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Derivatives reporting: the implications of recent accounting standards for corporate governance and accountability

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Theresa Dunne

2003

University of Dundee

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Derivatives Reporting: The Implications of Recent Accounting Standards for Corporate Governance and Accountability

Theresa M. Dunne

A Thesis Submitted to the University of Dundee in Fulfilment of the Requirements for the degree of Doctor of Philosophy, July, 2003.

Dedication

For my husband Bruce, my father Laurence, my sister Annette and my late mother Rita. Thank you all for your love and support.

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provided me with. Finally, to my late mother Rita whose love and encouragement will never be forgotten.

Declaration

I hereby declare that I am the author of this thesis, that the work of which this thesis is a record has been done by myself, and that it has not previously been accepted for a higher degree.

Signed.. Date. 19th September 2003

Ms. T. M. Dunne

Certificate

We certify that T. M. Dunne has worked the equivalent of nine terms on this research, and that the conditions of the relevant ordinance and regulation have been fulfilled.

Signed.. Date. 19 September 2003

Dr. C. V. Helliar

Signed.. Date. 19 September 2003.

Prof. D. M. Power

Abstract

This dissertation investigates the implementation of FRS 13 by UK non-financial companies, and assesses the impact of the Standard on both users and preparers of Annual Reports. The investigation involves (i) a content analysis of the reporting practices of companies on their derivatives usage before and after the introduction of FRS 13, in order to ascertain whether the standard had any significant effect on the contents of company financial statements, and (ii) interviews with both the preparers (treasurers) and the users (fund managers) of the information provided under FRS 13, in order to facilitate an understanding of the implications of the standard for their operations. The study focuses in particular on the effects of the increased derivatives-related disclosures for corporate governance structures and accountability relationships.

The results suggest that the amount of disclosure in company annual reports increased significantly following the introduction of the standard; companies were now disclosing far more about their hedging and risk management activity than they had before. In general, treasurers responded favourably to the standard, and considered the narrative disclosures to be particularly useful. The numerical disclosures were considered to be very detailed and specialised; interviewees thought that users might have difficulty in understanding them. However, the implementation of IAS 39, which will be mandatory for all EU companies from 2005, was causing treasurers far more concern. Many treasurers expected to purchase expensive new systems and establish sophisticated procedures in order to comply with the hedge accounting rules of IAS 39. In general, the institutional investors interviewed expressed similar views to those of the treasurers; they

found the narrative parts of the annual reports useful, but agreed that the numerical disclosures were too specialised. The investors thought that the disclosures did improve the corporate governance process and highlighted issues that they wished to raise with their investee companies' management as a result of the information gleaned from the financial statements.

Chapter 1

Introduction

Chapter 1 - Introduction

1.1 Preamble

Recent years have seen a proliferation of new and increasingly complex financial instruments being employed in a large number of international financial markets (Grant and Marshall, 1997; Mallin et al., 2001). As a result, many entities now employ such instruments to transform their financial position, reported performance and risk profile. There are a variety of factors that have stimulated the recent explosive growth in the use of derivative financial instruments. For example, the success of the finance industry in creating a variety of over-the-counter (OTC) and exchange-traded products has been suggested as one possible reason for the increase in derivatives usage (Froot et al., 1993). Other important factors include the deregulation of the financial services industry, the increased level of competition among financial institutions, changes in tax regulations and advances in computer technology (Chau et al., 2000).

In tandem with the large increase in the use of these innovative financial products, there has been a dramatic rise in reported scandals attributed to the use of financial derivatives (Jorion, 1995; Culp and Miller, 1995; Edwards and Canter, 1995; Overdahl and Schachter, 1995; Walmsley, 1995; Gapper and Denton, 1996; Leeson, 1996; Hogan, 1997; Jayaraman and Shrikhande, 1997; Arnold, 1998; Chance, 2001; Drummond, 2002; Dunne and Helliar, 2002; Brealey and Myers, 2003). The number of scandals, as well as the funds 'lost' from unauthorised derivative transactions associated with these scandals, have undoubtedly contributed to calls for greater disclosure of derivatives activities (McDonough, 1993; Grant and Marshall, 1997;

Beresford, 1998; Bodnar et al., 1998; Blankley et al., 2002). The lack of information (both internally and externally) about the usage of derivative instruments is frequently cited as a reason for many of the scandals associated with these innovative products over the last decade.

To address the urgent need for improved disclosure, the ASB issued FRS 13 'Derivatives and Other Financial Instruments – Disclosures' in September 1998. This Financial Reporting Standard (FRS) requires companies to disclose both narrative and numerical details about the extent to which they use derivative products to control various financial risks. These specific disclosures relate to (a) the objectives, policies and strategies for holding derivative financial instruments; (b) interest rate risk; (c) currency risk; (d) liquidity risk; (e) the fair values of financial instruments; (f) the use of financial instruments for trading; (g) the use of financial instruments for hedging; and (h) the details of specified commodity contracts. Thus, the UK financial reporting authority adopted a very different perspective from its US counterpart, which emphasised the valuation of these products and included them in a company's balance sheet[1].

One of the major issues to emerge from the discussion of the corporate use of derivative financial instruments involves the lack of control exercised over these products (Blankley et al., 2002). The failure of corporate governance and internal

[1] However, despite the reforms initiated by the accounting standard-setting bodies around the globe with respect to the increasing demands for disclosure of derivative activity and uniform accounting practices, concern still exists about these products. In his annual letter to shareholders in Berkshire Hathaway, Warren Buffet described derivatives as "time bombs" (Parker et al., 2003). He called these products "financial weapons of mass destruction" carrying potentially lethal dangers. Mr. Buffet mentioned the dangers of accounting for derivatives arguing that companies used derivative deals to create earnings that were supposedly accounted for at market value. He argued that these values were more likely to be "mark-to-myth".

control procedures is frequently cited as a contributing factor in the many scandals involving derivative products (Overdahl and Schachter, 1995; Hogan, 1997; Jayaraman and Shrikhande, 1997; Dunne and Helliar, 2002; Burton et al., 2003). The notion of internal control has been central to discussions about corporate governance since the 1990s. This inclusion led to the alignment of corporate governance processes with the risk management objective of the firm; failings in corporate governance are seen to have an adverse impact on business operations in general, and on treasury departments in particular. The increased focus on corporate governance in an international context initiated a focus on the legitimate demands for increased accountability. The Cadbury Report in the UK focused attention on the accountability and risk management aspects of corporate governance by highlighting notions of control. This report had the objective of securing the 'accountability' of the board of directors and the chief executive whilst ensuring that effective risk management and control systems of companies were developed and maintained, a responsibility reinforced in the subsequent Turnbull report (Cadbury, 1992; ICAEW, 1999). These demands necessitated the exercise of two fundamental duties of accountability: the responsibility to undertake certain actions (or forbear from taking actions) and the responsibility to provide an account of those actions (Gray et al., 1996). The annual report is seen as a means of discharging this accountability. The requirement to report to shareholders by means of the annual report, is one of the very few instances of explicit accountability established within the law itself (Gray et al., 1996). Acceptance by management of their need to account for the resources entrusted to them as well as for the organisation's operating and other policies is key to managerial legitimacy; this stewardship should be reflected in the financial statements of organisations (Khoury, 2001).

This thesis assesses the impact of FRS 13. It will utilise elements from broad notions of corporate governance and accountability theories to interpret the data provided by the content analysis of corporate annual reports, as well as insights gleaned from interviews with fund management and treasury department staff. No systematic analysis of the impact of derivatives reporting standards has been undertaken to date, in the UK. The enforced publication of derivatives usage details following the introduction of FRS 13 offers a tremendous opportunity to remedy this deficiency.

The rest of the introductory chapter is structured as follows. The core research questions investigated in the study are outlined in Section 1.2. An introduction to the methodology and methods utilised is also provided. The chapter concludes with a brief guide to the structure of the dissertation.

1.2 Scope of the Research

The primary objective of this study is an examination of the impact of FRS 13 on corporate reporting practices and accountability relationships. This objective is facilitated by an examination of corporate annual reports before and after the implementation of the derivatives accounting standard. Preparer and user perspectives regarding the implementation of the standard are also sought in order to provide a broad understanding of the issues associated with the introduction of this FRS, and the associated impact on accountability relationships. Although numerous motivations may be articulated for the disclosure of derivatives related information, the present

study is primarily focused on the effects of these disclosures for accountability relationships[2].

In seeking to examine the impact of FRS 13 on corporate reporting and accountability practices, this study attempts to add to the extant literature on accounting standard setting, derivatives usage, corporate governance and accountability. It does this initially by providing a detailed analysis of the particular effect of FRS 13 on the reporting practices of companies with respect to their derivatives usage. It then endeavours to understand and explain the views of preparers and users about this information. Potential consequences of the derivative-related information for corporate governance and accountability are also explored.

There is little empirical evidence that examines the nature of derivatives-related disclosure in a UK context. Despite the fact that the use of derivative financial instruments have been implicated in many corporate failures and scandals worldwide (Overdahl and Schachter, 1995; Hogan, 1997; Jayaraman and Shrikhande, 1997; Dunne and Helliar, 2002; Burton et al., 2003), little work has been undertaken on the consequences of reporting information relating to the usage of these products in corporate financial statements (but see Adedeji and Baker, 1999; McIlwraith and Dealy, 2000; Marshall and Weetman, 2002). One of the aspirations of this study is to

[2] The reasons for this choice include (i) the interest of the author in accountability issues, and (ii) the feeling that an accountability framework would facilitate a broader examination of the issues surrounding the introduction of FRS 13 rather than concentrating on a narrower principal-agent model or decision usefulness approach. In addition, it was felt that many of the scandals which gave rise to the standard centred on breakdowns in corporate governance and the lack of accountability in certain areas for the firms concerned. Thus, the usage of an accountability framework seemed ideal since it appeared prominent in the minds of the standard setters when arriving at this standard; indeed, the standard was issued at roughly the same time as the Turnbull Report. For further discussion on this issue see Chapter 3.

fill this gap, firstly by recording derivatives-related disclosure practices and secondly by examining the perspectives of preparers and users of this information. It is contended that these perspectives will facilitate an understanding of the difficulties associated with, and consequences of, derivatives reporting practice in a UK context to see if the information provided leads to the enhancement of corporate governance and accountability.

The study is exploratory in nature and firmly located within the interpretive paradigm identified by Burrell and Morgan (1979). The aim is to provide a descriptive account of derivatives-related disclosures, and to examine the perspectives of treasurers as preparers of the information, and the perspectives of fund managers as potential users of the information provided by FRS 13. Such an approach was thought appropriate because of the dearth of prior work in this area and because such a paradigm accords with the world views of the researcher. Other strategies could have been followed but were not adopted here.

1.3 Structure of the Thesis

The study is organised into eight chapters. Following the current introductory chapter, Chapter 2 presents a review of the literature concerning the issues to be investigated in the present thesis. Specifically, it outlines the studies that have examined both the theoretical and practical motivations for corporate risk management, accounting standard setting and risk management disclosure. The chapter outlines the results from studies that examine the corporate usage of derivative financial instruments. The theoretical motivations for corporate risk management are also discussed, while empirical investigations concerning corporate risk management are also described.

The need for accounting standards in general is examined, and the impact of UK and international attempts to regulate derivatives reporting is observed. The literature concerning risk disclosures to date is also reviewed. Thus, Chapter 2 attempts to draw together different strands of a number of related literatures in order to set the scene for the remainder of the thesis. Such an eclectic approach was thought to be necessary since the research questions to be addressed straddle different aspects of the accounting and financial management literatures. To omit some of the research areas covered might have led to a very partial view of the topic being investigated.

The purpose of Chapter 3 is to discuss the theoretical framework adopted in the present study. This theoretical framework is based on the corporate governance and the corporate accountability literature. The chapter highlights the theoretical underpinning of the corporate governance concept. The corporate governance and internal control framework that exists in the UK is examined; information about the framework in the US is provided for comparative purposes. The role of institutional investors in the corporate governance framework is discussed, as is the potential role for increased regulation. The notion of accountability is described in detail. Various interpretations of what constitutes accountability are documented and differing classifications of accountability are discussed. An attempt is made to integrate the insights offered by the corporate governance and the accountability frameworks. The notion of internal control is offered as one possible link between the two. The implications of corporate governance and accountability for treasury management are also presented.

Chapter 4 considers the research methodology, and discusses the methods underpinning the analysis in this dissertation. Views on the nature of reality and the contribution of knowledge have direct implications for methodological choices (Burrell and Morgan, 1979). The researcher's assumptions about the world are likely to implicitly or explicitly influence the research questions asked, the data sought and the conclusions drawn. The purpose of this chapter is to discuss the various methodological frameworks in the extant literature in order to document the ontological, epistemological and methodological assumptions that characterise the choice of methods utilised in the present study. The core philosophical assumptions that guide any academic research project are outlined. The particular research objectives of the present study and the choice of appropriate methods of analysis are then discussed. The ontological and epistemological assumptions of the researcher support the choice of a primarily qualitative, interpretive methodological approach to the research. The chapter explains the link between this approach and the two methods employed to examine whether FRS 13 is perceived to be useful: namely, (i) an investigation of the perspective of preparers and users of financial statements, and (ii) a study of how the contents of the annual reports of companies altered in response to the standard. These two qualitative research methods are outlined.

Chapter 5 is the first of three empirical chapters presented in the dissertation. This chapter examines the impact of FRS 13 on the financial statements of UK quoted companies. In particular a content analysis survey is used to investigate: (i) UK companies' reporting on derivatives in their annual financial statements prior to the introduction of FRS 13; and (ii) changes in UK companies' reporting practices for derivative instruments since the standard was mandated. The chapter therefore assesses whether the introduction of FRS 13 has had a material effect on the quantity

of information about derivative usage included in financial statements; such an assessment is important as the main aim of FRS 13 was the provision of additional information about the usage of derivative financial instruments. The study presents this analysis for the total level of disclosure, as well as for different categories of disclosure, market types and sectors. This breakdown should help to investigate if individual classes of company have been particularly affected by the standard.

Chapter 6 examines the implementation of FRS 13 by UK companies. Visits were made to 17 companies, and the implementation of the standard was discussed with corporate treasurers. Views were sought as to the problems that arose from the introduction of the standard, how the data and information was collected to meet reporting requirements and the problems that were envisaged in the future when complying with International Accounting Standards (IASs), in particular IAS 39. Treasurers were also asked about whether they had any views on the requirements of the US standard, FAS 133, or the suggestions put forward by the Joint Working Group on Derivatives. Finally, treasurers were asked for their opinions about whether the disclosures required by FRS 13 were likely to improve internal control within their firms and aid in their discharge of their accountability to different stakeholder categories.

Chapter 7 takes a different approach, and examines the implications of the standard from a user perspective. Many of the corporate scandals arising from derivatives usage in the past were often found to be a result of corporate governance failures. The introduction of a Financial Reporting Standard that made treasury activities more transparent might have implications for corporate governance. In particular, it might

result in large investors asking questions about treasury policy and procedures, thereby making management more accountable to their stakeholders. A series of interviews was therefore undertaken with large institutional investors to investigate whether: (i) UK institutional investors' general attitudes towards treasury management and derivatives usage had changed since the introduction of FRS 13; and (ii) the introduction of FRS 13 had any implications for corporate governance practices and procedures.

Chapter 8 provides a summary of the main findings from the three empirical chapters. It also offers some limitations of the current research. Potential avenues for further developments and future research are also explored.

Chapter 2

Literature Review and Background to the Derivatives Reporting Standards

Chapter 2 - Literature Review and Background to the Derivatives Reporting Standards

2.1 Introduction

This chapter presents a review of the literature concerning the issues to be investigated in the present thesis. Specifically, it outlines the studies that have examined both the theoretical and practical motivations for corporate risk management, accounting standard setting and risk management disclosure. The remainder of the chapter is organised as follows. Section 2.2 of the chapter outlines the results from studies that examine the corporate usage of derivative financial instruments. The theoretical motivations for corporate risk management are also discussed, while empirical investigations concerning corporate risk management are also described. Section 2.3 discusses the need for accounting standards. The impact of UK and international attempts to regulate derivatives reporting is described in Section 2.4. Section 2.5 reviews the literature concerning risk disclosures to date. Finally, Section 2.6 concludes the chapter.

2.2 The Corporate Use of Derivatives

Financial instruments are contracts whose values depend on, and are derived from, the price of an underlying asset, a reference rate or an index (Fabozzi and Modigliani, 1992). Derivative instruments comprise various types of contracts ranging from the more usual (such as futures, options and swaps), to the more complex products (such as swaptions) (Wilmott, 1998). The strategic use of derivatives and other financial instruments enhances a firm's ability to manage its financial exposure in an

environment characterised by fluctuating interest rates, variable exchange rates and turbulent commodity prices[3]. The use of these financial products in corporate risk management has grown rapidly in recent years. For example, Goldberg et al. (1998) claim that the volume of exchange-traded and over-the-counter (OTC) derivatives increased at an annual rate of 48 per cent, between 1986 and 1991. The Bank of England documented a 61 per cent rise in the average daily turnover in OTC currency and interest rate derivatives since April 1998 (Bank of England Quarterly Bulletin, 2001). Section 2.2.1 outlines the theoretical debate surrounding the necessity for corporate risk management.

2.2.1 The Theoretical Motivations for Corporate Risk Management

According to Modigliani and Miller (1958), the notion of risk management is irrelevant to the firm. They suggested that companies did not need to hedge risk because value was only created when a company made a positive net present value investment. The choice of funding had no impact on the value of the firm. Further, investors could replicate whatever risk management strategy a company might decide to pursue. Therefore, if a company was exposed to exchange rate or interest rate risk, there was no need for them to hedge such an exposure, since investors could accomplish this task themselves. However, Modigliani and Miller assumed the existence of perfect markets[4], where, for example, the cost of financial distress was considered to be zero. Consequently, the various economic rationales that have been advanced in an attempt to explain corporate risk management activity all depend on

[3] "Hedging" generally denotes the activities in which entities engage to reduce their exposure to price, interest rate, or exchange rate risk (Melumad et al., 1999).
[4] Modigliani and Miller (1958) also assumed the existence of no taxes, no bankruptcy costs and no asymmetric information.

the violation of one or more of the restrictive conditions required for this irrelevance proposition to be valid.

Despite the Modigliani and Miller (1958) argument, the increase in derivatives usage has continued. There are a variety of factors that have stimulated the recent explosive growth in the use of derivative financial instruments. This increase has in part been attributed to the success of the financial industry in creating a variety of OTC and exchange-traded products (Froot et al., 1993). Other important factors include the deregulation of the financial services industry, the increased competition among financial institutions, changes in tax regulations and advancements in computer technology (Chau et al., 2000). Several motives for the corporate use of hedging techniques are cited in the literature. These motivations relate to: (i) managerial motives[5]; (ii) taxation[6]; (iii) regulatory arbitrage[7]; (iv) economies of scale arguments[8]; (v) reductions in the costs of financial distress[9]; (vi) capital market imperfections and

---

[5] Froot el al. (1993) argued that through the use of hedging, management could smooth the earnings of the company, thus influencing the market's perception of their abilities. Stulz (1984) argued that management might engage in hedging activities to minimise the chance of themselves being forced to leave the company.

[6] This argument states that companies use hedging in order to ensure that the same tax rate was maintained in consecutive years. (Smith and Stulz, 1985; Rawls and Smithson, 1990; Froot et al., 1993; Graham and Smith, 1999). Hedging through the use of derivatives may result in companies paying less tax compared with their non-derivative user counterparts (Graham and Smith, 1999).

[7] Companies may try to avoid excessive costs in their domestic market by raising finance overseas (Smith and Stulz, 1985; Eckl and Robinson, 1990).

[8] Nance et al. (1993) argued that there were economies of scale in the costs associated with derivatives transactions that would make it cheaper for larger firms to hedge. Large companies could engage professional expertise in order to take full advantage of the many opportunities afforded by derivative financial instruments, as well as participating in speculative transactions where the cost of larger transactions might be cheaper than those of smaller transactions. Further, larger firms may have a greater range of exposures for which the use of derivative financial instruments might be appropriate (Bodnar et al., 1995; Prevost et al., 2000), a conclusion disputed by Bodnar and Gebhardt (1998) who found that derivatives usage was consistent across all companies irrespective of size.

[9] A number of writers have suggested that hedging minimises cash flow volatility, thus reducing the probability of defaulting on financial obligation and decreasing the costs of financial distress (Smith and Stulz, 1985; Rawls and Smithson, 1990; Froot et al., 1993; Mian, 1996).

information asymmetries[10]; and (vii) ensuring sufficient internal funds are present to fund attractive investment opportunities[11]. The findings of studies that have examined these hypotheses have been fairly mixed.

2.2.2 Previous Empirical Studies

A number of studies have tried to ascertain how corporations manage their financial risks in volatile environments; they have explored the broad array of new and innovative financial products available to corporate management. Grant and Marshall (1997) and Mallin et al. (2001) carried out surveys of how UK firms use derivatives. However, studies on the usage of derivatives are not confined to UK firms. Several academics have examined the extent to which derivatives are employed in large multinational companies. For example, Bodnar et al., (1995; 1996; 1998) and Philips (1995) examined derivatives usage among large US multinational firms. A number of studies have focused on derivatives usage among firms in New Zealand and Australia (Berkman and Bradbury, 1996; Berkman et al. 1997a; 1997b; 2002; Jin and Fang, 1999; Petersen and Thiagarijan, 2000). De Ceuster et al. (2000) investigated companies in Belgium, while Silva and Dias (2001) conducted a survey of derivatives

[10] Hedging can exploit any information asymmetries between the market participants, thus enabling corporate executives to gain benefit from insider knowledge. Companies can therefore exploit imperfect capital markets (Froot et al., 1993).

[11] Froot et al. (1994) argued that companies relied on cashflow projections in order to decide on their investment strategies. Froot et al. (1993) suggested that variations in the cashflows earned by assets might lead to variability in investments. Firms might be compelled to raise additional finance through external funding. Nance et al. (1993) suggested that firms with an abundance of growth options were more likely to engage in hedging activities aimed at reducing volatility in their firm's value.

usage by Portuguese firms. All of these surveys have documented evidence of an increase in the use of derivatives and other financial instruments in recent years. Some of the principal findings of these and other empirical studies will now be examined in greater detail. Table 2.1 provides a comparison of some of these studies.

