tackled, and its effects on valuation on financial reporting will be analysed. The dissertation shall then focus on the emergence of fair value as a measurement tool and its prospective usage. Furthermore fair value will be compared and contrasted with cost based valuation. The introduction will also include an examination of how each valuation method caters for the individual private shareholders’ requirements.

Literature Review: literature review can be focused on two aspects being the debate of fair value measurement versus cost based measurement, and the debate of whether private shareholders use accounting information mostly for economic decision making, or to assess stewardship.

Research Methodology: in this section I shall describe how the results were achieved, explaining how the data was collected and analyzed. This section shall contain the weaknesses and limitations of the research methods and methodology used. In the methodology I shall also include any problems that I anticipated and explain any steps taken to prevent them from occurring.

Findings: this part of dissertation will contain the information generated from the focus groups. Results will be presented, interpreted and discussed in this section.

Conclusion: this part will provide concluding insights on the research, and recommendations of other research questions that can be tackled to improve the research on the area. The main questions to be answered in this section are: what has been learnt from the results? How can this knowledge be used? What are the shortcomings of the research?

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