Table 2.1: A Comparison of some Previous Studies on Derivatives Usage

Study	Country	Data Collection Method	Sample Size	Overall Derivatives Usage	Reasons for Using Derivatives
Bodnar et al. (1995)	US	Questionnaire (mail)	2000 (530 responses)	35%	1. To hedge contractual commitments 2. To hedge anticipated transactions of < 12 months
Berkman and Bradbury (1996)	New Zealand	Data Set	124 (80 responses)	53%	N/A
Bodnar et al. (1996)	US	Questionnaire (mail)	2000+ (350 responses)	41%	1. To manage volatility in cash flows 2. To manage fluctuations in accounting earnings
Grant and Marshall (1997)	UK	Combined Data Set	250	90%	N/A
Bodnar et al. (1998)	US	Questionnaire (mail)	1928 (399 responses)	50%	To hedge identifiable contractual commitments
DeCeuster et al. (2000)	Belgium	Questionnaire (mail)	334 (73)	65.8%	1. To hedge contractual commitments 2. To hedge anticipated transactions of < 12 months
Prevost et al. (2000)	New Zealand	Questionnaire (mail)	334 (155 responses)	67.1%	To hedge anticipated transactions of < 12 months
Mallin et al. (2001)	UK	Questionnaire	800 (230 responses)	60%	1. To hedge contractual commitments 2. To hedge anticipated transactions of < 12 months

The first of these Bodnar et al. (1995) reported that at least 35 per cent of companies used some form of derivative financial instruments. In New Zealand, Berkman and Bradbury (1996) documented empirical evidence that corporate derivative usage increased with certain financial characteristics such as leverage, size, the existence of tax losses and the proportion of shares held by directors[12]. The use of these instruments was reported to have decreased with the existence of high interest coverage and high liquidity (Berkman and Bradbury, 1996)[13]. More recently, Chan and Gunasekarage (2001) also examined derivatives usage amongst companies in New Zealand. They found that four major factors influenced the usage of financial instruments; interest cover, managerial options, the quick ratio and size[14].

In the US, Mian (1996) found some evidence to support the hypothesis that firms hedged their risk to reduce contracting costs, to exploit capital market imperfections and to lower their tax liabilities. Geczy et al., (1997) also investigated the use of currency derivatives by US firms; they found that firms with greater growth opportunities and tighter financial constraints were more likely to use currency derivatives than other companies. In the UK, Dunne et al. (forthcoming) found that company size, the percentage of sales that companies exported overseas, the presence

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[12] For example, Berkman and Bradbury (1996) argued that the optimal hedging decision from the management perspective depended on the individual compensation contract of managers. In a situation where an individual manager's wealth is a function of firm value (by means of share options), then it might be optimal for these individuals to engage in hedging activities aimed at boosting firm value. Directors and managers who held a greater proportion of shares were more concerned about the variability in firm value and were therefore more likely to hedge.

[13] Berkman and Bradbury (1996) argued that a high proportion of liquid assets reduced the need to use derivatives to lower agency costs.

[14] They suggested that firms that were vulnerable to financial risk because of their inability to generate sufficient earnings in order to meet interest payment obligations, and in order to maintain enough liquid funds, were more likely to be users of derivative products.

of financial distress and under-investment problems were important factors in determining derivatives usage[15].

Amongst those firms that used financial products, the rate and frequency of usage had increased (Bodnar et al., 1995; 1996; 1998). Derivatives were predominantly employed for the management of easily identifiable risks (Bodnar et al., 1995; 1996; 1998), with the use of derivatives in the management of foreign exchange exposures topping the list (Bodnar et al., 1995; 1996; 1998). The minimisation of cash flow fluctuation was determined to be the most important goal of risk management, with the reduction in accounting earnings variability and the protection of the Balance Sheet ranking a distant second and third respectively (Bodnar et al., 1995).

Some regional variations with respect to derivatives usage have also been noted. US firms were reported to be more risk averse than their UK counterparts (Collier et al., 1990). Perhaps the existence of more centralised control systems in UK treasury departments might have an influence on perceived riskiness (Collier and Davis, 1985). Relative to their size, New Zealand firms were found to be more active users of derivative financial instruments than their US counterparts (Berkman et al., 1997b). This finding was attributed to the relatively high exposure of companies in a small open economy such as New Zealand. In contrast, New Zealand state-owned

[15] Company size was found to be the major influence on the results. This finding supports the view that economies of scale are important in determining corporate usage of derivatives. The other significant explanatory variable related to the percentage of sales that companies exported overseas. Where these sales were material, and companies needed to engage in hedging strategies using derivatives, this variable might also reflect the impact of company size on the results since larger companies tend to engage in more overseas selling.

enterprises were not found to be above-average users of derivative products (Berkman and Bradbury, 1998). In Belgium, a large number of firms were found to engage in active risk management (De Ceuster et al., 2000). The main focus in these firms was the decrease in earnings volatility (as opposed to cash-flow volatility), whereas for firms in Portugal the primary emphasis was on successful management of interest rate and foreign exchange risk exposures (Silva and Dias, 2001). Derivatives usage in Portugal was not widespread, although the variety of instruments used had increased in recent years (Silva and Dias, 2001).

Several studies have focused on the specific use of derivatives in the management of interest rate risk. Swaps were frequently found to be the most popular instrument employed in the management of interest rate risk (Bodnar and Gebhardt, 1998; Prevost et al., 2000; Li and Mao, 2003). In addition, Borokhovich et al. (2000) found a significant positive relation between interest rate derivatives usage and the proportion of outside directors for firms with significant research and development (R&D) expenditure[16]. At a more general level, Faff and Howard (1999) explored the interest rate risk of Australian financial sector companies and found evidence of reduced interest rate sensitivity in large banks and finance companies in recent years[17], while Oertmann et al. (2000) noted that the effect of interest rate changes on

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[16] Borokhovich et al. (2000) argued that R&D expenditure is commonly as a proxy for the growth options of a firm. The higher the R&D expenditure, the more likely a company is to develop a profitable new product. Therefore, the evidence suggested that outside directors influenced the decision to use derivatives in the best interests of the shareholders (including themselves), especially in firms with high levels of growth options.

[17] Faff and Howard (1999) found that the deregulation of the Australian financial system during the 1980s reduced the level of interest rate sensitivity experienced by financial institutions in that country. They attributed the reduced sensitivity to the improved systems adopted for the measurement and management of interest rate risk.

equity returns of large European corporations' depended on corporations' business activities[18].

In contrast to these investigations, other studies examined the use of derivative financial instruments in the management of foreign exchange risk. Currency forwards were documented as the most common financial instruments to be utilised in the management of foreign exchange exposures (Bodnar and Gebhardt, 1998; Prevost et al., 2000). Several reasons were offered about why companies engaged in foreign exchange management. Geczy et al. (1997) examined currency hedging activities for a sample of Fortune 500 firms and found that the use of currency derivatives was directly related to the amount of research and development expenditure[19]. Brown (2001) investigated the foreign exchange risk management programme at a manufacturer of durable equipment. The smoothing of earnings volatility was the primary motivating factor used to explain the firm's use of foreign exchange instruments. Issues concerning accounting treatment, exchange rate and exposure volatility determined how the firm conducted its hedging[20]. Using a larger sample, Allayannis and Ofek (2001) found evidence that firms used currency derivatives to hedge, rather than to speculate, as their use significantly reduced the exchange rate exposure that companies faced. The findings of Allayannis and Weston (2001)

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[18] They noted that the share returns of industrial corporations were positively affected by interest rate changes, while those of financial companies were negatively affected. They concluded that the commonly presumed negative relation between interest rate shifts and share returns was largely driven by the financial companies in the market.

[19] A similar argument to that articulated by Borokhovich et al. (2000) was advanced, namely that R&D expenditure was commonly as a proxy for the growth options of a firm. The higher the R&D expenditure, the more likely a company is to develop a profitable new product. Therefore, the evidence suggested that outside directors influenced the decision to use derivatives in the best interests of the shareholders (including themselves), especially in firms with high levels of growth options.

[20] Brown (2001) found that the company was very concerned about the impact of FAS 133; an internal evaluation on the likely impact of the standard suggested that there would be a noticeable increase in reported-earnings volatility following adoption.

confirmed this view; they uncovered evidence consistent with the hypothesis that the use of foreign currency derivatives for hedging purposes caused an increase in firm value[21]. Belk and Glaum (1990) concluded that accounting exposures were actively managed by the majority of UK firms; the management of transaction exposures was seen as a vital element of foreign exchange risk management.

International differences emerge with respect to currency risk management objectives and practices. Chow and Chen (1998) examined the exchange rate risks of Japanese firms and found that these firms were exposed to adverse movements in the year. Marshall (2000) surveyed the foreign exchange risk practices of large multinational companies operating in the UK, the USA and the Asia Pacific region; the author found statistically significant differences in the objectives and the techniques used in foreign exchange risk management across the regions. In particular, companies operating in the Asia Pacific region placed a great deal of emphasis on foreign exchange risk management and economic exposure. The author concluded that this difference was a response to the Asian economic crisis, when exchange rates throughout the region declined quickly by sizeable amounts (Marshall, 2000). Nydahl (1999) investigated the effect of exchange rate exposure for a sample of Swedish firms. He found that the estimated exposure was positively related to total sales and negatively related to the use of currency derivatives.

The foreign exchange risk management practices operating in institutional investment organisations have also been documented. Solomon (1999) found that UK

[21] They found evidence that firms that begin a hedging policy experience an increase in value above those firms that choose to remain unhedged and that firms that stopped hedging experienced a decrease in value relative to those firms that chose to remain hedged.

institutional investors adopted a dual strategy for managing currency risks; not only managing their own foreign exchange risk, but also requiring that their investee companies manage foreign exchange risk as well. She also found evidence to suggest that the institutional investors required their investee companies to disclose information relating to their foreign exchange risk management policies. This information was similar to that mandated under FRS 13.

All of the documented research in this area points to the increased use of derivative financial instruments by a large number of companies. This increase has been reported for companies from different countries throughout the world. However, in tandem with this increase, there has been a dramatic rise in reported scandals attributed to the use of financial derivatives. The number of scandals, as well as the funds 'lost' from unauthorised derivative transactions associated with these scandals, have undoubtedly contributed to calls for greater disclosure of derivatives activities.

2.2.3 Scandals Associated with the Use of Derivatives

Despite the fact that companies try to reduce their financial risks by using derivatives, there have been a plethora of scandals and insolvencies due to losses attributable to trades involving these products. For example, in March 1991, Allied Lyons lost $250 million in writing and selling currency options (Chance, 2001), while, in February 1993, Showa Shell Sekiyu suffered a $1,580 million loss on foreign exchange forwards (Brealey and Myers, 2003). In April 1994, Kashima Oil lost $1.5 billion on currency derivatives (Chance, 2001). In the same year, Proctor and Gamble lost $102 million in equity swaps following an increase in interest rates (Arnold, 1998) and Gibsons Greetings lost $19.7 million on interest rate derivative transactions (Overdahl

and Schachter, 1995). Overdahl and Schachter (1995) highlight the failure of corporate governance structures to avert the huge losses, at the time of the Gibson's Greetings crisis. Orange County in California was forced into bankruptcy as a result of a $1.7 billion loss from investments including derivatives (Jorion, 1995; Walmsley, 1995). Also in 1994, the German metals and oil-trading conglomerate Metallgesellschaft AG, disclosed losses of $1,340 million on energy derivatives (Culp and Miller, 1995; Edwards and Canter, 1995; Jayaraman and Shrikhande, 1997). Jayaraman and Shrikhande (1997) stated that the German corporate governance structure did not help in averting financial distress at Metallgesellschaft AG. However, they did acknowledge that the corporate governance structure in place in the company aided the recovery process.

In 1995, Barings Bank became insolvent with losses of $1,400 million (Gapper and Denton, 1996; Leeson, 1996; Drummond, 2002). Hogan (1997) claims that the collapse of Barings had "little to do with the use of derivative financial instruments", but more to do with "the failure of management in its monitoring and analysis of trading activities and the risks associated with them" (p. 14) – in other words, the failure of internal corporate governance structures and the absence of external accountability. More recently, Allied Irish Bank suffered a $750m loss due to suspected fraud by a trader in the headquarters of its US subsidiary, Allfirst Financial (Dunne and Helliar, 2002; Bhandari, 2002; Gallagher, 2002; Moore, 2002). Off-balance sheet finance vehicles were implicated in the collapse at Enron, one of the largest bankruptcies in US corporate history (Benston and Hartgraves, 2002; Clark and Demirag, 2002; Lev, 2002; Revsine, 2002; Blyth, 2003; Wilson and Campbell,

2003)[22]. Despite the losses associated with the use of financial instruments, proponents of these products argue that derivatives continue to play a crucial role in the intermediation of risk in the financial system. However, the high-profile losses have led to calls for more stringent regulation of derivatives activity from both regulators and legislators (Blankley et al., 2002). The lack of information (both internal and external) about the usage of such instruments is frequently cited as a reason for many of the scandals associated with these innovative products over the last decade. One of the areas where such calls are most evident is with respect to the need for greater transparency in the disclosure of derivatives activity (Grant and Marshall, 1997). McDonough (1993) noted that the increased use of derivatives coupled with the inadequacy of the accounting requirements for dealing with these instruments had reduced the transparency of company exposures. More recently, Beresford (1998) argued that the existing accounting guidance on derivatives and hedging was incomplete, inconsistent and difficult to apply. He suggested that the effects of derivatives were not transparent in the basic financial statements. The Jenkins Report (AICPA, 1994) expressed a similar concern about the lack of adequate disclosures in financial statements to assist investors in understanding the effects of derivative transactions. Bodnar et al. (1998) reported that 74 per cent of their survey respondents expressed a "high or moderate degree of concern" regarding the accounting treatment of derivative activity. Consequently, regulatory bodies such as the ASB in the UK and the FASB in the US came under increased pressure to make the development of a comprehensive set of rules for the reporting of corporate

[22] Enron management created a scheme that provided a vehicle to keep true economic losses off of Enron's earnings statement. They created 'special purpose vehicles', linked to the Enron share price, in order to offset investment losses. The scheme worked while Enron's share price continued to rise, however, there was not a backup plan when the share price declined and the questionable transactions were exposed (Wilson and Campbell, 2003).

derivative usage a matter of some priority. To address the urgent need for improved disclosure, the ASB issued FRS 13 'Derivatives and Other Financial Instruments – Disclosures' for application in the UK, and the FASB issued FAS 133 'Accounting for Derivative Instruments and Hedging Activities' for application in the US.

2.3 Accounting Standard Setting

The derivatives reporting project was precipitated by the large losses suffered by several corporations using derivatives. However, there are a number of key issues that need to be examined in association with the introduction of any new accounting standard. The purpose of a framework for financial reporting needs to be examined in order to ascertain the appropriateness and suitability of a particular financial reporting procedure. The reasons advanced concerning the need for accounting standards and the orientation of approaches adopted by accounting standard setters are examined in this section. The standard setting process operating in the UK is discussed. The issue of lobbying practices is documented, with particular attention devoted to studies that highlight the relative influence of particular interest groups in the lobbying process.

2.3.1 A Framework for Financial Reporting

Gray and Haslam (1990) argue that there is no single framework within which empirical evidence about the external reporting activity of organisations can be conceptualised, articulated and collected. Kirk (1981) states that a conceptual framework is necessary in order to identify the particular notion of reality that is most appropriate, and which would therefore need to be reflected in financial statements. Once the objectives for financial reporting are explicitly stated, a conditional normative approach makes it possible to evaluate the appropriateness and suitability

of a particular reporting practice (Shapiro, 1997). Many attempts have been made to develop a conceptual framework for financial reporting. For example, Laughlin and Gray (1988) and Gray et al. (1996) employed a model derived from general systems theory, in an attempt to conceptualise reporting activities[23], while Laughlin and Puxty (1981) highlighted the notion of 'organisational control' as a possible basis for a suitable conceptual framework[24].

Numerous reasons have been advanced to explain the need for accounting standards. In 1977 the American Accounting Association (AAA) published its 'Statement on Accounting Theory and Theory Acceptance' (SOATATA). SOATATA identified three dominant theoretical approaches to financial accounting: (i) the classical ('true income') model; (ii) the decision usefulness approach; and (iii) the information economics model. Proponents of the 'true income' paradigm argue that income measured using a single valuation base met the needs of all users of financial statements (Belkaoui, 1992). Current price information is regarded as more useful than conventional historical-cost information to users in making economic decisions (Belkaoui, 1992).

The decision-usefulness perspective suggests that the primary concern of accounting standard setting is the improvement of decision-making capabilities and consequences for certain users of financial statements (Chambers, 1966; Beaver and Demski, 1974). This approach is built on the view that the central purpose of financial accounting and

[23] General Systems Theory (GST) conceives of everything as a system. It recognises that each system is both part of a larger system and comprises sub-systems of its own. Understanding of one system requires an understanding of both the systems that comprise the system under study and the systems of which it is a part (Laughlin and Gray, 1988; Gray et al., 1996; Gray, 2002).

[24] They suggested that external reporting by organisations could be viewed as the means by which management sought to influence the organisational environment and attempted to control the firm.

reporting is to satisfy the information needs or wants of users situated in the substantive environment of any focal organisation (Laughlin and Gray, 1988). This results in a user orientation, where the fulfilment of the information needs of financial statement users is the main concern (Davis et al., 1982). Financial reports are deemed to be necessary in order to provide information to reasonably informed users to aid them in their investment decisions (FASB, 1978, p. viii). Multiple users with varying needs are recognised and conceptual alternatives are related to these needs (Kelly-Newton, 1980).

The proponents of the information economics perspective argue that the primary concern of accounting standard setters should be the economic consequences of changing accounting conventions for decision makers or preparers of financial statements. Accounting information is seen as a type of organisational resource which is demanded and supplied in much the same way as other economic goods and services (Bebbington et al., 2001). Therefore, because this information is produced and distributed at a cost to the firm any material that is found to be of little benefit should be eliminated (Hendriksen, 1982). The intrinsic characteristics of financial reporting concepts are viewed as an end in themselves, with a monolithic class of users implied but irrelevant to the resolution of accounting issues (Kelly-Newton, 1980). Thus accounting standards identify 'best' practice and develop technical rules and concepts to which organisations should adhere[25] (Gilfedder and Ó hÓgartaigh, 1998).

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[25] However, Warnock (1997) suggested that the rules formulated by the Accounting Standards Committee (ASC), the precursor to the ASB, left ample scope for the exercise of professional judgement.

Building on the SOATATA classification Laughlin and Puxty (1981) also documented three perspectives on financial accounting: (i) the weak decision usefulness approach; (ii) the strong decision usefulness approach; and (iii) the organisational control approach. The weak decision usefulness approach was similar to the true income approach documented by SOATATA but extended to include accountability models. The strong decision usefulness approach was almost identical to SOATATA's decision usefulness model in terms of catering towards the informational needs of decision-makers. Finally, the organisational control perspective argued that information is a vital organisational resource that can be used as a type of tool to control the organisational environment.

Davis et al. (1982) adopted an alternative classification for financial accounting. They maintained that four principal 'images' shaped the development of financial accounting[26]: (i) accounting as a historic record; (ii) accounting as a descriptor of current economic reality; (iii) accounting as an information system; and (iv) accounting as a commodity. The image of a 'historic record' encompasses the processes involved in recording economic transactions and regards the function of accounting as to faithfully render a historical record/account of the organisation to the owners; accounting records are provided in order to document a history of the manager's stewardship of the owner's resources. The image of accounting as a descriptor of current economic reality is concerned with using true economic/ current values instead of historical values. The image of an information system views accounting as the process of interpreting and communicating information to the user. Finally, accounting as a commodity treats accounting information as an economic

[26] Images are the "set of constructs used to shape and understand the reality being investigated" (p. 307). These images affect what is seen and what is investigated.

commodity produced (in the absence of regulation) in accordance with the laws of supply and demand.

The different approaches offered by SOATATA (AAA, 1977), Laughlin and Puxty (1981) and Davis et al. (1982) contain a degree of overlap. Certain common themes can be identified. Bebbington et al. (2001) collated the three perspectives and identified these common characteristics. Based on their integration of the three approaches, Figure 2.1 reproduces the overlap amongst the different classification systems.

Figure 2.1: Commonalities in Classification Schemes of Financial Accounting

Basic Common Approach	SOATATA (1977)	Laughlin and Puxty (1981)	Davis et al. (1982)
Data-Oriented	Classical Models	Weak Decision Usefulness	Historical Record and Current Economic Reality
Decision Usefulness	Decision Usefulness	Strong Decision Usefulness	Information System
Organisational Resource	Information Economics	Organisational Control	Commodity

Reproduced from Bebbington et al. (2001), p. 414.

The three classifications offered previously are all based on different attitudes by the supplier concerning the purpose for which the information is supplied (Bebbington et al. 2001). From an agency perspective the development of new standards or the change to an existing standard carries the potential for wealth transfers from some people to others, and thus become a political process (Watts and Zimmerman, 1986; Brown and Tarca, 2001). Within this perspective, accounting standards exist because

they are considered to be a relatively efficient solution to a serious agency problem (Brown and Tarca, 2001; Marshall and Weetman, 2002). It was frequently argued that strict disclosure requirements led to liquid and efficient markets and reduced the cost of capital for quoted firms (Admati and Pfleiderer, 1999). Therefore, potential winners and losers had an incentive to lobby the legitimating authority – the standard setters, or ultimately the government – in an attempt to influence the outcome (Brown and Tarca, 2001). This viewpoint reflects the political dimensions inherent in differing policy choices (Gilfedder and Ó hÓgartaigh, 1998). The consequences of these differing policy decisions reflect conflicts of interest that affect resource allocation and re-distribution of wealth amongst an entity's stakeholders. Tutticci et al. (1994) claimed that the setting of accounting standards involved the restriction of the behaviour of financial statement preparers. Such restrictions therefore implied that policy choices might not be neutral, but reflections of unequal amounts of power and influence among the interested parties (Cooper and Sherer, 1984; Tutticci et al., 1994; Gilfedder and Ó hÓgartaigh, 1998). Hope and Gray (1982) stated that any description of the political process of accounting standard setting should include a consideration of how, when and by whom power was exercised. Given the existence of due process, constituents (that is, shareholders, preparers, managers, auditors) who were economically disadvantaged by the introduction of a proposed standard, would be expected to utilise the process in an attempt to influence the regulators (Tutticci et al., 1994).

A critical-interpretative perspective on financial accounting maintains that financial reporting should be used as an instrument of social change. This sociological perspective of standard setting recognises the many interest groups involved and

facilitates a positioning of management in the process. Within this perspective, the standard setting function is viewed as a programme for planned social change by policy makers and fosters an understanding of the process of change in accounting practices (Kelly-Newton, 1980). Young and Mouck (1996) adopted a 'social constructivist' perspective based on Foucault and Derrida's insistence that the contingency of the present is a partial product of past discursive arguments. They noted that although the standard setting bodies did not claim to have a moral or legal authority to establish public policy, the accounting standards produced by the process did have social and economic consequences. However, they added that the success or failure of particular accounting standards was judged on technical issues, rather than in response to the particular social or political concerns that had prompted the standard's initial construction[27].

The ASB released the "Statement of Principles for Financial Reporting" in December 1999. This Statement was intended to be a comprehensive and reasonably detailed description of the approach that the ASB believed should underpin all financial statements. According to these principles, the objective of financial statements was:

> "to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity's management and for making economic decisions."
> ASB (1999, Chapter 1)

This thesis argues that the 'economic reality', as represented by financial reporting, aims to provide a representation of 'social reality'. The representations provided by financial reporting are not just the result of passive mappings of some objective,

[27] Much of the commentary on FRS 13 (and the other derivatives standards) to date has been concerned with technical issues, rather than on the potential of these standards to provide a solution to the previous scandals involving derivatives.

external reality, but contribute reflexively to the social construction of economic reality. Thus, accounting standards such as FRS 13, which lay down the rules to be followed by preparers of financial statements, involve presuppositions about the economic reality to be represented.

2.3.2 The Accounting Standard Setting Process

The standard setting process in the UK operates via a system of open consultation through the issue of a financial reporting exposure draft (FRED) which precedes the publication of a financial reporting standard. Lobbying forms an integral part of the due process employed in this standard setting arena. Such lobbying activity can be conducted through formal and informal channels. Formal lobbying typically takes the form of written submissions, position papers, questionnaire responses and via membership of the standard setting board. Informal lobbying includes luncheon discussions, telephone conversations and other word-of-mouth communications. Lobbying in the standard setting process has been examined on numerous occasions. Obtaining evidence of informal lobbying activity is difficult, as such activity is usually not directly observable. Therefore, previous studies have typically examined the formal submissions made to the various standard-setting bodies (Gorton, 1991; Grinyer and Russell, 1992; Tutticci et al. 1994; Weetman et al., 1996; Larson, 1997; Ó hÓgartaigh and Reilly, 1997; Gilfedder and Ó hÓgartaigh, 1998; Saemann, 1999; Fox and Russell, 2001; Weetman, 2001)[28].

The success of various lobbyist groups and the interplay of the power relationships have been subjected to academic scrutiny on several occasions. Research by Sutton

[28] For example, Tutticci et al. (1994) examined the submissions made to the Australian standard setting body on ED 49 (Accounting for Identifiable Intangible Assets).

(1984) and Weetman et al. (1996) indicated that producers of financial statements were more likely to lobby than were the users of such financial statements. The incentives for preparers of financial statements to engage in lobbying activity are great given the potential economic consequences of any new accounting standards (Gilfedder and Ó hÓgartaigh, 1998). Further, there has been a suggestion that the ASB favours the users of financial statements, representing the demand side of the market, rather than the preparers (Puxty et al., 1987; Weetman, 2001). With respect to the preparers of financial statements, one possible reason why they dislike full disclosure is because such disclosure is costly to their firms (Admati and Pfleiderer, 1999). Saemann (1999) claimed that preparers are likely to oppose requirements that increase disclosures because such disclosures might draw attention to unfavourable results or excessive profits. He argued that the costs of obtaining the necessary data for compliance, in addition to the increased printing requirements, also motivated financial statement preparers to oppose any additional disclosures. The additional information might also need to be disclosed or certified by third parties, such as accounting firms, thus increasing costs even further (Saemann, 1999). Further, because increased disclosure might reveal information to competitors or others who interacted strategically with the firm, they could cause the firm to lose competitive advantage or bargaining power in certain situations (Admati and Pfleiderer, 1999). Any standards that resulted in increased volatility in terms of reported income were likely to be opposed by managers because of the effect on any performance-related bonuses (Saemann, 1999).

Georghiu (2001) examined less observable forms of lobbying as part of the ASB standard setting process. He found that the majority of the lobbying activity took

place at the public exposure stages of the standard setting process. The most popular lobbying method was considered to be appealing to external auditors for support (Sutton, 1984; Georghiu, 2001; Georghiu, 2002). There has been considerable debate concerning the effectiveness of comment letters (Sutton, 1984; Walker and Robinson, 1993; Weetman et al., 1996)[29], however, Georghiu (2001) found that the submission of such letters was an effective form of lobbying.

Although the preparers of financial statements are more likely to lobby than are the users of these reports (Sutton, 1984; Weetman et al., 1996; Gilfedder and Ó hÓgartaigh, 1998; Admati and Pfleiderer, 1999; Saemann, 1999), users are also impacted by the release of financial reporting standards. There are many external users of financial statements – shareholders, bondholders, financial institutions, taxing authorities, potential investors, regulatory agencies, employees, customers, suppliers, and so on. It is likely that these users have different informational requirements from financial reports, but there are also identifiable similarities. For example, prior research tends to indicate that all users favour uniformity and full disclosure in financial reports (Weetman et al., 1996). However, other conflicting objectives between user groups might result in different preferences for the content and the form of accounting reports (Cooper and Sherer, 1984). Such conflicting objectives may be satisfied either by publishing different accounting reports directed towards each specified group[30], or by designing general purpose accounting reports which attempt

[29] Much of this debate centres on the assumption that comment letters are representative of overall corporate lobbying behaviour. For example, Weetman et al., (1996) challenge this assumption; they claim that written submissions "are almost certainly not indicative of the entire lobbying process" (p. 75).
[30] This option has been criticised because of the excessive use of resources involved in potentially producing several different annual reports for the various user groups (Cooper and Sherer, 1984).

to satisfy the preferences of all user groups[31]. Nevertheless, in general, the annual report is seen by the accounting profession, as an important device for financial communication between management and stakeholders (Gray et al., 1995a; 1995b; Bartlett and Chandler, 1997). Arnold (1977) highlights the fact that although accounting information is generally historical by nature (and is therefore seen as providing little insight into the process of assessing future worth), such information may still have a control value in enabling investors to monitor companies' performance.

Investors are likely to hold well-diversified asset portfolios, whereas lack of diversification may render the preparer more exposed to the adverse economic consequences of a proposed standard on their firm (Gilfedder and Ó hÓgartaigh, 1998). Users are found to be more likely to lobby in private and by means of informal meetings with standard setters (Weetman et al., 1996; Martens and McEnroe, 1998). Sutton (1984) postulated that because the lobbyist bore the costs of lobbying and received only a fraction of the benefit, the wider ranging the group (as is the case with users), the less likely individual members were to lobby.

Purdy (1997) criticised the ASB for defining its objectives to include all users of financial statements, but then restricting the application of the standards. He argued that by focusing on the needs of investors, the ASB specified the information that had to be provided to investors, but other user groups did not benefit. Purdy also argued that the use of the term 'relevant' with accounting standards implied that financial

[31] Cooper and Sherer (1984) highlight a potential difficulty with such an approach; any user conflict concerning content preferences would need to be dealt with by choosing one method of accounting over another.

statements represented attributes that could only be expressed in money terms with either predictive or confirmatory value[32].

At an international level, the IASB claim that the objective of an international set of accounting standards is to standardise firms' financial disclosures and accounting method choices among different nations (Wyatt, 1989; Ashbaugh, 2001; Damant, 2001; Parker and Morris, 2001). International Standards are gaining visibility and acceptance in the international marketplace for financial reporting information (Larson, 1997)[33]. Proponents of international standards claim that if all firms follow the same set of accounting standards, firms' external financial reports will provide more uniform disclosures and accounting variables will be more useful to investors (Wyatt, 1989; Purvis et al., 1991; Damant, 2001). It is further argued that companies, in addition to investors, will benefit from disclosing financial information prepared in accordance with an internationally acceptable set of accounting standards (Parker and Morris, 2001).

2.4 Accounting for Derivatives

The derivatives reporting project was precipitated by large losses suffered by several corporations using these novel financial products. The emergence of new more complex financial instruments was seen as a challenge to existing financial accounting practices. Accounting claimed to provide the information necessary in

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[32] This would have implications for wider accountability. Further, FRS 13 makes extensive use of narrative disclosures; where can such disclosures fit within the overall framework?

[33] Horton and Macve (2000) would dispute this. They claim that international accounting standard setting is in crisis. They highlight both the political arguments over the required structure necessary to ensure worldwide credibility and applicability as well as the technical disputes concerning a suitable conceptual framework, as fundamental flaws in the establishment of international standards. They found that this argument was particularly relevant with respect to accounting for financial instruments by means of IAS 39.

order to assess the financial condition as well as the operational results of an entity. Yet, the absence of information about financial instruments, which had the potential to alter risk within an organisation, threatened the maintenance of this claim. Therefore, standard setters proposed to make the use of financial instruments more transparent and to represent the effects of these instruments on an entity's financial position[34].

In order to examine the impact of FRS 13 on preparers of the financial statements, a brief summary of the Standards that are relevant to treasury operations are discussed in Table 2.2. Parker and Morris (2001) argued that US GAAP had increasingly become an influence on accounting practices in other countries, even aside from those jurisdictions traditionally considered under direct US influence. For example, a survey by PWC and the Euro Association of Corporate Treasurers (EACT) in 2002, found that although local standards predominated, 50 per cent of companies across Europe complied with the US or International Accounting Standards (Masquelier and Di Paola, 2002). Therefore, because many UK companies are affected by both US and International Accounting Standards, a summary of the key US and international standards relating to disclosures about the use of derivatives is also supplied. Table 2.2 highlights some of the key differences between the principal derivatives reporting standards.

[34] However, Young (1996) argued that the standard setting bodies, rather than accept the challenge posed to the existing reporting framework, chose to try to fit financial instruments within its confines, in order to maintain claims about representational faithfulness and to fit these instruments within existing accounting categories. Therefore, he maintained that the accounting issues associated with financial instruments were framed in established and programmed ways.

Table 2.2: A Comparative Analysis of the Main Derivatives Reporting Standards

	FRS 13	FAS 133	IAS 39	Joint Working Group Proposals	FRED 23	FRED 30
Application	UK companies (other than insurance companies)	US companies and companies reporting under SFAS	All companies reporting under IAS	All companies reporting under IAS	UK companies	UK companies
Coverage	Disclosure only	Disclosure, Measurement and Recognition	Disclosure, Measurement and Recognition	Disclosure, Measurement and Recognition	Hedge accounting	Measurement and Recognition
Principal Disclosures	Objectives and Policies, Interest rate risk, Currency risk, Liquidity risk	All derivative financial instruments should be reflected at fair value. Hedge accounting allowed	All derivative financial instruments should be reflected at fair value. Hedge accounting allowed	All derivative financial instruments should be reflected at fair value. Does not allow hedge accounting	Hedge accounting only permitted if pre-designated and if meets hedge effectiveness tests	Implementation of IAS 39 fair value provisions. Insurance companies no longer exempt from FRS 13. Prohibit use of "recycling" techniques
Effective Date	March 23rd, 1999	June 15th, 2000	January 1st, 2001, Compulsory in 2005 for all EU companies	N/A	N/A	N/A

This table presents a summary of the main derivative reporting standards: FRS 13, FAS 133, IAS 39, the proposals of the Joint Working Group (JWG) and the two exposure drafts (FRED 23 and FRED 30.

2.4.1 Financial Reporting Standard 13

In July 1993, an international association of bankers and former government officials published a document which called for improved disclosure in financial statements of transactions involving derivatives and other financial instruments (Group of Thirty, 1993). However, it took the ASB three years to produce a discussion paper on financial instruments in July 1996 and a further two years to issue FRS 13 in September 1998.

FRS 13 defines a financial instrument as "any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity" (ASB, 1998, par. 2). The stated objective of FRS 13 is to ensure that reporting entities "provide in their financial statements disclosures that enable users to assess the entity's objectives, policies and strategies for holding or issuing financial instruments" (ASB, 1998, par. 1). The standard is effective for accounting periods ending on or after, 23 March 1999.

FRS 13 requires publicly traded entities, and all financial institutions other than insurance companies, that use financial instruments, to give sufficient narrative and numerical disclosures regarding their use of derivatives and other financial products. The main purpose of the narrative disclosures seems to be the stimulation of discussion on a company's reasons for using financial instruments. The idea is to put the numerical disclosures that are required into some sort of context. The ASB also hopes that narrative information will help stakeholders evaluate the role that these instruments have played in the overall risk management strategy of a company (ASB,

1998)[35]. A key objective of the standard is that users should be able to receive relevant and reliable information about the extent to which financial instruments contribute to business risk. The narrative disclosures focus primarily on the risks that arise in connection with the use of derivative financial instruments and how such risks have been managed. Therefore, the narrative disclosures typically include (i) a discussion of the role of financial instruments in creating or changing the risks that an entity faces in its activities; (ii) a description of the objectives, policies and strategies for holding and issuing financial instruments; (iii) an explanation of how the year-end figures reflect the agreed objectives; and (iv) an outline of how financial instruments are (or are not) recognised in the financial statements.

The numerical disclosures aim to show how the policies are implemented and to provide supplementary information for evaluating the magnitude of any significant exposures (ASB, 1998). The main numerical disclosures required by FRS 13 fall under four headings: (a) interest rate risk disclosures; (b) currency risk disclosures; (c) liquidity risk disclosures; and (d) fair values disclosures. There are also further numerical disclosures related to the use of financial instruments for trading and hedging purposes as well as the provision of details relating to specified commodity contracts.

The interest rate risk disclosures relate to all significant financial assets and liabilities. An analysis of the carrying amount by principal currency, subdivided between: (i)

[35] FRS 13 does not specifically state where the narrative disclosures should be made and instead allows companies to make them "in the financial statements or in some other statement such as the operating and financial review" (ASB, 1998: par., 23). A survey by Arthur Andersen (2000) found that overall, 48 per cent of the companies surveyed decided to make the narrative disclosures principally in the OFR.

those at fixed interest rates; (ii) those at floating interest rates; and (iii) those on which no interest is paid, is required. This analysis should be after taking account of any risk management that the entity has undertaken using derivatives.

With respect to currency risk disclosures, FRS 13 requires an analysis of the net monetary assets and liabilities at the balance sheet date by reference to the principal functional currency of operations. The purpose of this analysis is to explain the currency exposures that give rise to exchange gains or losses. As with the interest rate risk disclosures these should be after taking account of any risk management that the entity has undertaken using derivatives.

Liquidity disclosures focus on the maturity profile of the financial instruments. The FRS requires disclosure of the maturity profile in the following bands: (i) in one year or less, or on demand; (ii) in more than one year, but not more than two years; (iii) in more than two years, but not more than five years; and (iv) in more than five years. In addition to requiring disclosure of the maturity profile of financial instruments FRS 13 also requires a similar analysis of any committed but un-drawn borrowing facilities. The required analysis is of facilities expiring: (i) in one year or less; (ii) in more than one year, but not more than two years; and (iii) in more than two years.

The basic requirement of the fair value disclosure is that an entity should divide its financial assets and liabilities into appropriate categories and to disclose either: (a) the aggregate fair value at the balance sheet date compared to the aggregate book value; or (b) the aggregate fair value of those financial instruments at the balance sheet date

with a positive fair value (i.e. in excess of book value) and separately, those with a negative fair value.

FRS 13 encourages, but does not require, the disclosure of overall market price risk. This involves attempting to predict the overall effect on an entity of changes in key indicators such as interest rates and exchange rates. A more detailed summary of the key requirements of FRS 13 is provided in Appendix 2.1.

Very little research has been conducted into the impact of derivatives reporting standards in the UK[36]. Adedeji and Baker (1999) conducted a review of derivatives reporting practice prior to the introduction of FRS 13. They uncovered a large gap between the requirements of FRS 13 and the reporting practice that existed prior to the introduction of the standard. In a survey carried out by PricewaterhouseCoopers, McIlwraith and Dealy (2000) conducted a review of FRS 13's implementation based on the disclosures made by 60 companies from the FTSE 500. They found that of the 60 firms whose financial statements were reviewed, 10 were 'early adopters', having a year-end before the standard became mandatory in March 1999, while the other 50 were obliged to comply. The authors found that the explanations that were put forward concerning the use of derivatives and the policies in place seemed "incomplete" (p. 88).

Much of the early commentary concerning FRS 13 was negative (Dealy, 1998; Bircher, 1999). Certain aspects of FRS 13 were criticised for being "unclear" (Bircher, 1999). Companies were also having difficulties implementing the standard.

[36] To the best of my knowledge, this is the most comprehensive study to have been undertaken to date, into the implications of derivatives reporting standards in a UK context.

The Financial Reporting Review Panel (FRRP) has issued a general warning on FRS 13, stating that it has already had to take a number of companies to task about their failure to abide by the guidelines (Hinks, 2001). Companies that have incurred the wrath of the FRRP include Artisan, Ensor Holdings and Wiggins; the latter was forced by the panel to restate their accounts from 1996 to 2000 (Hinks, 2001). However, the introduction of the US standard (FAS 133), the International Accounting Standard (IAS 39) and the proposals of the JWG met with much greater resistance (Di Paola, 1999a; Di Paola, 1999b; Chalmers and Godfrey, 2000; Di Paola and Cattoor, 2000; Horton and Macve, 2000; Alby, 2001; Chopping, 2001; Michell, 2001; Osterland, 2001; Bodurtha and Thornton, 2002).

2.4.2 International Derivatives Accounting Standards

FAS 133: "Accounting for Derivative Instruments and Hedging Activities was issued in June 1998" [37,38,39]. This standard represents the culmination of the US Financial Accounting Standards Board's nearly decade-long effort to develop a comprehensive framework for derivatives and hedge accounting. The goal of FAS 133 is to provide investors with more information on companies' risk management practices and derivative transactions. However, the standard goes much further than that of FRS 13 by requiring that the financial statements not only provide notes and disclosures, but also decrees that the impact of certain hedging activities be reflected through the

[37] 'FAS 137 Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133—An Amendment of FASB Statement No. 133' was issued in June 1999 deferring the adoption date for FAS 133 to January 2001.

[38] 'FAS 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities—An Amendment of FASB Statement No. 133' was issued in June 2000.

[39] 'FAS 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities' was issued in April 2003. This document offered some clarification of the FAS 133 definition of a derivative; it identified the circumstances where a contract with an initial net investment met the characteristics of a derivative. It also clarified when a derivative that contained a financing component required special reporting in the statement of cashflows.

earnings statement. In particular, FAS 133 requires that: (i) an entity recognise all derivatives as either assets or liabilities in the financial statements; (ii) derivative financial instruments are measured at fair value; (iii) accounting for changes in the fair value of a derivative (that is, gains and losses) be dealt with through the earnings statement; and (iv) special rules exist for hedge accounting (FASB, 1998)[40]. These hedge accounting rules state that there must be formal documentation commencing at the inception of the hedge that explains how the hedge will work and how effectiveness will be measured.

The International Accounting Standards Board issued International Accounting Standard 39 "Financial Instruments: Recognition and Measurement" (IAS 39 hereafter), which became effective for annual statements covering financial years beginning on or after 1 January 2001[41]. The European Commission has mandated that all EU listed companies must prepare their accounts under international accounting standards by 2005 (European Commission, 2001). According to IAS 39, all financial assets and liabilities are recognised on the balance sheet, including derivatives. They are initially measured at cost, which is the fair value of whatever was paid, or received, to acquire the financial asset or liability and are then regularly re-valued to reflect their fair value (IASC, 1998). Table 2.3 summarises some of the key differences between FAS 133 and IAS 39.

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[40] FAS 133 made it harder for a derivative position to qualify for hedge accounting. Those hedges that fail the 'effectiveness test', or are not properly designated as hedges at inception, must be regularly marked to market with changing valuations going directly to the profit and loss account, rather than the balance sheet.

[41] Prior to the introduction of IAS 39, the IASC released IAS 32 "Financial Instruments: Disclosure and Presentation". This standard dealt with issues relating to disclosure and presentational format.

Table 2.3: Some Major Differences between FAS 133 and IAS 39

FAS 133	IAS 39
• Covers only instruments which fall under the definition of a derivative	• Covers derivatives, but also any financial asset and liability
• Includes hedges of firm commitments within the definition of a fair value hedge	• Considers hedges of firm commitments to be cash flow hedges
• Includes a third category of hedge, namely the foreign currency hedge	• Recognises a third category of hedge, namely hedges of a net investment in a foreign entity
• Requires that firm commitments be recorded at their fair value on the balance sheet	• Does not alter the old rule that firm commitments are not recorded

The Joint Working Group (JWG) on fair value accounting was set up by the International Accounting Standards Committee (IASC) in November 1997 and comprised ten national accounting standards setters. The committee was disbanded on the formation of the International Accounting Standards Board (IASB), but the findings of the JWG, covering over 300 pages, were reported in December 2000, and were adopted for discussion by the IASB. The three central tenets of the JWG proposals are summarised here. First, entities should measure all financial instruments at fair value, and should recognise all changes to those fair values immediately in the Profit and Loss account. Second, the fair value of an instrument should be its estimated market exit price. Finally, there should be no hedge accounting for financial instruments. This final requirement has proved to be the most controversial issue.

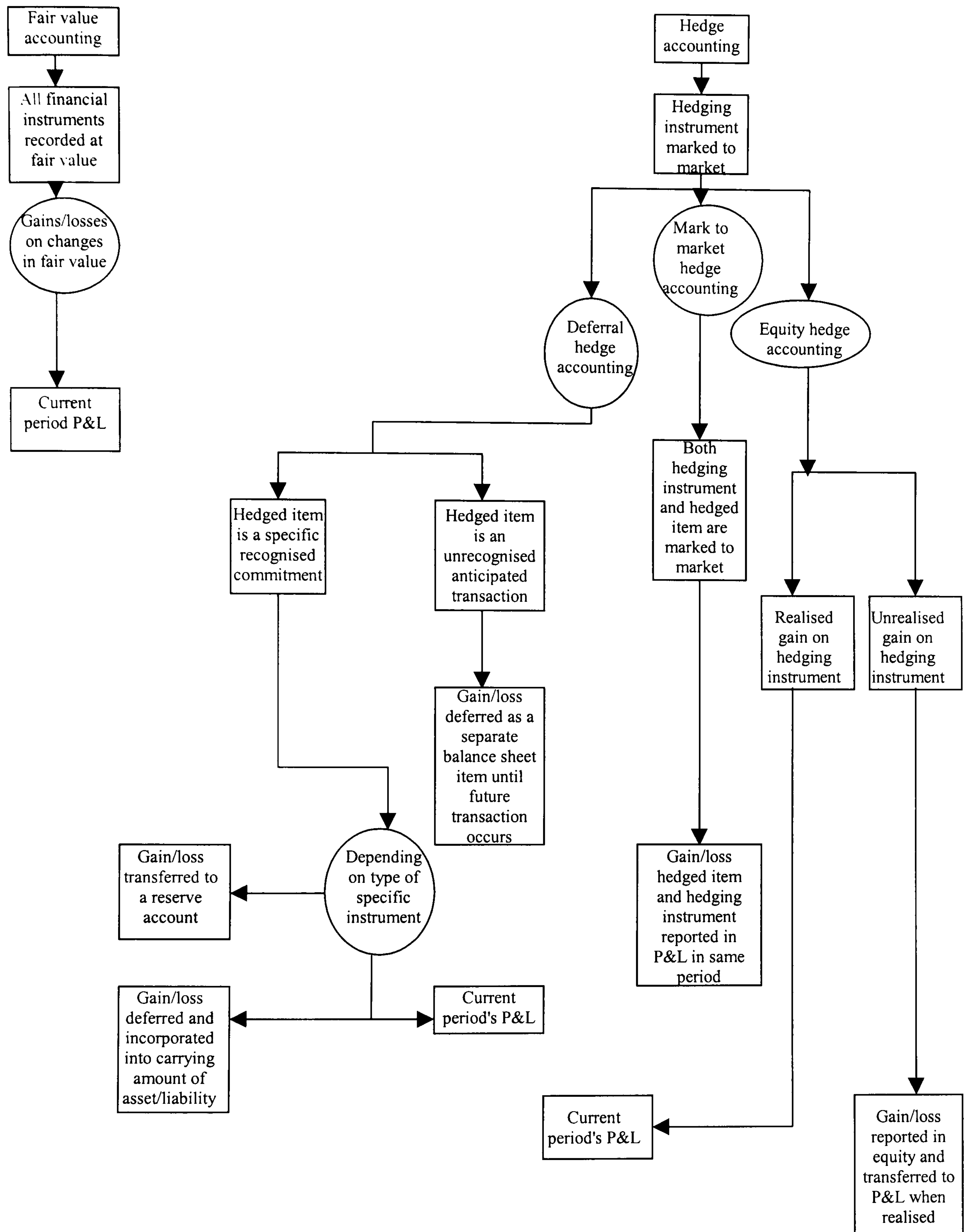
2.4.3 The Issue of Hedge Accounting

The central difference between the approaches adopted by the ASB, the JWG, the FASB and the IASB relates to the issue of hedge accounting. FRS 13 is a disclosure only standard; it does not deal with measurement or valuation of derivative financial instruments. Therefore, the standard does not contain any pronouncements concerning

the use of hedge accounting. FAS 133 and IAS 39 allow hedge accounting while the JWG approach does not allow the use of this approach. Much of the discussion concerning what form the accounting rules should actually take centres around (i) the relative merits of hedge accounting and fair value accounting[42] and (ii) the question of what the qualifying criteria for hedge accounting should be. Chalmers and Godfrey (2000) offer a summary of the alternative accounting methods and their respective implications. This summary is adapted and reproduced here[43].

[42] The terms mark-to-market accounting, fair value accounting, market-value based accounting, and market value accounting are often used as synonyms.
[43] The original Chalmers and Godfrey (2000) figure contained more detail than the simplified version presented here.

Figure 2.2: Alternative Treatments of Accounting for Derivative Financial Instruments and Hedging Activities



Adapted from Chalmers and Godfrey (2000): p. 41.

Figure 2.2 depicts two alternative treatments of accounting for derivative financial instruments and hedging activities: fair value accounting and hedge accounting. Broadly speaking, hedge accounting is the preferred method of accounting from a company's viewpoint[44]. Essentially, hedge accounting refers to a method of accounting for derivative financial instruments whereby gains or losses on a particular instrument are only recognised in the Profit and Loss Account when the corresponding losses or gains on the item being hedged are recognised[45]. The use of hedge accounting complies with the "matching concept" and may be useful to treasurers in their attempts to smooth their bottom line earnings. There are a number of tests to determine whether a hedge is allowable or not. The first of these tests examines the "effectiveness" of a transaction, whereby broadly, 80 per cent to 120 per cent of any gain or loss on the asset or liability being hedged is matched by an opposite and offsetting gain or loss on the hedge instrument. However, there are a number of different calculations for the effectiveness test, and companies have to decide before the outset which method they will use; this method is not allowed to

[44] This preference arises from the perceived reduction in earnings volatility associated with hedge accounting (Di Paola, 1999b). The use of 'hedge accounting' techniques is considered to be imperative in terms asset and liability management, because this technique assures that gains or losses associated with hedging instruments contribute to earnings simultaneously with the risks being hedged (Kawaller, 2003). Without hedge accounting the effect of the gain or loss on the hedging instrument and the item being hedged would impact earnings in different accounting periods, resulting in an elevated level of income volatility which could obscure the risk management objectives of the hedging activity (Kawaller, 2003).

[45] Three variants of hedge accounting are recognised. First, the fair value of the derivative is recorded on the balance sheet as an asset or liability and any realised gains or losses which result are recorded in the income statement immediately. This method would only be appropriate if unrealised gains or losses on the item being hedged are accounted for in this way. Second, the fair value of the derivative is recorded on the balance sheet as an asset or liability and any gains or losses are recorded as either a stand alone balance sheet item, an adjustment to the reserves figure in the balance sheet, with disclosure of the figure in the Statement of Total Recognised Gains or Losses. This procedure would be particularly appropriate for a derivative which is being used to hedge an existing asset or liability which is recorded on the balance sheet but for which gains or losses are only recognised as income when realised. Third, no accounting entries are made in respect of the derivative until some time after the position is established, in other words, the derivative is treated as an off balance sheet item until this time. Melumad et al. (1999) argued that the use of 'no-hedge' accounting did not allow for the communication of important and relevant information and reduced the level of hedging. They found that long-term shareholders preferred comprehensive fair value hedge accounting, while short-term shareholders preferred either comprehensive fair value hedge accounting or 'no-hedge' accounting.

change. The results can be dramatically different between the two: under one method a hedge may be effective, while under another method, it may not be (Finnerty and Grant, 2002).

In contrast, under fair value accounting, the fair value of the derivative is recorded on the balance sheet as an asset or liability and any unrealised gain or loss which results is recorded in the Profit and Loss Account in the accounting period the change occurs, irrespective of the accounting treatment afforded to the item being hedged. Advocates of fair value accounting believe that fair values provide more relevant measures of assets, liabilities, and earnings than historical costs (Barth, 1994). For example, Simko (1999) found that fair values were more informative than historical costs for long-term debt, but were less relevant for financial assets. This conclusion was in line with the earlier work done by Eccher et al. (1996) who also found that fair value disclosures were value relevant. Fair value accounting has also been praised because performance measurements are more difficult for management to manipulate through the realisation of financial instruments when fair values are used; hence it is thought to provide a fairer representation of company performance (Chau et al., 2000).

However, fair value accounting has been criticised. Opponents point to the reduced reliability of fair value measures relative to historical costs; their argument suggests that investors would be reluctant to base valuation decisions on the more subjective fair value estimates (Barth, 1994). Detractors also highlight the potential for increased volatility associated with fair value estimates and the potential for misleading reporting of gains and losses not yet realised. Despite these criticisms, the fair value

approach to derivatives reporting has been favoured by regulatory authorities to date; they have attempted to restrict the use of hedge accounting by specifying stringent conditions that must be met before this method is permitted.

2.4.4 Reactions to International Developments

The initial response to the recent international developments has been extremely negative. Osterland (2001) cited an Association for Finance Professionals (AFP) survey, which found that more than two-thirds of the respondents considered that FAS 133 imposed an excessive burden on reporting companies. Murphy and Maguire (2001) described the standard as "conceptually challenging" (p. 14) and argued that the standard was complex and "tedious to apply" (p. 14). Osterland noted that most of the frustration with FAS 133 stemmed from the issue of hedge accounting. The requirements of FAS 133 to document every hedge from the outset in order to avail of hedge accounting, and to mark-to-market their derivatives every quarter, were proving quite difficult, even for larger companies. For example, General Electric were reported to have spent $8 million over the past two years developing systems to perform these functions (Osterland, 2001). It was also noted that some, arguably sensible, hedging strategies were being abandoned because company boards did not want to see volatility in the accounts (Osterland, 2000; 2001; Michell, 2001; Bodurtha and Thornton, 2002).

The crux of the argument appears to be that the increased volatility which resulted from not adopting hedge accounting techniques will make firms appear riskier than they are really (Di Paola, 1999a; 1999b; Di Paola and Cattoor, 2000; Horton and Macve, 2000; Osterland, 2000; 2001; Michell, 2001; Murphy and Maguire, 2001;

Bodurtha and Thornton, 2002)[46,47]. Further, although treasurers had always preferred plain-vanilla derivative products such as exchange rate forwards and interest rate swaps, the use of these plain-vanilla products was exacerbated at the expense of more complex interest rate and currency options. Di Paola and Cattoor (2000) indicated that FAS 133 would therefore drive changes in treasury policy. Thus, treasurers' operational practices seemed to have been changed by FAS 133, even though it was a financial reporting standard.

However, not all the commentary on FAS 133 has been negative. Essaides (1999) argued that the adoption of the standard imposed greater discipline on risk management programmes; companies would be compelled to articulate their risk management policies more clearly. More precise forecasts and measurement of exposures would ensue, in addition to the more frequent and accurate measurement of the performance of hedging strategies. For example, Farley (2002) argued that a well-constructed derivatives accounting process was "critical" in order to enhance corporate governance and add value to companies.

IAS 39 has also been the subject of widespread comment. Horton and Macve (2000) described IAS 39 as "conceptually flawed and unworkable in practice" (p. 26), while Alby (2001) considered the standard to be "the most complicated accounting standard ever released". The implications of the standard for small companies are reported to

[46] This attitude may be a little naïve; given adequate disclosure, users should be able to "strip out" the source of the volatility which should therefore have no value relevance. Perhaps this masked a concern that the proposed standard would not enable firms that are using derivatives for legitimate hedging purposes to properly distinguish themselves from firms that are using then for speculative purposes.

[47] In June 2003 US mortgage provider giant Fannie Mae announced a 52 per cent fall in profit in January 2003 despite a surge in business. The company went to great lengths to explain away this increase to investors due to the imposition of FAS 133 and the need to reflect increases or/and decreases in the fair value of derivative instruments in the financial statements (Crenshaw, 2003).

be even more pronounced[48] (Chopping, 2001). Di Paola (1999a) commented that both FAS 133 and IAS 39 would dramatically change the figures reported in the balance sheet and profit and loss account of any company using financial instruments; this impact would be even more pronounced for heavy users of derivatives. Other commentators have pointed out that the rationale for a particular financial decision should not be based on accounting implications and treatments. Yet it appears as if this would be the result of the standard. For example, Di Paola (1999b) argued that those implementing accounting or treasury systems would face fundamental challenges and difficulties because of the imposition of these accounting standards.

The two main objections to the JWG proposals were that: (i) a company's own debt had to be held at fair value; and (ii) hedge accounting would be abolished. Chalmers and Godfrey (2000) argued that the abolition or curtailment of hedge accounting would require companies to alter their current accounting practices and risk management strategies: it would probably force companies to assess their use of derivatives. Horton and Macve (2000) agreed, claiming that the JWG would benefit from adopting accounting concepts that showed an understanding of economic and commercial reality. They added that there were both balance sheet and income statement problems inherent in adopting the particular version of a "current value" basis of accounting for financial instruments developed by the JWG[49]. They also argued that the IASC and the JWG concept of capital maintenance was inadequate[50].

[48] There is no current international equivalent of the Financial Reporting Standard for Smaller Entities (FRSSE).
[49] Horton and Macve (2000) claimed that balance sheet problems related to the fact that the FASB and the IASC definition of 'value' had no theoretical basis in economic logic or capital market theory.
[50] Horton and Macve (2000) claimed that "book" gains (or losses) appeared when there was a reduction (or increase) in market value of liabilities (whether these variations resulted from changes in interest rates or other company-specific factors) while the overall impact on the value of the equity was as likely to be negative (or positive).

2.4.5 Other Potential Future Standards

In May 2002, the Accounting Standards Board issued FRED 23, 'Financial Instruments: Hedge Accounting', to become mandatory for companies in 2003, until the IASs become mandatory in 2005. This was followed in June 2002, by FRED 30, 'Financial Instruments: Disclosure and Presentation, Recognition and Measurement'. The introduction of these proposals has not been popular, because, they will only be effective for two years and although similar to IAS 32 and IAS 39, they differ with respect to the notion of 'recycling'. The provisions contained in IAS 39 require certain gains and losses recognised in the statement of total recognised gains and losses to be recognised subsequently in the profit and loss account (a practice known as 'recycling'). However, FRED 30 would prohibit the use of these recycling techniques (ASB 2002b). Therefore, most companies would need to set up systems to comply with FRED 23 and then change them again to meet IAS 39 requirements. Preparers are, arguably, unhappy about implementing a new standard for just one, or possibly two years. From a corporate governance standpoint, following the recent accounting scandals, the accountancy profession needs to restore faith in the value of financial statements (Abdel-khalik, 2002; Benston and Hartgraves, 2002; Lev, 2002; Revsine, 2002). The effects of changing the financial reporting demands placed on company management, as well as the difficulties associated with achieving year-on-year comparisons, are likely to make this objective more difficult to achieve (Raeburn and Boyle, 2002).

In conclusion, Di Paola and Cattoor (2000) noted that despite changes to treasury processes and procedures, many companies were beginning to see the positive side to

derivatives reporting standards. They indicated that some companies viewed FAS 133 as an opportunity to get treasury "out of its ivory tower" and closer to the central business function (p. 38). Di Paola and Cattoor (2000) also noted that the implementation of the standard allowed companies to ensure that exposures were properly captured and that hedging policies were aligned to corporate objectives. It could be argued that the imposition of an accounting standard that placed the responsibility for ensuring that staff were adequately trained, informed and supported in their use of derivative financial instruments on company management, was an improvement. Such a standard could also afford companies the unique opportunity to reinforce financial risk management practices thus improving treasury management guidelines and practices and ensuring that more robust control mechanisms were in place.

2.5 Risk Disclosure – Research and Practices to Date

This section examines the research into the practices and disclosures of companies with respect to risk reporting in corporate annual reports. The nature of voluntary reporting mechanisms, which existed prior to the recent introduction of derivative reporting standards, is explored. The suitability of narrative versus numerical presentation of information is discussed. Finally, the extant literature exploring the response of financial entities to the derivatives reporting requirements is presented.

2.5.1 The Nature of Voluntary Reporting

Most of the reported research concerning risk-related disclosures was conducted at a time when such reporting was produced on a voluntary basis[51]. Some prior research suggests that firms might benefit from providing voluntary disclosures (Botosan, 1997). It has been shown that voluntary disclosures can be socially more efficient and privately beneficial as such disclosures can improve risk sharing, reduce information costs for investors, lower a firm's cost of capital and signal the absence of negative conditions such as maturity mismatch in an institution's assets and liabilities (Dye, 1990; Botosan, 1997). However, various commentators noted that through the use of voluntary reporting, management might have incentives to represent their companies performance in the best possible light, which could potentially result in "selective financial misrepresentation" (Tweedie and Whittington, 1990; Revsine, 1991; Beattie and Jones, 1997). Birnberg et al. (1983) identify "biasing" (the selection of favourable signals) and "focusing" (the enhancement/degradation of aspects of the information set) as two types of information manipulation facilitated by the use of voluntary reporting (p. 120-122). Such "framing effects", also described as "interpretative shading", have been shown to alter significantly the meaning attributed by readers to certain data (Tversky and Kahneman, 1981; Bazerman, 1990; Beattie and Jones, 1997). Hofstedt (1972) shows that such "framing effects" extend to financial reporting.

[51] There has been a marked increase in the volume of voluntary information produced in corporate annual reports (Beattie et al., 2002). This has partly been explained by some commentators as the exploitation of the potential of the annual report as a public relations and promotional vehicle (Hanson, 1989; Lee, 1994; Hopwood, 1996; Beattie and Jones, 1997).

2.5.2 Narrative versus Numerical Disclosures

The presentational format of accounting information has also been demonstrated to affect human perceptions and judgements of performance and the interpretation of this information may be contingent on environmental variables (Thomas, 1991; Beattie and Jones, 1997). Narrative statements offer a different way of communicating with investors and other stakeholders (Rutherford, 2002). However, accounting narratives have been shown to be non-neutral in presentation (Aerts, 1994). The ratio of words to numbers used in corporate annual reports has increased rapidly (Rutherford, 2002). According to a survey by Arthur Andersen, between 1996 and 2000 the weight of words tipped the balance, and on average, narrative reporting occupied more than half the annual report (Arthur Andersen, 2000). This can be viewed as a decision by companies to voluntarily disclose more than just numerical information, and/or it might be interpreted as acknowledging an awareness by regulators that the information needs of users extend beyond the numerical (Rutherford, 2002). FRS 13 is an example of an accounting standard that explicitly mandates narrative disclosures. These narrative disclosures may be provided in the financial statements or within the Operating and Financial Review (with reference in this latter case being made in the financial statements themselves). The information contained within the financial statements is subject to the usual audit process, however, the Statement of Auditing Standard 160 (SAS 160) only requires the auditor to perform a review of the narrative information provided outside the financial statements in order to check for inconsistencies with the financial statements.

2.5.3 Risk Reporting to Date

Prior to the introduction of FRS 13, a comprehensive reporting framework did not exist for the disclosure associated with the use of derivative financial instruments (Porterfield, 1994; Linsley and Shrives, 2000). This situation resulted in a lack of transparency, about the effects of these products on the basic financial statements of companies[52]. A central motivation for the various derivatives reporting projects was the need to integrate the various fragmented and inconsistent approaches adopted by companies. Empirical research studies supported the notion that several deficiencies in accounting practice regarding derivatives disclosure existed prior to the introduction of the reporting standards. For example, Goldberg et al. (1995) surveyed the foreign exchange derivatives disclosures made by 98 companies in response to FAS 105 and FAS 107[53]. They found inconsistencies in how the notional or contract amounts of transactions were reported; only approximately one-third of sample firms reported enough information to calculate ratios based on notional values, book values and fair values. Duangploy and Cheung (1995) also revealed a great deal of diversity in both the recognition and disclosure procedures employed when accounting for currency swaps.

Prior to the introduction of FRS 13 in 1998, recommendations concerning risk management and risk reporting arose mainly from the various corporate governance codes of practice that were issued during the 1990s (Cadbury Report, 1992; Greenbury Report, 1995; Hampel Report, 1998; Turnbull Report, 1999; Linsley and

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[52] This fact was highlighted by the FASB in the text of FAS 133 (FAS 133, 1998: par. 234-237).

[53] FAS 105 "Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk" was issued by the FASB in July 1990. FAS 107 "Disclosure about Fair Value of Financial Instruments" was issued by the FASB in December 1992. These standards provided for voluntary disclosure of derivatives usage.

Shrives, 2000; Myners Report, 2001; Higgs Report, 2003; Smith Report, 2003)[54]. The central tenet of these recommendations advocated the notion of internal control. Adequate internal reporting structures were deemed appropriate as a means of ensuring sufficient control of the treasury and risk management functions. However, the accountancy profession and some business representatives criticised the Hampel Committee report on corporate governance for failing to tackle the issue of risk management adequately (Accountancy, 1998a; 1998b). Solomon et al. (2000b) used a questionnaire survey to canvas the attitudes of UK institutional investors towards risk disclosure in relation to their portfolio investment decisions. The results indicated that almost one third of the institutional investors agreed that increased corporate risk disclosure would help their portfolio investment decision-making. There was also a strong indication among the responses that risk disclosure was an important issue on the agenda for corporate governance reform. However, since companies privately disclosed information which could potentially affect share prices to analysts and institutional investors at their annual meetings, it was possible that the information contained in financial reports was not sufficiently timely to have a strong effect on institutional investors' day-to-day investment decisions (Solomon et al., 2000b). Many of the Solomon et al. respondents appeared keen to see some increase in the level of risk disclosure, thereby endorsing recent efforts to formalise and encourage better internal control systems (for example, in the Turnbull Report). Respondents considered that further developments in corporate risk disclosure should be nested within the agenda for corporate governance reform. Thus, the research suggests that institutional investors perceive a strong link between corporate risk disclosure and the wider agenda for corporate governance reform.

[54] Further details about the recommendations of the various corporate governance codes will be presented in Chapter 3 of this thesis.

Prior empirical studies have also focused on the practical problems associated with the reporting of derivative activities. De Marzo and Duffie (1995) documented the fact that decisions concerning accounting policy and derivatives disclosure could influence corporate hedging decisions. They found that alternative accounting standards could substantially affect the equilibrium level of hedging. They viewed profits as a signal about a manager's talent and showed that the accounting for hedge positions might lead to sub-optimal hedging on the part of the manager[55]. They found that with disclosure of only aggregate accounting earnings, managers would always choose a policy of full hedging. However, if separate disclosure of the two components of profits was mandated (operating profits and hedging gains/losses), this was no longer the case with the result that no hedging might occur in equilibrium. Damant (2000) noted that companies were unlikely to welcome accounting standards that would highlight the internal mechanisms of treasury departments. Chacko et al. (2001) agreed with this view arguing that accounting treatment occasionally discouraged firms from engaging in risk management; following their analysis of the financial statements of Cephalon Inc., the authors concluded that the accounting treatment in this instance served to encourage the company to engage in a different risk management strategy.

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[55] De Marzo and Duffie 1995) argued that hedging could minimize the 'noise' around corporate earnings produced by financial risk exposure. The improvement of the informativeness of those earnings may motivate managers to favour risk management in order to better communicate their skills to the market. Thus, De Marzo and Duffie argued that managers might incorporate private interests such as career and future wage considerations when determining the optimal hedge strategy for the firm. Because managers' compensation is frequently tied to reported earnings, increased volatility might affect managers' compensation and reputation. This might also have a real impact on managers' hedging decisions.

Much of the empirical research conducted to date concerns an examination of the disclosure practices with respect to derivatives activities at banks and other financial institutions. Banks tend to be the focus for a lot of this research, because of the widespread usage of derivative financial instruments at these institutions. For example, Wong (2000) investigated the usefulness of FAS 119 derivatives disclosures in assessing the sensitivity of equity returns to currency fluctuations. However, these studies are not directly relevant to the present research, where the focus is on the reporting practices of non-financial companies. Moreover, the FRS 13 reporting requirements differ for financial institutions because of their extensive trading in derivative financial instruments.

The value relevance of derivative and fair value disclosures has been the focus for much of the empirical research concerning financial instrument reporting and accounting (Barth et al., 1996; Eccher et al. 1996; Simko, 1999; Mozes, 2002). Barth et al. (1996) investigated the value relevance of fair value disclosures made by banks under FAS 107, by examining whether differences between the market and book values of common equity could be explained as a function of differences between fair value estimates disclosed under the standard and their related book values. They found that the disclosed fair value estimates provided significant exploratory power for bank share prices beyond that provided by book values. FAS 107 disclosures were also under the spotlight in the Eccher et al. (1996) study. They documented that the fair value of investment securities was value relevant, and, dependent on the model utilised, for other investment types. These studies again concentrated on the informativeness of fair value disclosures in financial firms. However, Simko (1999) examined the value relevance of fair value disclosures in non-financial firms. The

results suggested that the fair value of long-term debt had incremental explanatory power over its historical cost counterpart, but this additional informativeness did not appear to be the case for financial assets or net off-balance sheet instruments. Evidence was also provided that the usefulness of fair value disclosures was limited by the absence of information on the fair value of non-financial instruments. Sapra (2002) investigated the consequences of hedge disclosures on a firm's risk management strategy. The results of this study indicated that the greater transparency afforded by additional hedge disclosures was not necessarily a panacea for imprudent risk management strategies. Further, firms can adopt prudent risk management strategies in the absence of hedge disclosures.

2.6 Conclusion

The preceding analysis has documented the previous literature associated with some of the central concerns of this thesis. The theoretical motivations for corporate risk management were examined. Previous empirical evidence on the corporate usage of derivative financial instruments was highlighted. The framework of financial reporting was discussed. The various international attempts to regulate derivatives reporting activities were explored. Initial research attempts at exploring extant risk reporting disclosures were investigated.

Chapter 3 will explore the theoretical underpinning of the current research. The corporate governance and the accountability literatures will be examined, in order to develop a framework in which the investigation of the impact of FRS 13 and other derivatives reporting standards can be explored.

Chapter 3

A Theoretical Framework: The Role of Corporate Governance and Accountability

Chapter 3 – A Theoretical Framework: The Role of Corporate Governance and Accountability

3.1 Introduction

Chapter 2 outlined the studies which have examined the theoretical and practical motivations for corporate risk management, which precipitated the need for accounting standard setting with respect to risk management disclosure. The purpose of the present chapter is to discuss the theoretical framework adopted in the present study. This theoretical framework is based on the corporate governance and the corporate accountability literature. Section 3.2 highlights the theoretical underpinning of the corporate governance concept. The corporate governance and internal control framework that exists in both the United Kingdom and the United States are examined. The role of institutional investors in the corporate governance framework is discussed, as well as a potential role for increased regulation. Section 3.3 examines the notion of accountability. Various interpretations of what constitutes accountability are documented and differing classifications of accountability are discussed. Section 3.4 attempts to integrate the insights offered by the corporate governance and the accountability frameworks. The notion of internal control is offered as one possible link between the two. The implications of corporate governance and accountability for treasury management are presented in Section 3.5. Finally, Section 3.6 concludes the chapter.

3.2 The Concept of Corporate Governance

Change is ubiquitous in contemporary society, and is particularly evident in large corporations. The depth and rapidity of these changes has compelled a reassessment of the applicability of the various governance structures in existence within corporate

entities. This situation has resulted in major companies receiving widespread attention in recent years regarding their corporate governance practices (O'Sullivan, 2000; Goodwin and Seow, 2002). In particular, the monitoring and control procedures in existence within publicly held corporations have been researched (Dunne and Helliar, 2002; Helliar and Dunne, 2004). Concerns like these have grown markedly in the last year following difficulties at high profile organisations such as Enron, Worldcom and AIB (Abdel-khalik, 2002; Benston and Hartgraves, 2002; Betit, 2002; Clark and Demirag, 2002; Cohan, 2002; Dunne and Helliar, 2002; Fearnley, et al., 2002; Gerde et al., 2002; Lev, 2002; Puri and Borok, 2002; Revsine, 2002; Sullivan, 2002; Swift and Dando, 2002; Vinten, 2002; Zandstra, 2002; Blyth, 2003; Hunt, 2003). Such failings in corporate governance can have an adverse impact on treasury operations; a company with poor corporate governance may find it harder to access funds, may face higher finance costs, may suffer credit rating downgrades and experience a weakening of investor confidence (ICAEW, 1999; Abbott et al., 2000; Bushman and Smith, 2001; 2003; Burton et al., 2003).

Modern corporations have to balance many competing considerations, reflecting material obligations to shareholders, employees, customers, suppliers, creditors, and others, as well as wider social responsibilities to the communities in which they operate. There is no single, accepted definition of corporate governance, but a number of perspectives can be elucidated. A narrow definition of corporate governance focuses on the relationship between a company and its shareholders. In this vein, the Cadbury Report (1992) defined corporate governance as "the system by which companies are directed and controlled" (Cadbury, 1992, par. 2.5). The need to reflect the shareholders' desires has typically been the focus for debate regarding corporate

governance reform (Bushman and Smith, 2001; 2003; Vinten, 2001). This reflection is largely a result of the "agency" problems that arise from the separation of ownership and control (Berle and Means, 1932; Donaldson, 1963; Jensen and Meckling, 1976; Byrd, et al., 1998). From this perspective, corporate governance issues are said to arise in an organisation whenever two conditions are present (Hart, 1995). First, there is an agency problem, or conflict of interest, involving principal and agent members of the organisation in a situation characterised by information asymmetry – these might be owners, managers, workers or consumers (Hart, 1995). Second, transaction costs are such that this agency problem cannot be dealt with through a contract (Hart, 1995). The basic assumption of agency theory leads directly to a perceived need by shareholders to place limits on management discretion (Fama and Jensen, 1983; Burton, 2000; Prevost et al., 2002). The protection of investors from agency risks associated with the separation of ownership and control has been the central preserve of corporate governance recommendations throughout the world (Bushman and Smith, 2001; 2003; Vinten, 2001). This rather narrow and limited view of the governance problem, where the focus is primarily concentrated on the relationship between the firm and its capital providers, has become so dominant in the literature that it is, arguably, almost automatically accepted[56].

The mechanisms of corporate governance are seen as integral tenets in the operation of modern corporations; "good" corporate governance is seen as essential in terms of safeguarding company assets and maintaining and enhancing investor confidence, thus providing greater access to funds and reducing the potential risks associated with

[56] Shleifer and Vishny (1997) in their review of the corporate governance literature, readily admit that their "perspective on corporate governance is a straightforward agency perspective, sometimes referred to as separation of ownership and control" (p. 738).

fraud or incompetence (ICAEW, 1999; Abbott et al., 2000; Bushman and Smith, 2001; 2003; Burton et al., 2003)[57]. Shleifer and Vishny (1997) in their review of the corporate governance literature, maintained that much of the subject matter dealt with the self-imposed constraints of management in their attempts to reduce the ex-post misallocation of funds and induce investors to provide more funds ex-ante.

A broader definition of corporate governance examines a wider set of stakeholder relationships encompassing interactions between employees, customers, suppliers, creditors and society at large (Tricker, 1984; Baker and Owsen, 2002). Implicit and explicit relationships between the company and these stakeholders, and interactions among these various constituents, fall within the remit of this wider definition of corporate governance[58]. Such definitions of corporate governance stress a broader level of accountability to shareholders and other stakeholders. Tricker (1984) defined corporate governance in terms of identifying rights and responsibilities, legitimising actions and determining accountability. Tricker explained the corporate governance process in terms of four principal activities: (i) formulating the strategic direction for the future of the enterprise in the long term; (ii) influencing crucial executive decisions; (iii) monitoring management performance; and (iv) recognising the responsibilities of management to those with a legitimate demand for accountability. The first two activities are management functions whereas the latter two relate to governance. This latter notion of corporate governance emphasises the wider notions

[57] Copnell (2002) argued that corporate governance was about knowingly taking risks, rather than being unwittingly exposed to them. He added that "good" corporate governance might never put a stop to all corporate failures, but that "it should better equip companies to face recessionary times and reduce surprises for both directors and shareholders alike" (p. 11).

[58] Donaldson and Preston (1995) indicated that stakeholders could be "identified through the actual or potential harms and benefits that they experience or anticipate experiencing as a result of a firm's actions or inaction". Thus, influences can come from internal or external sources, which results in an array of potential stakeholders. Turnbull (1997, p. 183) provides a listing of potential influences affecting the operations of publicly traded firms.

of corporate social responsibility, which have attracted greater attention in recent years (Gray et al., 1987; Gray et al., 1996; Moir, 2001).

In the UK, the corporate governance debate was stimulated by a series of corporate scandals and collapses in the late 1980s and early 1990s (Weir and Laing, 2001). Press coverage of BCCI, Polly Peck and the Maxwell Communications Group caused much public questioning about how effective the boards of these companies had been in monitoring the actions of their executive management (Stiles and Taylor, 1993; Kay and Silberston, 1995; O'Sullivan, 2000; Pye, 2000). The most visible manifestation of the interest in improved governance has been the emergence of numerous governance guidelines and codes (Laing and Weir, 1999). Codes have now been drafted in a number of countries and by a variety of institutions. An overview of the UK and US systems of corporate governance and internal control is provided in section 3.2.1 and section 3.2.2 respectively[59].

3.2.1 Corporate Governance and Internal Control in the UK[60]

Chapter 2 provided a review of the extant literatures associated with the corporate use of derivative financial instruments. One of the major issues to emerge from this discussion was the lack of control exercised over the corporate use of derivative products. For many years, internal control was largely a private affair for companies. However, this situation has changed dramatically. Internal control moved to the centre of discussions about corporate governance during the 1990s, which led to the

[59] The overview of corporate governance systems provided in Section 3.2.1 and Section 3.2.2 is limited to the UK and the US, because the primary focus of the thesis is on the implementation of derivatives accounting standards in the UK, where many companies adopt US and International Accounting Standards (Masquelier and Di Paola, 2002).

[60] This overview is not concerned with all areas of corporate governance, but reflects the literature pertinent to aspects of internal control, the role of institutional investors and issues associated with transparency, accountability and the role of corporate reporting.

alignment of corporate governance processes with the risk management objective of the firm. The publication of the Cadbury Report in December 1992 witnessed the first attempt to formalise UK corporate governance best practice. The Cadbury Code was not legally binding on boards of directors. However, the Stock Exchange Yellow Book[61] required companies to provide a "statement of compliance" with the code[62]. One of the requirements of The Cadbury Report on the financial aspects of corporate governance was that compliant UK companies must report to shareholders on the effectiveness of internal control procedures[63]. Short et al. (1999) noted that this recommendation has proved problematical in practice because of the difficulty in defining the scope of the notion of internal control.

The subsequent Rutteman Working Group guidance, issued in December 1994, watered the Cadbury proposal down, and restricted itself to internal *financial* control with the required disclosures limited to the process for ensuring effectiveness rather than reporting on effectiveness itself (Rutteman Working Group, 1994). The Hampel

[61] The Yellow Book listed compliance rules for companies listed on the Stock Exchange. Listing rules are now the responsibility of the Financial Services Authority (FSA).

[62] The result of this was that all companies publicly quoted on the Stock Exchange had to state in their annual reports whether or not they have implemented the code in all respects. If they had not complied with the entire code, then they were compelled to make a clear statement of the reasons why, and the points with which they had not complied. This voluntary 'comply or explain' approach to corporate governance reform has been a feature of all the subsequent codes and recommendations issued in the UK.

[63] The Cadbury Report recommendations apply to all companies irrespective of their size. There has been much debate concerning the applicability and appropriateness of the Code to small companies (Mallin and Ow-Yong, 1998). The Hampel Report included a discussion about the applicability of corporate governance standards for smaller companies, but concluded that no distinctions were necessary. GAAP concludes that each company should be able to determine its corporate governance procedures in the best interests of the company. Solomon et al. (2000a) in their survey of the views of institutional investors found that their respondents believed that high standards of corporate governance were as important for smaller companies as for larger companies. However, the respondents did acknowledge that corporate governance reforms were primarily driven by the motives of large companies. The DTI issued a report in 1999 entitled "Creating Quality Dialogue between Smaller Quoted Companies and Fund Managers" which focused attention on the transferability of standards for "good" corporate governance for smaller companies. Many authors have argued that different mechanisms of corporate governance are suited to specific types of economic activity and different stages of economic development (Forker and Green, 2000; O'Sullivan, 2000; Lewis, 2001).

Committee, which was established to review the implementation of the Cadbury and Greenbury[64] proposals, published its final report in January 1998, and subsequently undertook to produce a set of principles and a code on corporate governance aimed at consolidating Cadbury, Greenbury and the Committee's own work (Hampel Committee, 1998). The outcome of this process – The Combined Code of Best Practice - was issued in June 1998. The Combined Code contained a series of Principles of Good Corporate Governance. A detailed series of provisions followed, which demonstrated how the principles could be implemented and achieved. The Code required that directors review the effectiveness of all internal controls, not just internal financial controls. However, it dropped the Cadbury proposal that directors report on such effectiveness[65]. The Turnbull report, published by the Institute of Chartered Accountants in England and Wales (ICAEW) in September 1999, aimed to make the internal control recommendations of the Combined Code more explicit.

The Turnbull report recognised the importance of internal control and risk management; it did this by formalising an explicit framework for internal control in companies (ICAEW, 1999). The report argued that the maintenance of an effective system of financial controls (including the maintenance of proper accounting records) (i) helps to ensure that the company is not unnecessarily exposed to avoidable

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[64] *Directors' Remuneration*: *Report of a Study Group chaired by Sir Richard Greenbury* was issued in 1995. The remit of the Committee was "to identify good practice in determining Directors' remuneration" (p. 9).

[65] The Combined Code states that:

"The Board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets ... The directors should at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management" (p. 22).

financial risks; and (ii) contributes to the safeguarding of assets, including the prevention and detection of fraud (ICAEW, 1999)[66].

Turnbull argued that the board was ultimately responsible for the system of internal control. The Chartered Institute of Management Accountants (CIMA, 1993) defined the internal control system to include the whole gambit of controls, financial and otherwise, to ensure adherence to management policies, safeguard assets and secure the completeness and accuracy of the records. The system advocates familiar management control procedures, including the setting of objectives and plans, monitoring performance measures and taking appropriate action in changing circumstances. Boards will normally delegate to management the task of establishing, operating and monitoring the system. However, they cannot delegate their responsibility for it. The report advocates a top-down approach to the establishment of an integrated risk management policy. The system of control must include procedures for reporting immediately to appropriate levels of management any significant control failings or weaknesses that are identified, together with details of corrective action being undertaken. This requires that systems of control be embedded in the operations of the company and form part of its culture. "Good" corporate governance is seen to be more than simple box-ticking; it requires good risk management practices, based on the spirit, as well as the letter, of the Turnbull report (Copnell, 2002).

A key recommendation of the Turnbull report concerned the essential role to be played by audit committees (ICAEW, 1999). The literature suggests that an effective

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[66] The argument for an adequate financial reporting system was raised by Whittington (1993) who argued that improvements in financial reporting are a necessary but not sufficient condition for improving corporate governance.

audit committee should not only play an important role in strengthening the financial controls of an entity (Collier, 1993; O'Sullivan, 2000) and provide a non-confrontational reporting structure for insiders (Keasey and Wright, 1993), but should also render companies less susceptible to fraud (Abbott et al., 2000). According to the Turnbull recommendations, audit committees are expected to evaluate, on a regular basis, internal control reports from management in order to: (i) assess the effectiveness of the control systems in place; (ii) take necessary action if weaknesses or failings are found; and (iii) engage in more extensive monitoring of the internal control system if the need arises (ICAEW, 1999). Zaman (2001), however, urged caution about the increasing emphasis on the importance of audit committees in the corporate governance framework; he argued that over-reliance on these committees might lead to undue expectations as too much responsibility was delegated to the committee members. The Turnbull recommendations bring the UK more into line with international developments such as the recommendations of the Treadway Commission in the US (Aldridge and Colbert, 1994; Vanasco et al., 1995)[67]. A recent survey by PricewaterhouseCoopers indicates that although a significant minority of listed companies try to hide their lack of compliance with the corporate governance codes for best practice overall, compliance with the Turnbull internal control disclosure recommendations is quite high (Hodge, 2002)[68].

[67] Full details of US developments in internal control and corporate governance will be given in Section 3.2.2.

[68] Several studies have looked at compliance with the various codes on corporate governance (Bostock, 1995; Cadbury, 1995; Short, 1996; Conyon and Mallin, 1997; Doble, 1997; Dahya et al., 2002). For example, Dahya et al. (2002) documented: (i) a general increase in the size of corporate boards; (ii) an increase in the percentage of outside directors; and (iii) an increase in the number of firms in which the positions of CEO and Chairperson were held by two individuals, following the publication of the Cadbury Committee's recommendations in December 1992.

Although the aforementioned reports arguably stimulated substantial improvements in the corporate governance practices of UK companies, certain areas have been highlighted for further attention. The collapse of Enron in the US, initiated a further examination of corporate governance procedures (Abdel-khalik, 2002; Benston and Hartgraves, 2002; Betit, 2002; Clark and Demirag, 2002; Cohan, 2002; Fearnley et al., 2002; Gerde et al., 2002; Lev, 2002; Puri and Borak, 2002; Revsine, 2002; Sullivan, 2002; Swift and Dando, 2002; Vinten, 2002; Zandstra, 2002; Blyth, 2003; Hunt, 2003). The Higgs Report was issued in January 2003. This report focuses on the role and effectiveness of non-executive directors; it recommends that at least half the board of listed companies should comprise non-executives. The report has been given a guarded welcome by both business leaders and the profession (Accountancy, 2003; Bittlestone, 2003; Moxey, 2003). The recommendations of the Higgs Report are to be incorporated into the Combined Code (Accountancy, 2003). The Smith Report, also issued in January 2003, was primarily concerned with the relationship between external auditors and the companies they audit, as well as the role and responsibilities of companies' audit committees. It recommended that audit committees should include at least three members, all of whom were independent non-executive directors, where at least one had significant financial knowledge and experience.

3.2.2 US Developments in Corporate Governance and Internal Control

In the United States, the *Internal Control – Integrated Framework* report was issued by the Committee of Sponsoring Organisations (COSO) of the Treadway Commission in 1992. The report established for the first time a standard for evaluating the effectiveness of internal control systems (Steinberg and Tanki, 1992). This report indicated that an effective system of internal control comprises several elements.

First, a solid control environment is essential to lay the foundations for other aspects of internal control; this requires that sufficient attention is paid to control procedures at Board level. Second, risks and control objectives need to be identified and evaluated to determine how such risks can be managed. The third element that is essential for internal control relates to the specific control activities necessary to ensure that management directives are carried out. Such activities typically include approvals, authorisations, verifications, reconciliations, performance reviews and segregation of duties (Emmanuel et al., 1992). The fourth component relates to information and communication processes. Relevant information must be identified, captured and communicated in a suitable format as well as in a timely manner. Individual employees must understand their role in the control framework and have a means of communicating information up the organisational hierarchy (Keasey and Wright, 1993). Finally, adequate processes must be in place to monitor the system of internal control; this may be achieved by means of ongoing monitoring activities and separate evaluations. Deficiencies or weaknesses in the internal control mechanisms should be reported up the management chain, with any serious matters reported to senior executives and the board. These five components also serve as criteria for internal control effectiveness, whereby achievement of internal control objectives can be facilitated (Kajuter, 2001). Rezaee et al. (2001) argued that a sufficient understanding of these five control components would assist auditors in deciding whether or not adequate control activities were built into the accounting system.

In 1996, Deloitte & Touche, in association with the Treadway Commission, issued a document highlighting how the 1992 COSO framework could be applied to risk management activities involving the use of derivative products. This report

recommended that policies governing derivative usage should be defined and communicated throughout the organisation. The risk management policy should be clearly set out and should include controls relating to the nature and extent of derivative activities, including limitations on their use, adequate reporting processes and operational controls. Mechanisms should be in place to obtain relevant and timely information covering derivative activities, and communicate this information to directors and senior management in order to enable them to monitor whether their objectives and strategies for using derivatives are being achieved.

The Sarbanes-Oxley Act (SOA) was signed into law by President Bush in July 2002. This Act is considered to be the most comprehensive corporate governance legislation to date and is expected to have significant implications for publicly traded companies, shareholders and those allied to corporations for years to come. This legislation dramatically increases corporate management's governance role and accountability relating to the reporting of financial results and maintenance of sound internal controls. It clearly defines a host of rigid responsibilities and requirements, as well as consequences for non-compliance. The SOA runs to 130 pages and includes provisions for: (i) the establishment of the Public Company Accounting Oversight Board (PCAOB); (ii) guidelines to ensure auditor independence; (iii) increased requirements for corporate responsibility and accountability; (iv) enhanced accurate financial disclosures; and (v) clear definition of enhanced penalties for corporate fraud and white collar crime. The certification provisions of the Act are much more rigorous than that previously in existence. The CEO and CFO are required to acknowledge in each annual or quarterly report their responsibility for internal controls, and present their conclusions as to the effectiveness of those internal

controls. With respect to treasury operations the Act places emphasis on control maintenance and fraud/error detection. Gallanis (2003) identified four areas where the SOA afforded treasury departments opportunities for improvement: (i) the identification of key control points or issues, such as accounting, technology, risk management, transactions and so on; (ii) the establishment and improvement of treasury process controls by means of preventative controls such as the segregation of duties, transaction limits, and detective controls such as technology alerts and mandatory job rotation; (iii) the provision of validation support in the financial reporting process; and finally, (iv) the provision of 'global governance' to ensure decentralised organisations are kept informed by means of effective information reporting systems.

3.2.3 Institutional Investors and Corporate Governance

The potential influence of groups of large shareholders on managerial activities was identified as early as the 1930s when Berle and Means (1932) highlighted the impact of the separation of ownership and control in corporations. Over seventy years later, institutional investors own large portions of equity in many companies across the world[69], and play a key role in the corporate governance process (Short and Keasey, 1997; Tricker, 1998; Mallin, 2001). Institutional investors are often accused of being transient owners who lack the incentives to monitor the firms they own (Porter, 1997). However, the potential importance of the role of institutional investors in corporate governance and the links with financial reporting were identified by Whittington (1993); Whittington identified three systemic problems of corporate governance. The

[69] Gaved (1997) stated that institutional investors held more than three-quarters of the value of the shares on the London stock market. He added that the ten largest investors accounted for a quarter of the total market capitalisation.

first related to the supply of accounting information; he believed financial accounts form a crucial link between providers of finance and directors. Therefore imperfections in the financial reporting process might cause imperfections in the effectiveness of the corporate governance system. The second problem related to the demand for information; the cost of processing information was seen as a barrier to shareholders' involvement in the corporate governance process[70]. The third problem related to monitoring costs; shareholders might incur very significant costs in exercising their monitoring function (Mallin, 1995). This problem could be overcome by large institutional shareholders combining and exercising block voting power (although this situation is rare in the UK)[71] or through the use of the take-over mechanism which allowed shareholders the opportunity to exercise their voting power in the decision as to whether to accept a hostile bid. Whittington concluded that some form of regulation would also be needed and added that enforcement powers would be necessary, in order to prevent free riders from exploiting the good reputation built up by those who conformed to the regulation. Baker and Wallage (2000) agreed that audited financial statements constituted an essential element of the financial reporting system that is required for effective corporate governance. They stated that the role of financial reporting should not be confined to the needs of investor decision-making, but should also be viewed in relation to the more general concerns of corporate governance. Gaved (1997) argued that the role of annual reports in communicating with institutional investors needed to be redefined and extended; he argued that

[70] This was traditionally 'solved' by the semi-strong form of the efficient market hypothesis (EMH) whereby small shareholders free rode on the sophisticated judgements of larger investors, but the EMH was not always believed to hold!

[71] However, in May 2003, shareholders at GlaxoSmithKline plc voted against the boardroom pay policy that included a provision to offer a multi-million pound pay rise to its chief executive, Jean Pierre Garnier. At the marathon three-hour-long annual general meeting in London, shareholder after shareholder criticised the company's pay policy.

companies needed to keep shareholders and other investors well informed on a much more frequent basis than once a year[72].

The Cadbury Committee (1992) viewed institutional investors as having a special responsibility for ensuring that companies adopted its recommendations. The Report placed emphasis on a free market solution rather than on external regulation to solve any corporate governance problems; it relied on institutional investors to shake off their traditional apathy (Mallin, 1995) and take a more active interest in the companies that they owned. In keeping with these sentiments, the Committee stated that "institutional shareholders in particular ... should use their influence as owners to ensure that the companies in which they have invested comply with the Code" (p. 54). A similar view was expressed in the Greenbury Report (1995) which stated that "the investor institutions should use their power and influence to ensure the implementation of best practice" (p. 19). Similarly, in the report of the Hampel Committee (1998), it is stated that "it is clear ... that a discussion of the role of shareholders in corporate governance will mainly concern the institutions" (p. 40). Therefore, the three most influential committees that have reported on corporate governance in the UK clearly emphasise the role of institutional investors[73]. It is very obvious from the aforementioned reports that the potential of institutional investors to exert significant influence on companies has clear implications for corporate governance, especially in terms of the standards of corporate governance adopted and the extent to which issues are enforced (Short and Keasey, 1997). The significant proportion of shares held by institutional investors in the UK, where institutional

[72] The EU will require quarterly reporting from 2005.
[73] The Cadbury (1992), Greenbury (1995) and Hampel (1998) reports were brought together in (and superseded by) the Combined Code.

ownership is estimated at 75-80 per cent (Holland, 1998; Pike and Neale, 1999), means that the voice of the institutional investor cannot go unheard.

In his seminal work, Hirschman (1970) identified the exercise of institutional power within an 'exit and voice' framework; he argued that dissatisfaction could be expressed directly to management, (the *voice* option), or by selling the shareholding, (the *exit* option). The latter choice is not viable for many institutional investors given the size of their holdings and their policy of maintaining diversified, balanced portfolios (Keasey and Wright, 1993; Short and Keasey, 1997)[74]. Meetings between institutional investors and companies are therefore extremely important as a means of communication between the two parties (Mallin, 1995; Holland, 1998; Solomon and Solomon, 1999). For example, Pye (2000; 2001) found that the amount of time the Chief Executive devoted to institutional investors doubled in the decade from 1989 to 1999.

Firms' boards of directors often have a close relationship with their major institutional investors (Holland, 1995; 1998; 1999; 2001) and will usually arrange to meet with their largest institutional investors on a one-to-one basis during the course of the year (Holland, 1999; Mallin, 1999). These meetings tend to involve key board members

[74]In the Anglo-American system of corporate governance, individual shareholders generally have little incentive to exercise 'voice' concerning the firms' direction (Keasey and Wright, 1993). With freely tradable shares, corporate governance relies heavily on the effect of shareholders selling their shares ('exit'). There are several reasons why institutional investors might be reluctant to express their 'voice' publicly. First, if they exercise the 'voice' option publicly, they are effectively drawing public attention to the difficulties the company is facing, which could culminate in a falling share price, thus devaluing their investments (Short and Keasey, 1997). Second, effective monitoring of companies might be costly to firms with diverse portfolios (Short and Keasey, 1997). Further, selling large block of shares in a problem company is likely to be difficult, particularly as the potential buyer is likely to be an alternative institution with knowledge of the potential problems which exist in the company (Keasey and Wright, 1993).

such as the Chair, the Chief Executive Officer and the Finance Director; Non-executive directors are not usually present (Mallin, 1999). The discussions typically centred on the firm's overall strategy, with the aim of ensuring institutional investors' continuing support for management decisions (Holland, 1998; 1999; Mallin, 1999). In addition, individual key members of the board often meet once or twice a week to discuss corporate governance issues (Mallin, 1999). A board's 'target' institutional investor audience would normally include large shareholders (often the largest 30) and brokers' analysts (usually the top 10 for that sector), as well as any institutional investors who are underweight in its company's shares or are thinking of selling their holdings (Mallin, 1999). Typically the issues most frequently discussed at meetings between company executives and large institutional investors related to: (i) the firm's strategic positioning (Mallin, 1997; Holland, 1998; 1999); (ii) how the firm was planning to achieve its objectives (Mallin, 1997; Holland, 1998, 1999); (iii) whether these objectives were being met (Mallin, 1997; Holland, 1998, 1999); and (iv) the quality of the management (Mallin, 1997; Holland, 1998, 1999). Shareholder proposals or resolutions were another means of expressing discontent with board decisions. However, such proposals were rare in the UK (Mallin, 1999).

Russell Reynolds Associates examined the preferences of institutional investors with respect to different corporate governance structures and procedures. They found that the quality of a company's board of directors was an important factor when making decisions; institutional investors expected boards to represent shareholder interests, particularly in the determination of management compensation. Institutional investors were found to marginally favour an organisational structure where the roles of the CEO and Chair were shared by two individuals. The splitting of the Chair/CEO role

was also emphasised in a study by Solomon et al. (2000a). This research provided strong support for the reforms initiated by the Cadbury and Greenbury Committees[75].

Institutional investors were viewed as being an important part of the management process and their views might be fed back to the board in the planning process, and incorporated, as appropriate, in the annual strategy plan (Holland, 1998, 1999, 2001; Mallin, 1999). However, institutional investors were often viewed as having a collective influence, where management paid most attention to the commonality of institutional investors' views in meetings over time (Mallin, 1999). However, Sherman et al. (1998) found heterogeneity amongst institutional investors' views on several matters. In line with Sherman et al. (1998), it might be that institutional investors in UK firms are not a homogeneous group with respect to the views they express on corporate governance, financial reporting, and individual accounting standards such as FRS 13.

The Myners Report (2001) recommended that fund managers should be more active, so that, for example, reservations about corporate strategy and performance should form the basis for greater intervention. This development would also almost certainly lead to more interaction and communication amongst the non-executive directors of the company. Further, following the recommendations of the Turnbull Report (1999) on the management of internal controls and risk, items of this nature should be included on the agenda of meetings between institutional investors and directors. However, institutional investors may, or may not, discuss the use of derivatives with

[75] Solomon et al. (2000a) found that institutional investors emphasised the appointment of NEDs as the greatest improvement in corporate governance procedures. Institutional investors also welcomed the establishment of remuneration and audit committees and the increased disclosure of internal control mechanisms that represented important improvements in corporate governance.

directors, despite the potential risk exposure consequences of inappropriate derivatives usage.

In the post Enron/Worldcom environment, there is increasing pressure for more transparency and for directors, especially non-executive directors, to have access to more information about the company (Abdel-khalik, 2002; Benston and Hartgraves, 2002; Betit, 2002; Clark and Demirag, 2002; Cohan, 2002; Fearnley, et al., 2002; Gerde et al., 2002; Lev, 2002; Puri and Borak, 2002; Revsine, 2002; Sullivan, 2002; Swift and Dando, 2002; Vinten, 2002; Zandstra, 2002). In the UK, bodies such as the National Association of Pension Funds (NAPF) are increasingly encouraging non-executive directors to communicate directly with institutional investors. In a recently issued report (NAPF 2002), it is stated that "the NAPF encourages communication between IDs (independent directors) and investors, and not solely through the company's annual report" (p. 6). The recently issued Higgs review of the role of non-executive directors, established by the Department of Trade and Industry (DTI) in the UK, addressed the relationship between non-executive directors and institutional investors[76].

3.2.4 A Role for Regulation?

One of the major criticisms levelled at the various corporate governance codes around the world relates to their reliance on voluntary compliance (Short, 1996; Short et al., 1998; Dewing and Russell, 2000). The codes that have appeared worldwide, to date, have not relied on statutory backing, although the majority require companies to include a statement about compliance. The justifications offered, for a system that

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[76] The Higgs Review recommends that at least half the board of listed companies should be comprised of non-execs.

essentially employs self-regulation within an overall statutory framework, typically reflect commercial concerns. Compliance with corporate governance best practice is seen to be in the best interests of the company in terms of attracting investors (Cadbury, 2000). The greater speed of response to international developments and increased flexibility are cited as added benefits in a self-regulatory environment (Dewing and Russell, 2000). Resistance to statutory regulation has focussed on the notion that legislation would impose only minimum requirements that could encourage compliance with the letter rather than the spirit of regulation (Keasey and Wright, 1993). Solomon et al. (2000a) found a strong indication from institutional investors that corporate governance should remain within a voluntary framework and an even stronger rejection of the suggestion that corporate governance reforms should be dealt with by means of government regulation. Holland (1998) claimed that the combination of informal links, boardroom, market and media control mechanisms were sufficient to reduce the need for extended legislation in the field of corporate governance. Cadbury (2000) believed that there was no need to produce European or international codes on corporate governance, as there were two forces driving governance standards internationally towards convergence. First, he highlighted the growing influence of institutional investors. If companies and countries wanted to avail themselves of increased institutional investment, they needed to meet the standards that these institutions demanded in terms of board effectiveness and disclosure (Cadbury, 2000). The second factor related to the capital markets of the world; expanding companies had to meet the requirements of international capital markets in respect of transparency and control (Cadbury, 2000). However, Cadbury conceded that benefits would be gained from an agreed set of international accounting

standards that would improve financial transparency and lead globally to a more efficient allocation of funds[77]. In its report to the OECD, the Business Sector Advisory Group on Corporate Governance (1998) argued that although corporate governance should remain a private sector prerogative, they considered that there was a role for government in providing a regulatory framework that would allow investors and enterprises to adapt their corporate governance practices quickly in response to rapidly changing circumstances.

However, the idea of self-regulation is not welcomed by all. For example, Mitchell and Sikka (1996) denounced the concept of self-regulation as "an abdication of responsibility" (p. 11). They argued that the aim of regulation was to protect the public interest, rather than the interests of corporate insiders. Lack of statutory backing was deemed to produce confusing, over-elaborate results from competing and overlapping bodies. They concluded that self-regulation "can't work, isn't working, and can't be made to work" (p. 11). Demirag et al. (2000) noted the ad hoc approach to the setting and monitoring of corporate governance codes, which they argued, occurred in response to public concerns over specific company behaviour. Corporate governance reform had been criticised for being piece-meal, whereby interrelationships had not been fully considered or integrated (MacDonald and Beattie, 1993). Dewing and Russell (2000) questioned whether corporate governance was currently 'regulated' in any meaningful sense. They argued, first, that there was no need to comply with the Code but only to disclose non-compliance; and second, that the disclosure of non-compliance appeared to be inadequately monitored by the

[77] Cadbury (2000) viewed the Codes as largely sharing two aims; to strengthen the position of investors and to encourage them to play their part in the governance of the companies in which they held shares; and to strengthen the influence of boards over the companies which they directed. He regarded disclosure as "the lifeblood of governance" (Cadbury, 2000, p. 9).

regulatory body assigned to undertake the task. To this end, they proposed three regulatory models and sought the opinions of stakeholder representatives[78,79]. The general view was that self-regulation overseen by an independent public body with statutory powers was appropriate for the private sector.

Utilising a broader notion of corporate governance as advocated by Tricker (1984) the primary focus is on the legitimate demands for increased accountability. This notion of corporate governance owes much of its theoretical underpinning to the corporate social responsibility literature (Gray et al., 1987; Gray et al., 1996; Moir, 2001). Section 3.3 discusses the theory underpinning the notion of accountability, while Section 3.4 attempts to integrate broad definitions of corporate governance with accountability.

3.3 The Concept of Accountability

Many different views exist regarding the nature of, and the parties to, an accountability relationship. This section begins with an overview of some the many definitions of accountability discussed in the extant accounting literature[80]. Some of these differing perspectives that exist with respect to the concept of accountability are discussed. The use of accounting procedures and financial reporting mechanisms as

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[78] Three alternatives were offered. First, an Auditing Council modelled on the Financial Reporting Council (FRC) and receiving statutory recognition from the Department for Trade and Industry (DTI). Second, a Commission for Audit sponsored by the DTI. Finally, a UK version of the Securities and Exchange Commission (SEC) to assume responsibility for the overall regulation of audit and corporate governance (Dewing and Russell, 2000).

[79] Questionnaire respondents were divided into primary stakeholders (e.g. fund mangers), secondary stakeholders (e.g. banks) and other influential onlookers (e.g. individuals involved in regulatory regimes).

[80] The accountability literature encompasses a broad spectrum of views, definitions and categorisations spanning subjects as diverse as accounting and finance, law, economics, sociology, psychology, and so on. It is beyond the scope of the present thesis to outline all these views, so key contributions in the accounting and finance literature are noted.

means of discharging accountability is illustrated. Limitations of the accountability framework are presented.

3.3.1 Giving an Account?

Various definitions, and lengthy discussions, about the notion of accountability exist in the academic accounting literature (Garfinkel, 1967; Stewart, 1984; Gray, 1992; Arrington and Francis, 1993; Sinclair, 1995; Czarniawska-Joerges, 1996; Gray et al., 1996; Munro and Hatherly, 1993; Roberts, 1996; Willmott, 1996)[81,82]. For example, Gray (1992) states that accountability is "concerned with the right to receive information and the duty to supply it" (p. 413). The concept is further defined to involve "the duty to provide an account (by no means necessarily a *financial* account) or reckoning of those actions for which one is held responsible" (Gray et al., 1996, p. 38). Thus accountability involves two responsibilities or duties: the responsibility to undertake certain actions (or forbear from taking actions) and the responsibility to provide an account of those actions (Gray et al., 1996). Roberts (1996) argues that accountability involves various social practices whereby we seek to remind each other of our reciprocal dependence; of the ways our actions unavoidably make a difference

[81] Accountability has been defined in several ways. Garfinkel (1967) defined accountability as "the giving and demanding of reasons for conduct" (p. 64). Accountability is typically seen as "a chronic feature of daily conduct" (Giddens, 1979, p. 57). Munro and Hatherly (1993) defined accountability as "a willingness and ability to explain and justify one's acts to self and others" (p. 369). Sinclair (1995) suggested that accountability involves a relationship "in which people are required to explain and take responsibility for their actions" (p. 221). Czarniawska-Joerges (1996) saw accountability as involving the "justification of deviations from the structure of normality and explanations of conformity to it" (pp. 307-308). Willmott (1996) viewed accountability as a "rendering intelligible of some aspect of our lives" (p. 23).

[82] Benston (1982b) argued that the concept of corporate accountability had several roots. Bloom and Heymann (1986) noted that the early Progressive reformers in the US emphasised "the importance of corporate and public accountability and the role of accounting in monitoring abuses of stewardship" (p. 167). These reformers viewed the 'invisible hand' of the marketplace as inefficient and claimed that the government was necessary to mitigate the wastefulness. Coy and Pratt (1998) traced the origins of 'accountability' to the writings of Aristotle two thousand years ago, via the writings of John Stewart Mill in the 19th century, to the more recent calls for increased accountability in business and political circles (Gray et al., 1996).

to each other[83]. Sinclair (1995) suggests that accountability could be understood in a variety of ways, ranging from a sense of personal obligation to a "price" that one pays for power or authority, to an incidental consequence of scrutiny (Sinclair, 1995, p. 221). Arrington and Francis (1993) observe that accountability requires the economic subject to be "answerable"; this obligates the answerable subject to demonstrate the reasonableness of his/her actions to a community of others, thus embedding a degree of moral responsibility. Willmott (1996) was concerned with the universal aspect of accountability, which he considered involved "rendering intelligible some aspect of our lives or ourselves" (p. 23). He believed that accountability was a distinctive and pervasive feature of human existence – the continuous making and giving of accounts. He suggested that the giving of an account is a political act because it either confirms or unsettles whatever happens to be taken for granted as the world of normal appearances. In doing so, processes of accountability contribute to the continuation or disruption of the practices that they serve to sustain[84].

Roberts (2001) argues that accountability should be viewed as a constraint upon the powerful and that it is a pervasive feature of organisational and social life. In the case of shareholder and a company, the directors of a company have a responsibility to manage the resources (financial and non-financial) entrusted to them by the shareholders and also have a responsibility to provide an account of this management.

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[83] Such reciprocal dependence can be thought about in both instrumental and moral terms; we are bound up with each other not simply in narrow, calculable ways, but also more broadly in the way that intended and unintended actions (or inactions) have a myriad of consequences for others (Roberts, 1996).

[84] He suggested that frameworks of accountability differentiate people in terms of their status, access to resources, responsibilities, etc. When coming within the orbit of the influence of particular frameworks of accountability, human beings find themselves constructed within, and accountable to, the disciplines that accompany these frameworks. The giving of accounts has consequences for how subjectivity is organised as well as influencing the way others perceive and relate to the person giving the account. Processes of accountability and their outcomes are invariably subject to interpretation and negotiation; they are never wholly pre-determined.

Thus the annual report can be seen as a means of discharging this accountability[85]. The requirement to report to shareholders (financial accounting), is one of the very few instances of explicit accountability established within the law itself (Gray et al., 1996). Cyert and Ijiri (1974) claim that:

> "at least one of the fundamental objectives of financial statements may be stated as the need to communicate information on the discharge of accountability of an entity to parties to whom the entity is accountable" (p. 32)

Bloom and Heymann (1986) noted that the first FASB Statement of Financial Accounting Concepts recognised the role of accountability:

> "To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and the public in general. Society may also impose broad or specific responsibilities on enterprises and their managements." (p. 25)

The IAS framework recognises the need for accountability with respect to the preparation of financial statements. It suggests two objectives for financial statements. The first objective is to provide information about the financial position and the results of an organisation's operations that will be useful and relevant to a wide range of users. The second recognises acceptance by management of their accountability for the resources entrusted to them as well as for the organisation's operating and other policies, which should all be reflected in the financial statements (Khoury, 2001).

3.3.2 Systems of Accountability

Several categorisations of accountability have been developed. The variety of classification schemes attests to the complexity of the subject. This section will review some of the classifications outlined in the accounting and finance literature.

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[85] Accounting reports create a boundary to the organisation, influencing what is and what is not of significance in discussing organisations, their performance and their impact (Hines, 1991).

The most general framework of accountability in the accounting literature is based on the principal-agent model (Laughlin, 1990). This is a hierarchical model which assumes that some individual, small group or organisation, called the principal, has certain "rights" to make demands on the conduct of a agent as well as to demand reasons for the conduct undertaken by that agent (Swift, 2001). These rights are assumed to derive from the fact that the principal transfers resources to the agent with an expectation as to how these resources are to be used (Laughlin, 1990). Under an accountability approach based upon principal-agent theory, where the rendering of account is regarded as imposing some costs on the conveyor of accounting information, it is recognised that agents have an incentive to enter into contracts involving the monitoring of the principal. Accounting practices and procedures facilitate this monitoring, which leads to a Pareto optimum position (Watts and Zimmerman, 1986).

The accountability model derived from principal-agent theory claims ideological strength and resilience; this strength and resilience purportedly lies in its ability to rationalise, normalise, and legitimise the relationships between management and shareholders (Chwastiak, 1999). Principal-agent theorists claim to objectively model the underlying economic conditions which give rise to the agency problem; they accomplish this by promoting a very limited perception of what it means to be human, (where, for example, self-realisation is equated with wealth accumulation) (Chwastiak, 1999). Within this framework, all human actions are guided by rationality. Such rationality, which by definition is devoid of more abstract notions of

epistemology (such as emotion or intuition), facilitates an abstract, cold, calculating and quantifying reasoning rooted in self-interest (Chwastiak, 1999).

On the other hand, Roberts and Scapens (1985) claim that different forms of accountability emerge in different contexts. In a situation where regular personal contact is involved, explanations given or interpretations made can be challenged or negotiated[86]. This delineation based on spatial proximity, was highlighted by Roberts (1991) when he referred to "hierarchical" and "socializing" forms of accountability. The hierarchical form of accountability, which is similar to the contractual context of accountability identified by Laughlin (1990), focuses on accounting as a reckoning function. It encompasses a much more formal set of accountability relationships where action expectations and information demand and supply are tightly defined and clearly specified (Laughlin, 1990). Viewing the individual as the economic unit leads to the construction of the calculating, isolated and compartmentalised self. By commodifying and enumerating an individual's talent and skill according to a mechanistic scheme of categorisation, Roberts argues that people are homogenised and become involved in hierarchical relationships with one another based on their

[86] Roberts and Scapens (1985) argue that the principal potential of accounting systems lies both in the way they reduce information to bridge physical distance by making what is physically remote from senior managers "visible" to them, and giving them a form of "presence" at lower levels in an organisation. This visibility and this presence, however, are only partial. Consequently, despite the ability of information to bridge physical distance, such distance has a decisive impact on the forms of accountability that emerge. The salient feature of accountability across distance is the relative absence of mutual knowledge. Where accountability is given in a different environment from where it is produced and where different interests operate, the significance attached to accounting information undergoes a series of subtle transformations. Knowledge of the possibility of such transformations, in turn, informs the practices of individuals and thereby shapes the forms of accountability that emerge across distance. For example, managers may invest heavily in accounting information systems in an attempt to meet their interests. The increased surveillance provided by a new accounting system may in fact allow them to exercise a greater degree of control over outcomes and may help them to enforce their expectations.

relative worth. This sets up an environment of continuous comparison, contrast and competition[87, 88].

In contrast, the socializing form of accountability serves a narrative requirement rather than a calculative accounting function. This form of accountability is situated in the interactions between people who share a common context and have the ability to talk face-to-face to one another and is referred to by Laughlin (1990) as a "communal" context of accountability. According to Roberts' (1991) definition of socializing accountability, spatial proximity is a necessary condition for the giving of an account. This is because the construction of self in dialogue with others ensures that the 'self' is embedded in relationship with others. Thus, the communal context encompasses a less formal set of accountability relationships where action expectations and information demand and supply are less structured and defined.

Munro (1996) identified two variants of accountability: First, he argued that company management tend to think of accountability in terms of "outcomes"; as something their company or institution needs to "get", rather than as something people already do. Here, much of the emphasis on accountability focuses on measurement of individual performance. Second, is the notion of accountability as the capacity to give

[87] In this regard one of the most unsettling aspects of management or company accounts is the complete absence of individuals from them; at best the self appears in peculiar agglomerations of selves, e.g., in terms of sales per employee or unit costs.
[88] Based on Foucault's (1979) analysis of the "individualising" effects of disciplinary power, Roberts (1996) suggested that the peculiar mirror of activity that accounting provides, causes the self, others, and even productive activity to be discovered merely as instruments to the monetary values accounting advertises. To secure 'self' within the terms of such values, individuals must maintain a state of constant vigilance over their own activity and incessantly compare and differentiate 'self' from others in these terms. It is within this self-disciplining regime that the individualised self is constituted; anxiously absorbed with superiors' views of their utility, indifferent to subordinates except in so far as their actions will reflect on the individual, and aware of colleagues only as potential competitors for recognition.

an account, explanation or reason. This is a process view – accountability is already endlessly going on: the giving of accounts is that in which everyday activities subsist. Munro (1996) believed that accountability involves the study of how accounts happen to line up – or indeed are made to line up, that is, the ways in which accounts line up are "expressive" of a participant's position; they are thus open to processes of surveillance and sanctioning.

Alternative dimensions of accountability were deployed by Boland and Schultze (1996), who argued that the addition of a narrative method of understanding to accountability's cognitive aspects might prove to be valuable. Willmott (1996) examined universal, historical, socially acceptable and unacceptable, hierarchical and lateral aspects of accountability. Sinclair (1995) presented a typology of accountability, based on five elements (political, managerial, public, professional and personal), which were crossed with two dimensions (structural and personal) of understanding[89]. Using this typology managerial or financial accountability was expressed in terms of the efficient and effective use of resources. Sinclair acknowledged that accountability is multidimensional and fragmented. An organisational control perspective argues that accountability is one of the mechanisms for striking a balance between organisational effectiveness and order (Birkett, 1988).

[89] By means of contrast to the typology offered by Sinclair, (1995), Stewart (1984) talks about bases of accountability in terms of a "ladder of accountability" (p.17). The first rung of his ladder is "accounting for probity and legality" which reports that funds have been used in an appropriate and authorised manner. The second level is "process accountability" which accounts for the appropriateness of the action processes followed by the agent. Levels three and four relate to "performance accountability" and "programme accountability" which together are intended to provide an account of the total work performance of the agent in terms of the specific goals set by the principal. Finally, "policy accountability" relates to accountability relationships when undefined and uncertain goals and processes exist. Each level is a tighter and more precise account of actions undertaken by the agent. However, each accountability relationship does not necessarily involve all levels of Stewart's ladder; many formal accountability relationships may reflect only one or two levels. Broadbent et al. (1996) claimed that although accounting could play a part at all levels of the "ladder", it was at the "performance" and "programme" levels that accounting could make the greatest contribution.

Accounting is but one of the means of controls in organisations (Otley, 1980; Ouchi, 1980; Birkett, 1988). Accounting has the power to influence the behaviour of those subjected to the accounting process because what is accounted for can shape participants' view of what is important, what to do and what not to do (Burchell et al, 1980; Hopwood, 1983; Gallhofer and Haslam, 1993). For example, managers' decisions will be affected by the expected changes in performance measures as a result of changes in accounting policy and recognition with respect to derivative financial instruments by means of information inductance[90] (Prakash and Rappaport, 1977).

3.3.3 Rights and Responsibilities

Although several perspectives on accountability were offered in Section 3.3.2, the notion of accountability as the *rendering of an account* is the most intuitively appealing to the researcher and is therefore adopted. The Gray et al. (1996) definition of accountability introduced in Section 3.3.1, highlights two central tenets of the accountability concept, namely rights and responsibilities. The most obvious rights and responsibilities are those established in law. The law lays down the minimum level of responsibilities and rights and thus the minimum level of legal accountability at any given time in any given country (Tinker et al., 1991); "the minimum set of rules by which the game must be played" (Bebbington and Gray, 1993, p. 2). However, extant law cannot be taken as an absolute statement of society's preferences

[90] Prakash and Rappaport (1977) stated that: "An individual's anticipating the consequences of his or her communication might lead him or her – before any information is communicated and, hence, even before any consequences arise – to choose to alter the information, or his or her behaviour, or even his or her objectives. This is the process of information inductance".

(Bebbington and Gray, 1993, p. 2)[91]. The requirement for minimum responsibility via compliance with the law brings a need for a secondary responsibility to account for the extent of that compliance - "this is the duty of accountability" (Bebbington and Gray, 1993, p. 2). There are various justifications put forward for this duty to render accounts, including the notion of a social contract (Gray, et al., 1987; 1988). Most of the justifications are premised on the interdependencies between individuals and groups, whether this be through market exchanges or organisational arrangements or via the impact of organisational activities on society (Birkett, 1988; Gray et al., 1987; Gray, 1992). Bebbington and Gray (1993) argue that current measures of accountability are skewed in favour of the limited financial accountability provided by management to shareholders. This allows the rights to information of financial participants to dominate those of all other stakeholders (Bebbington and Gray, 1993).

The requirement to report to shareholders (financial accounting) is one of the very few instances of explicit accountability established within the law itself (Gray et al., 1996; Stanton, 1997). However, in order to be fully accountable, non-legal/moral/natural rights also need to be considered. Ijiri (1975) asserted that accountability relationships might stem from "a constitution, a law, a contract, on organisational rule, a custom or even an informal moral obligation" (p. ix). Quasi-legal rights and responsibilities are those enshrined in codes of conduct, statements from authoritative bodies to whom the organisations subscribe, or other 'semi-binding' agreements (such as mission statements). Philosophical rights and responsibilities (those responsibilities not enshrined in statute or other forms of agreement) may be absolute or relative, and their establishment can only be achieved

[91] For further discussion see Lindblom (1984); Gray et al. (1987; 1988; 1991); Bebbington and Gray (1993).

through debate, education and agreement (Gray et al., 1996). But a business is accountable to all of its various constituents, not just shareholders, based on its relationships with them. Pallot (1992) explained that accountability is 'rights based' not utilitarian – that is, accountability is owed by organisations, to the *public*, irrespective of the use of the accountability information. Ramanathan (1976) argued that the provision of relevant information on the firm's objectives, policies and actions in the social arena was necessary in assessing the extent to which the corporation was effectuating its social contract. However, Stanton (1997) argued that non-investor users of accounting information who claimed a right to accountability were asserting a moral rather than a legal right.

Gray et al. (1996) state that information is a prerequisite of an active (participative) democracy; therefore, they argue, that accountability is a necessary condition for greater democracy. Also, an increase in organisational transparency through greater accountability may help to socially reconstruct the organisation by making organisational activity more visible (Burchell et al., 1980; Chua, 1986; Hines, 1988; Gray, 1992; Gray et al., 1996; Lehman, 2002)[92]. Coy and Pratt (1998) argue that public disclosure of information is "fundamental to the workings of a pluralistic democratic system" (p. 544). They also suggest that the issuing of audited financial statements is designed to give "equitable access to information for all interested parties" which in turn, "helps to maintain public confidence in the economic system"

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[92] Chua (1986) argued that the act of communication inherent in accounting made it analogous to story telling because it gave visibility to a particular definition of reality. By highlighting economic constructs it reinforces the idea that such concepts are important; by not highlighting social or environmental concepts the accountant reinforces the idea that such concepts are not of great importance. Therefore the accountant through the presentation and re-presentation of perceived social reality, is involved in the organisation, reproduction and transformation of the social world (Hines, 1988).

(p. 544). The transparency engendered by accountability can have the effect of bringing the organisation and the results of the organisation's actions closer together, that is, accountability is a result of responsibility and, in turn, increases responsibility (Gray et al., 1996; Lehman, 2002). Bebbington and Gray (1993) argue that responsibility without accountability can become "largely meaningless" (Bebbington and Gray, 1993, p. 2) and that "the proper discharge of accountability can have the effect of opening – and developing – debate between the organisation and society about the appropriate types and levels of social responsibility" (Bebbington and Gray, 1993, p. 2)[93].

3.3.4 Accounting as a Discharge of Accountability

The conventional view of accounting sees it as a process of representing an objective financial and economic reality, exclusively in a numerically based, monetary manner (Laughlin, 1990; Gray et al., 1996; Bailey et al., 2000; Logsdon and Lewellyn, 2000; Klumpes, 2001). Bailey et al. (2000) argue that the legal requirement that companies lodge information with the Registrar of Companies, together with the wide dissemination of annual reports, affords a degree of public accountability in the UK. They further argue that "very little has changed this century regarding the nature of such financial accountability" (p. 207). They recognise that, although the volume of information reported has grown, the basic system remains largely the same historic cost model of the last century. Bloom and Heymann (1986) noted that the conventional accounting system, based on the notion of free markets, defined accounting in terms of providing relevant information to individual decision makers

[93] Based on the writings of Foucault (1990), Coy and Pratt (1998) argue that "the effect of accountees' awareness of the possibility of surveillance through published annual reports can influence behaviour towards institutional as opposed to individual benefits" (p. 548).

(owners of the firm), who in turn used this information in accordance with their profit goals, thereby effecting an efficient allocation of resources[94]. They suggested that, in this framework, the role of the government was to "promote neutral rules that maintain a competitive environment and to otherwise refrain from interfering in the markets" (p. 168). Ijiri (1975) recognised the role of accounting in the accountability relationship when he maintained that:

> "... accounting is a system designed to facilitate the smooth functioning of *accountability* relationships among interested parties." (p. ix)

However, Benston (1982a; 1982b) suggested that the only mandatory form of corporate accountability necessary in a free market system is financial accountability. He identified three possible groups to whom corporations could be held accountable: shareholders, stakeholders (whom he defined to include employees, customers, creditors and others with direct contractual or transactional relations with the corporation) and the general public. Benston believed that the aim of corporate accountability was to assure shareholders and stakeholders that their interests were served by the functioning of a free market system in conjunction with internal and external monitoring systems. However, he argued that the market for managerial services (whereby managerial staff were appointed and re-appointed on the basis of performance) was presumed to provide sufficient assurance that shareholders' interests would be safeguarded[95]. Creditors were protected by market forces, since the financial markets worked to assure them that poor credit performance would increase borrowing costs. Employees' interests were seen to be met because they would vary

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[94] The free market forces will, under the direction of Adam Smith's invisible hand, provide for Pareto optimal social welfare.

[95] Coy and Pratt (1998) noted that "(t)he collection and public reporting of new information may influence managerial behaviour if there is the possibility of gaining reward or avoiding sanction" (p. 545).

their work effort with respect to their total compensation. Finally, the interests of consumers were seen to be protected by the workings of the market for consumer goods and services. Therefore, he concluded, that if concern for shareholders was the motivating factor behind financial accountability, there was no need to require inclusion of information relating to financial accountability in corporate reports. He argued that the inclusion of accountability information imposed costs on shareholders for the benefits of others. He did see one possible use for wider information as an internal management tool for use in evaluating activities. He suggested that "required reporting in annual financial reports of data that purport to measure the benefits or costs of social responsibility issues have little chance of being other than public relations or other self-serving exercises" (Benston, 1982b, p. 100).

In the conventional accounting system, external auditors and published financial statements were seen as vital in monitoring and controlling the actions of management. Watts and Zimmerman (1986) agreed with Benston on the important role played by the external audit in this process; they suggested that market forces could be relied on to ensure that external auditors would report discovered improprieties and to generate generally accepted accounting principles, thus ensuring adequate financial accountability.

This form of financial accounting, however, was but one form of accounting that might be considered when accountability is thought of in a broad sense. From this perspective, accounting based purely on financial objectives was perceived to be "significantly and artificially constrained" (Gray et al., 1996, p. 11). Shearer (2002) demonstrated that the reliance of extant accounting theory and practice on the

theoretical constructs and behavioural assumptions of neo-classical economics resulted in ethically deficient accounting reports. Shearer (2002) argued that Benston's analysis was premised on the unarticulated presupposition that the collective good was defined and achieved by the pursuit of private interest. From a neo-classical economics perspective, accounting was viewed as limiting the concept of gain and loss to the financial wealth created or depleted by corporate actions, which in turn helped to perpetuate the myth that human happiness lay in acquiring material possessions (Chwastiak, 1999). Thus, accounting was seen to produce a delusion that the economic consequences of an action were all that mattered (Tinker et al., 1991; Chwastiak, 1999).

Tinker and Neimark (1987) argued that accounting reports played an important part in forming world views, or social ideology, by allowing management to present its view of the world, and, where appropriate, choosing what to comment on and what to ignore. Therefore, non-disclosure might be seen as "a means of protecting business self-interest" (Bailey et al., 2000, p. 210). Roberts (1991) suggested that the ability of accounting to render things invisible lay in its capacity to present information as if it were objective fact; the detail could be questioned but not its basic capacity to reflect the truth. Presently, accounting information is presented as somehow independent of the interests of those who produce and use it. Coy and Pratt (1998) note that over the past decade or so critical accounting scholars have rejected the notion of accounting as a neutral objective system, which simply reports an independent social reality. Proponents of this viewpoint believe that the accounting process itself contributes to society's beliefs about social reality and through this influence, accounting contributes to creating the reality it reports (Hines, 1988; 1989).

It has been noted that accounting has potential as a broader human practice which may involve more meaningful conceptions of the world to be accounted for (Arrington and Francis, 1993). The social accountability literature would seek to extend accountability well beyond the narrow principal-agent relationship and would require disclosure of a broad array of economic and social information to society at large, and the environment, that extend beyond traditional contractual relationships. Cooper and Sherer (1984), Tinker et al. (1991), Hooper and Pratt (1995) and Coy and Pratt (1998) argue that accountants are not objective benign actors in a capitalist society, but participate in the creation of social reality through the selected disclosure and aggregation of financial events.

Carnaghan et al., (1996) presented an analysis of financial disclosure as one managerial device for satisfying accountability pressures. Accountability pressures from stakeholders, who may be either individuals or groups, drive company managers into manoeuvres that highlight features of the company and actions that they have undertaken to meet at least the most important accountability pressures that they have experienced. The central argument is that disclosure does not just appear, unaided. Rather, disclosure, together with the procedures by which it is aimed at its targets, is the product of an extensive set of managerial activities. Financial disclosures are shown to be the result of managerial activities, which create a particular depiction of the firm; through deliberate choices of content, wording, timing, media, and other disclosure dimensions. Within the limits and opportunities provided by disclosure laws and regulations, these disclosures are highly suggestive about what management believe is appropriate about the company (Carnaghan et al., 1996). Therefore,

stakeholders receive a portrayal of a firm's activities and performance coloured by management's perceptions about stakeholders' priorities and interests – albeit mediated by existing regulation, the managers' own attitudes and reputation and internal accountability relationships (Tinker and Neimark, 1987; Tinker et al., 1991; Carnaghan et al., 1996; Chwastiak, 1999).

Roberts and Scapens (1985) argued that accounting practices involve more than the production and reproduction of meaning; systems of accountability are seen to embody a moral order comprising a complex system of reciprocal rights and obligations. The practice of accounting institutionalises the notion of accountability; it institutionalises the rights of some people to hold others to account for their actions (Roberts and Scapens, 1985). Thus, the practice of accounting can be seen to involve the communication of a set of values, of ideals about expected behaviour, of what is approved and disapproved (Roberts and Scapens, 1985). They further argue that accounting practices can thus be seen to involve the operation of relations of power. This power could take two forms. First, it can take on the mantle of what Giddens calls the "transformative capacity of human action", that is, the power of human action to transform the social and material world; accounting is seen as providing a common language thus serving as a means of directing and organising (Roberts and Scapens, 1985). Second, the notion of 'power over' is discussed; that is, power as the domination of some individuals by others. They state that the real power of accounting lies in the way in which, as a structure of meaning, it comes to define what shall and shall not count as significant within the organisation.

3.3.5 Criticisms of Accountability

One of the most frequently cited criticisms of the accountability concept is that the process of 'being held to account' determines, reflects, reifies, strengthens and solidifies power relationships between the accountee and accountor (Robert and Scapens, 1985; Arrington, 1990; Roberts, 1991; Gray, 1992). For example, Roberts and Scapens (1985) argue that the practice of accountability (conducted by means of accounting) institutionalises the rights of some people to hold others to account for their actions. This process, they argue, reinforces power relationships and attempts to communicate "notions of what *should* happen" in order to make sense of "what *has* happened" (p. 448, emphasis in original).

Another criticism of the accountability framework, as articulated by Tricker (1983), suggests that accountability only exists when the right to account is enforceable. Burritt and Welch (1997) emphasise this point when they argued that:

> "The giving of an account is not enough for an accountability relationship to exist; there has also to be a process for holding the accountor to account for actions taken and consequences incurred. Hence, enforcement mechanisms are crucial to accountability" (p. 533).

However, Gray (1992) argued that neither criticism is necessarily insurmountable. He stated that the criticism offered by Roberts and Scapens (1985) and others presupposed that the world was antagonistic and manipulative, whereas he viewed the accountability process as "social and liberating, a means of defining and re-defining community" (p. 413). Gray (1992) suggested that the argument proposed by Tricker (1983) was primarily of differing terminology and thus easily resolved.

The accountability framework is essentially non-radical and grouped in the current status quo (Gray, 1994). The accountability model has been criticised in respect of its implicit political quietism by Tinker et al. (1991) when they argued that the status quo was a constantly changing notion. However, such a non-radical base has been deemed to be desirable by many (Puxty, 1986; 1991; Gray et al., 1991). The concept of accountability reflects notions of fairness and justice (Gray, 1994) and is seen as essential in terms of the re-introduction of an ethical basis to accounting (Gray, 1994).

3.4 The Relationship between Corporate Governance and Accountability

This section explores the relationship between accountability and corporate governance. As noted previously, the corporate governance debate has been marked by a discussion about the rights of shareholders versus the rights of stakeholders, with the proponents of the former arguing that a company is responsible only to its legal owners (Gamble and Kelly, 2001). Proponents of the stakeholder orientation argue that other constituencies, such as employees, or local communities may have a legitimate right to demand accountability from the firm. However, although the contemporary debate continues to attribute some degree of importance to the issue of accountability, the outcome of the debate increasingly focuses on what systems of governance best promote economic efficiency and generate "shareholder value" or returns for owners (Gamble and Kelly, 2001). In the area of corporate accountability to a broad range of stakeholders, there is a significant change in focus between the Cadbury Report and the Hampel Report. The Hampel Report clearly considered the need to redress the balance between shareholders and stakeholders and made strong statements on these issues. For example, the Hampel Committee stated that:

> "The importance of corporate governance lies in its contribution both to business prosperity and to accountability. In the UK the latter has preoccupied much public debate over the past few years. We would wish to see the balance corrected. Public companies are now among the most accountable organisations in society … We strongly endorse this accountability and we recognise the contribution made by the Cadbury and Greenbury committees. But the emphasis on accountability has tended to obscure a board's first responsibility – to enhance the prosperity of the business over time"
>
> The Hampel Report, 1998, p. 7, par. 1.1

Formally, the UK's system of corporate governance provides for a chain of accountability whereby executives are accountable to the board of directors, who are in turn accountable to the shareholders (Forbes and Watson, 1993). However, in practice the distinction between managers (accountable to the board) and directors (accountable to the shareholders) is less than obvious because the boards of most large publicly quoted firms are dominated by executive directors (Forbes and Watson, 1993).

At a basic level, boardroom accountability is the key to the legitimacy of the corporate system. Corporations are seen to have power and their use of that power is only legitimised through being exercised within a recognised framework. The commonly held view is that companies are answerable to the law, regulations, their shareholders and to public opinion. However, increasingly, major long-term investors, such as pension funds, have come to understand that better run companies will strive to meet the legitimate interests of a wider group of stakeholders.

The preceding discussion has highlighted the central tenets of the corporate governance and accountability frameworks to be utilised for the purpose of the current research. Several similarities can be identified between the definitions utilised within both the narrow notions of corporate governance and the agency-driven varieties of

accountability. Similar overlap may also be found within the wider more socially responsible driven notions of corporate governance and corporate accountability. Table 3.1 captures some of the fundamental distinctions between these two corporate worldviews.

Table 3.1: Narrow versus Broad Notions of Corporate Governance and Accountability

	Narrow View	Broad View
Perceptions of Human Nature	Utilitarianism and Individualism	Humanistic, Holistic
Definition of the Firm	An economic organisation defined as an aggregation of individuals	A social, political, historical and economic entity
Manager's Role or Duty	To maximise shareholders wealth	To attempt to accommodate the needs of all stakeholders
Decision Norms	Freedom	Responsibility
Role of Internal Control	The pricing of contractual exchanges	To maintain trust amongst those in stakeholder relationships
Role of Regulation	To promote ex ante contractual freedom	To promote ex post distributive fairness

As Table 3.1 shows, the agency framework that characterises the narrow definition of corporate governance and accountability is built upon the well-established principles of neo-classical economics (Bushman and Smith, 2001; 2003). This viewpoint emphasises the contractual nature of a firm's operations (Fama and Jensen, 1983). The maximisation of shareholder wealth and the maintenance of individual liberties are the cornerstones of this framework. Thus, proponents argue that unfettered by regulation, corporations can write and enforce mutually beneficial contracts, which

maximise individual freedoms, as well as promoting economic efficiency (Friedman, 1970)[96].

The broad notion of corporate governance and accountability is rooted in humanism. Tricker (1984) suggests that broader notions of governance identify rights and responsibilities – this notion is widely recognised in the accountability literature (for example, Gray et al., 1996). Such a framework views the firm not as an economic aggregation of individuals, but rather as an entity, connected in some organic way with the social and political world[97]. Proponents argue that the focus of management in the achievement of corporate aims is based around the notion of responsibility, where economic entities are responsive to all stakeholders. Involvement is stressed rather than control; trust is more important than control (Burton, 2000). Regulation is seen as a vehicle to promote distributive justice and equality.

In summary, both the narrow and broad notions of corporate governance and accountability believe that firms can and should be a source of wealth and wellbeing for society. The differences arise over how firms should fulfil this purpose.

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[96] According to Friedman (1970) the only social responsibility of a business was to increase its profits 'within the rules of the game', that is, engaging in open and free competition without deception or fraud. The system of rules in which business is to pursue its profit is, in Friedman's view, one that is conducive to the laissez-faire operation of Adam Smith's 'invisible hand'. By allowing the market to operate with only the minimal restrictions necessary to prevent fraud and force, society will maximise its overall economic wellbeing. Anything that inhibits this incentive, or its operation, will weaken the ability of the market to deliver the economic goods. By means of contrast, the opposing view to that of Friedman, is that business has other obligations in addition to pursuing profits. Such obligations are argued to exist with respect to consumers, employees and society at large. One proposition is that social responsibility arises from the social power that modern corporations enjoy in areas such as environmental pollution. If business has power, then a just relationship demands that business also bears responsibility for its actions in these areas. Social responsibility arises from concern about the consequences of business' actions as they affect the interests of others. Business decisions do have social consequences. Hence, business cannot make solely economic decisions because they are interrelated with the whole social system (Gray et al., 1996).

[97] In providing limited liability to corporations, society accords entities status in the eyes of the law.

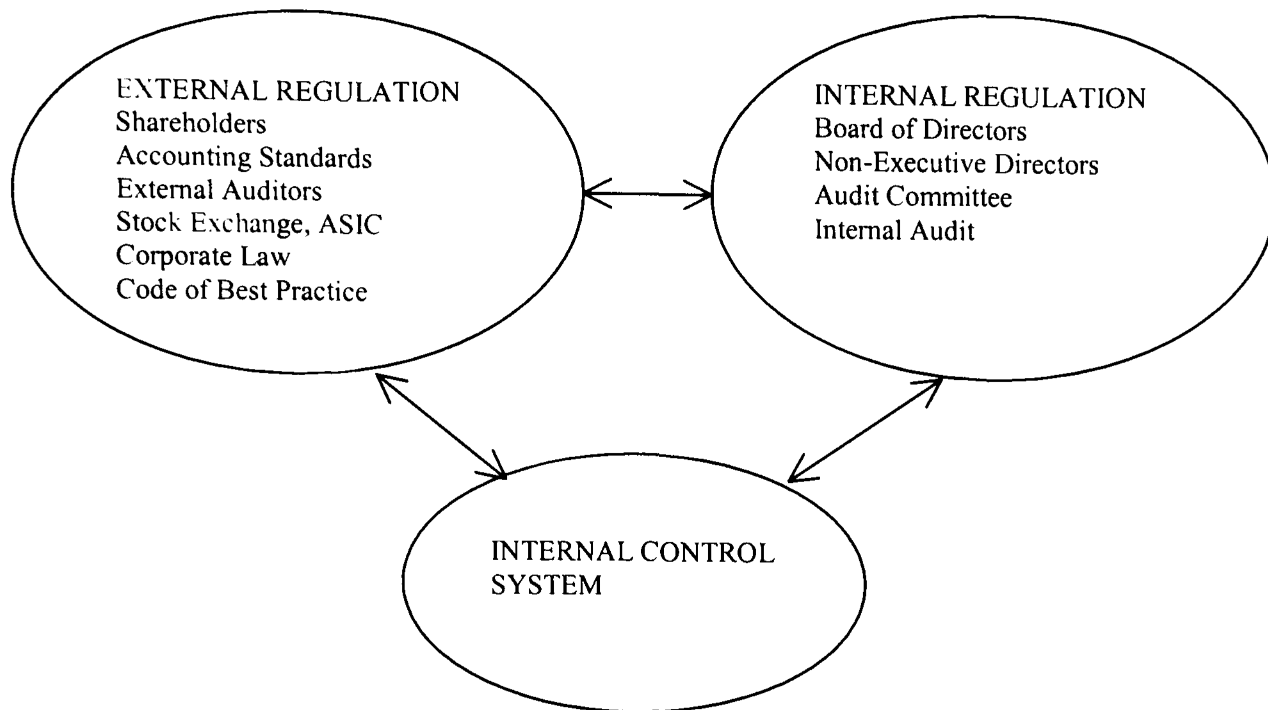
3.4.1 Internal Control as a Nucleus?

Many links have been established in the literature between corporate governance and accountability. Keasey and Wright (1993) regard accountability as a "sub-set of governance" (p. 291). One of the categorisations of accountability is based on the notion of the control of an organisation's activities. Hopwood (1976) points out two ways in which accounting systems serve accountability goals. First, accounting systems aid in the recognition and definition of problem areas. Second, accounting plays a role in the analysis and appraisal of alternative courses of action. Robinson (2003) suggests that accountability reports might play a useful role in the achievement of these goals simultaneously by reporting on both desirable and undesirable results of a change in activity, while concurrently inviting comment for further modification. Keasey and Wright (1993) highlight the notion of control in their definitions of both corporate governance and accountability. Corporate governance is defined to include "the structures and processes associated with production, decision-making, control and so on within an organisation", while accountability is defined as "a sub-set of governance" which "involves the monitoring, evaluation and control of organisational agents to ensure that they behave in the interests of shareholders and other stakeholders". Accountability issues are raised concerning the design of internal control systems that fully reflect events (Keasey and Wright, 1993). Such systems are necessary for the provision of information to ensure accountability (Keasey and Wright, 1993). The Cadbury Report in the UK focused attention on accountability and risk management aspects of corporate governance by highlighting notions of control. It had the objective of securing the "accountability" of the board of directors and the chief executive whilst ensuring that effective risk management and control systems of

companies were developed and maintained in order to enact this accountability function (Cadbury, 1992).

Banaga et al. (1995) argue that accountability is a critical factor and this is obtained through the interaction of three aspects of corporate governance: (i) external regulation; (ii) internal regulation; and (iii) the internal control system. They argue that such an interaction might be achieved through properly constituted boards of directors and audit committees, observed by responsible shareholders and regulatory bodies, supported by full and timely disclosure of information and effective reporting and auditing systems. The three elements interact as can be seen in Figure 3.1. For example, the Board, through the Audit Committee, will interact with the external auditor and the internal control reporting system. Such accountability is built into the Code of Best Practice, where for example, recommendations were made on behalf of the external regulatory system that affected the internal regulatory system, in areas such as board composition.

Figure 3.1: Corporate Governance: Conformance



Reproduced from Banaga et al. (1995)

However, Broadbent and Laughlin (2003) argue that the aspiration for control within a principal-agent based accountability framework can be problematic. They point to the necessary distinction between 'managerial' and 'political/public' forms of accountability. They argue that political accountability is more open-ended and less detailed whilst managerial accountability is more closed and defined, which in turn implies that there are limitations on the controlling power of 'principals' in particular situations.

3.5 Implications for Treasury Management

The IASC mentions in its framework that the financial statements, besides providing information about the financial position, and performance and changes in the financial position, should also show the results of the stewardship of management, or accountability of management for the resources entrusted to it (Tornqvist, 1999). An integral part of this stewardship is the disclosure of information about exposure to risk. Information about company risk policies could be a way of informing

stakeholders about the company's objectives, attitudes towards risk, the measures to be undertaken and the delegation of responsibility (Tornqvist, 1999)[98].

In the treasury community, the Association of Corporate Treasurers (ACT) via their *Treasurer's Handbook* (2001), highlighted the importance of internal control mechanisms in treasury operations. They summarised the main recommendations of the Turnbull Report, highlighting the importance of risk identification and management in a treasury setting. The handbook also provided a checklist for treasury departments to aid in their identification of risk. This advice seems timely as the publicity from high profile cases of financial distress from the usage of derivative products mounts up (Dunne and Helliar, 2002). Section 3.2 discussed the role played by the various corporate governance, and internal control, codes and initiatives and their implications for treasury management and derivatives usage. A strong financial risk management culture is a key component of good corporate governance (Michell, 2001). However, the various corporate governance codes have faced criticism for failing to tackle the issue of risk management in an adequate manner (Accountancy, 1998a; 1998b).

The Higgs Report (2003) clearly specified the role of non-executive directors on risk issues by indicating that they should satisfy "themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible" (p. 26). Therefore, Buckley and Van Der Nat (2003) argued that non-executive directors must possess sufficient knowledge to ensure that they exercise

[98] Tornqvist (1999) highlighted the importance of internal management control information when focusing on wider corporate accountability; the reflection of the 'internal' in the externally disclosed information is viewed as vital for a complete understanding of accountability.

good judgement on the appropriate use of derivatives for corporate risk management purposes, in order to avoid the use of such products for speculative purposes. Otherwise, they argue that "the uncritical, uncontrolled and unchallenged use of derivative products is a financial time bomb ticking away in many corporate board rooms" (p. 11).

Roberts and Scapens (1985) highlighted the importance of accounting standards; they claimed that the increased surveillance provided by new accounting systems might allow a greater degree of control to be exercised over eventual outcomes. The increased surveillance provided by FRS 13 might allow the treasury and finance functions to exercise a greater degree of control over outcomes, thereby preventing recurrences of previous financial scandals. Roberts (1996) highlights the reciprocal dependence of individuals involved in accountability relationships – consequences (intended or unintended) of actions or inactions.

3.6 Conclusion

This chapter has documented some of the key issues in the corporate governance and corporate accountability literatures. An integration of some of the central tenets of these concepts has been attempted. The implications for treasury management have also been discussed.

A number of authors have expressed concern for the future of corporate governance and accountability in an environment where the stewardship reports of management take second place to voluntary disclosures aimed at consumer engineering. For example, Short et al. (1998) claimed that the policy debate surrounding corporate

governance reform focused too much on accountability to the possible detriment of enterprise. They suggest that there is a need to weigh the costs and benefits of efforts to enhance accountability in terms of potential entrepreneurial actions foregone in order to achieve a greater balance in the approach to corporate governance. Forbes and Watson (1993) argue that the central issue of corporate governance is "how to ensure accountability of senior managers to their shareholders and other stakeholders whilst still providing executives with the autonomy and incentives to exploit wealth producing strategies".

The present study will utilise elements from broad notions of corporate governance and accountability theories and frameworks to interpret the data provided by the content analysis of corporate annual reports, as well as insights gleaned from interviews with fund management and treasury department staff, in order to assess the impact and implications of an accounting standard such as FRS 13. Chapter 4 will outline the methodology and methods to be used for this analysis.

Chapter 4

Research Methodology and Methods

Chapter 4 – Research Methodology and Methods

4.1 Introduction

Chapter 2 reviewed in detail the main literature driving this research study, while Chapter 3 outlined the theoretical framework to be employed. This chapter considers the research methodology, and discusses the methods underpinning the analysis in this dissertation. Two methods are employed in order to examine whether FRS 13 was perceived to be useful from (i) the perspective of preparers and users of financial statements, and (ii) a study of how the contents of the annual reports of companies altered in response to the standard.

Views on the nature of reality and the contribution of knowledge have direct implications for methodology choices (Burrell and Morgan, 1979). The researcher's assumptions about the world are likely to implicitly or explicitly influence the research questions asked, the data sought and the interpretation of findings. The purpose of this chapter is to discuss the various methodological frameworks in the extant literature in order to document the ontological, epistemological and methodological assumptions that characterise the choice of methods utilised in the present study. Section 4.2 outlines core philosophical assumptions that guide any academic research project. The ontological and epistemological assumptions of the researcher support the choice of a primarily qualitative, interpretive methodological approach to the research. Section 4.3 discusses the research objectives of the study and the choice of appropriate methods of analysis. Section 4.4 and Section 4.5 outline the two qualitative research methods chosen for the study, namely content analysis and interview techniques. Section 4.6 concludes the chapter.

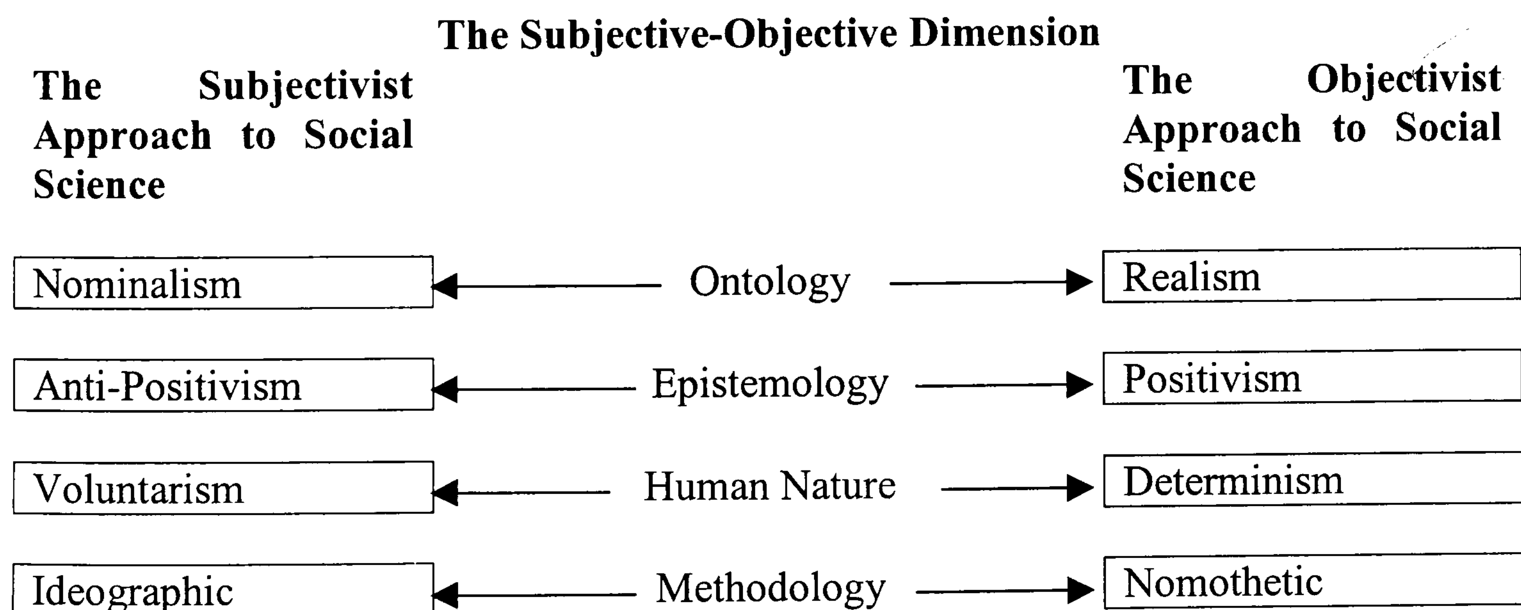
4.2 Philosophical Assumptions and Research Methodology

This section outlines the various philosophical assumptions that underpin any research study. Much of this discussion is based on the framework articulated by Burrell and Morgan (1979).

4.2.1 Assumptions regarding the Nature of Social Science

Burrell and Morgan (1979) identified four factors, assumptions about which determine our position in research: (i) ontology; (ii) epistemology; (iii) human nature; and (iv) methodology. The schematic diagram presented by Burrell and Morgan to illustrate these four factors and associated assumptions has been reproduced in Figure 4.1. Each of these factors is now discussed.

Figure 4.1: Burrell and Morgan's (1979) Scheme for Analysing Assumptions about the Nature of Social Science



Reproduced from: Burrell and Morgan (1979)

Ontological assumptions consider the nature of reality (Burrell and Morgan, 1979; Guba and Lincoln, 1994). Nominalism assumes that social reality is relative and that the world has no real structure (Burrell and Morgan, 1979). The 'reality' of the social world is deemed to be the product of an individual's consciousness and is not external to the individual. On the other hand, a realist views the world as comprising hard, tangible and relatively immutable structures, which exist independently of perception (Burrell and Morgan, 1979). 'Reality' is deemed to be objective in nature and viewed as external to individual consciousness. With respect to accounting, the philosophy of realism arises from the assumption that objective economic reality can be observed, measured and communicated (Godfrey et al., 2000). Morgan (1988) offered a six-way classification of the nature of the social world. This classification is reproduced in Table 4.1.

Table 4.1: Morgan's (1988) Six Basic Ontological Assumption Sets

Category	Assumption
1	Reality as a concrete structure
2	Reality as a concrete process
3	Reality as a contextual field of information
4	Reality as symbolic discourse
5	Reality as social construction
6	Reality as projection of human imagination

Reproduced from: Morgan (1988)

Categories 1-6 are alternative ways of looking at the world. Category 1 is a strict objectivist viewpoint of the world, while category 6 represents a subjectivist ontology. As one moves from category 1 to category 6 assumptions about the 'concreteness' of the world become more relaxed (Morgan, 1988). The ontological assumptions made imply different epistemological approaches and particular research methodologies and

methods, which in turn influence the types of research problems analysed and the hypotheses which are tested (Burrell and Morgan, 1979; Morgan, 1988; Godfrey et al., 2000).

Epistemological assumptions consider the nature of knowledge; the relationship between the researcher and that being investigated is considered (Burrell and Morgan, 1979; Guba and Lincoln, 1994; Creswell, 1998). Positivism argues that knowledge can only be based on observation, while anti-positivism seeks 'understanding', rejects objectivity and the need for independence of the observer (Burrell and Morgan, 1979). Positivists believe that what happens in the social world can be explained and predicted by means of the development and testing of hypotheses (Godfrey et al., 2000). Knowledge is seen to be a cumulative process. The epistemology of positivism encourages a concern for "an 'objective' form of knowledge that specifies the precise nature of laws, regularities and relationships among phenomena measured in terms of 'social facts'" (Morgan and Smirich, 1980, p. 493). Anti-positivism views knowledge as something that has to be personally experienced. This perspective rejects the notion that social science can create true objective knowledge of any kind (Morgan and Smirich, 1980, p. 493).

Assumptions about human nature are concerned with the relationships between humans and their environment (Burrell and Morgan, 1979). Determinism assumes that human beings, and their activities, are products of the environment and the situation in which they are located. Voluntarism assumes that man is 'free', autonomous and free-willed and thus governs his/her own actions and is thus responsible for them (Burrell and Morgan, 1979). These ontological and epistemological assumptions

taken in conjunction with views on the human nature have direct implications for methodological choices (Burrell and Morgan, 1979).

Methodology concerns the study of how we acquire knowledge about the world; it considers how the entire research process is conceptualised (Burrell and Morgan, 1979; Guba and Lincoln, 1994; Creswell, 1998). It provides the reasons and justification for the choice of methods through which we investigate and obtain knowledge about the world (Burrell and Morgan, 1979). Ideographic methodologies argue that understanding can only be achieved by obtaining first hand knowledge, by getting inside situations and learning the complexities of particular issues[99] (Burrell and Morgan, 1979). An ideographic approach "stresses the importance of letting one's subject unfold its nature and characteristics during the process of investigation" (Burrell and Morgan, 1979, p. 6).

On the other hand, nomothetic methodologies employ quantitative analysis protocols and techniques that search for answers (Burrell and Morgan, 1979). Such an approach uses methods of the natural sciences by focusing on the formulation of scientific tests and the use of quantitative and experimental methods in order to test hypotheses (Burrell and Morgan, 1979; Patton, 1990). Tomkins and Groves (1983) cited an extensive range of studies that questioned the validity of scientific modes of research in the social sciences[100]. Peasnell (1978) discredited accounting as a pure science; he therefore claimed that the application of scientific methods to its study was misleading. Burrell and Morgan (1979) stress that nomothetic and ideographic

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[99] Examples of this type of enquiry include interviews, case studies and ethnomethodology.

[100] Berger and Luckman (1966), Garfinkel (1967) and Tomkins and Groves (1983) challenge the use of the scientific method in social science research. However, all of these writers worked in the philosophy and social psychology arenas, therefore their findings may not be applicable to research in accounting.

approaches do not represent strict dichotomies, merely two different ways of influencing research methodology. To this end, Tomkins and Groves (1983) suggest identifying hypotheses using a naturalistic approach and then utilising a scientific approach for testing each one[101].

4.2.2 Assumptions about the Structure of Society

Burrell and Morgan (1979) considered two alternative approaches adopted in research about the way society is structured. Two theories concerning the structure of society were advanced: order and conflict. The 'order' or 'integrationist' view of society emphasises stability, integration, functional co-ordination and consensus (Burrell and Morgan, 1979). Meanwhile, the 'conflict' or 'coercion' view of society emphasises change, conflict, disintegration and coercion (Burrell and Morgan, 1979). Burrell and Morgan (1979) translate these theories about the nature of society into a debate concerning regulation versus social change. It is argued that regulation is concerned with unity and cohesiveness by consensus, whereas, the sociology of radical change is principally concerned with seeking emancipation from the structures which limit or stunt the potential for development (Burrell and Morgan, 1979).

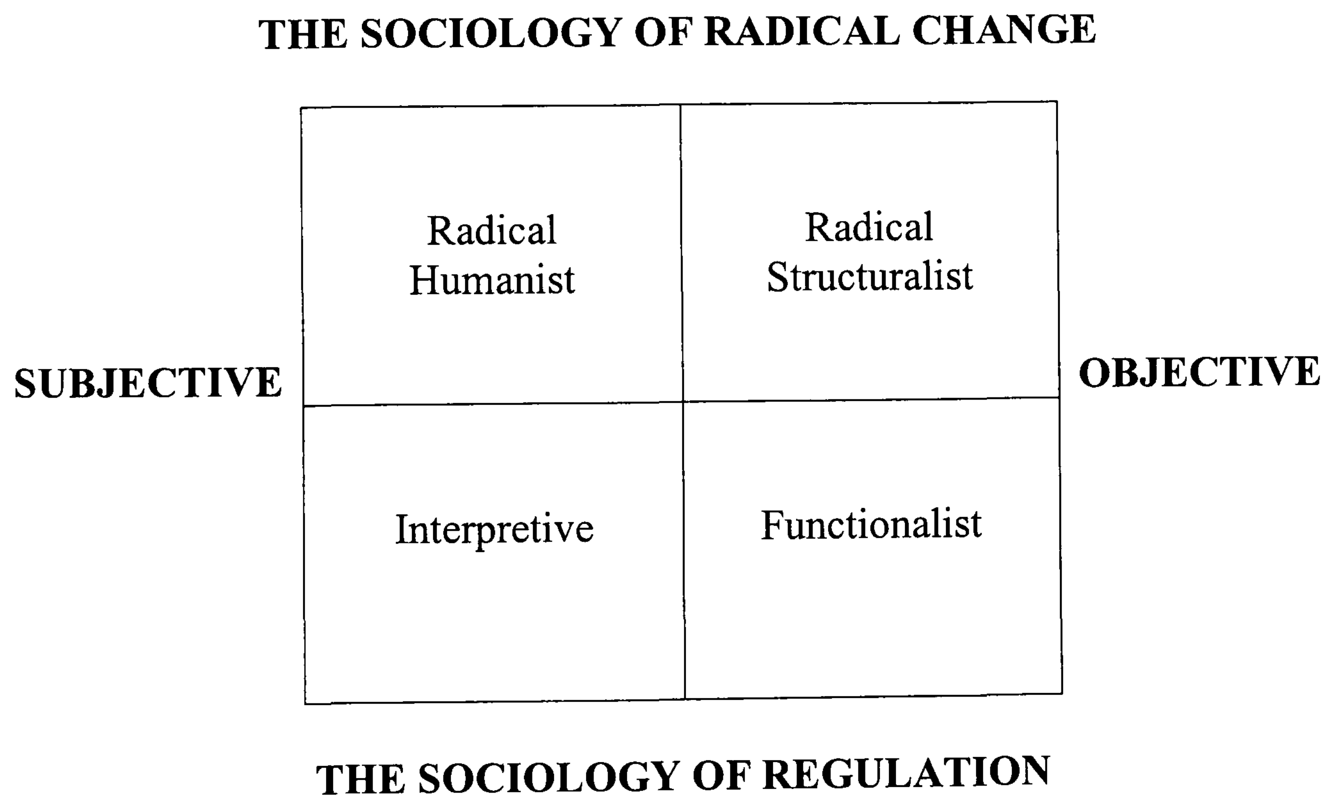
4.2.3 The Burrell and Morgan Classification Framework

The Burrell and Morgan (1979) analysis provides a useful framework to examine how the ontological assumptions about the world we live in, shape the epistemological notions concerning the nature of knowledge, which in turn influence the research

[101] Tomkins and Groves (1983) use the term 'naturalistic' in the manner of Abdel-khalik, that is, as a reference to the styles of research which owe their heritage to phenomenology, hermeneutics and pragmatism. However, Godfrey et al. (2000) argue that naturalistic research commences from specific real-world situations, and that it does not provide generalisable conditions for wide segments of society.

questions asked and the interpretation of resultant findings. Their analysis is based on a two-by-two matrix, reproduced here in Figure 4.2. The two dimensions of the matrix are based on the approaches to social science and the structure of society outlined in Section 4.2.1 and Section 4.2.2 respectively. This results in (i) the subjectivist-objectivist dimension (represented by the horizontal axis); and (ii) the assumptions about the nature of society dimension (represented by the vertical axis). These two sets of assumption yield four mutually exclusive paradigms offering four alternative views of social reality, namely: functionalist, interpretive, radical structuralist and radical humanist.

Figure 4.2: Burrell and Morgan's (1979) Matrix for the Analysis of Social Theory



Reproduced from Burrell and Morgan (1979, p. 22)

The functionalist paradigm assumes a realist ontology, with a positivist epistemology, a deterministic view of human nature and a nomothetic methodology. It seeks to provide rational explanations of human affairs. It is pragmatic and deeply rooted in

sociological positivism; relationships are concrete and can be identified, studied and measured using scientific techniques. This approach has tended to be the dominant paradigm for much accounting and finance research since the 1970s. The interpretive paradigm is underpinned by a nominalist ontology, with an anti-positivist epistemology, a voluntarist view of human nature, and an ideographic methodology. Researchers in this paradigm try to observe on-going processes in order to understand individual behaviour better. Both the functionalist and the interpretive paradigms are underpinned by a societal assumption based on the sociology of regulation. The radical structuralist paradigm shares its assumptions about the nature of science with the functionalist paradigm, while the radical humanist paradigm is underpinned by the same assumptions concerning the nature of science as the interpretive paradigm. However, both the radical structuralist and the radical humanist paradigms are underpinned by a societal assumption based on the sociology of radical change, with its associated commitment to emancipation and significant change. Theorists in the radical structuralist paradigm see inherent conflicts within society that generate constant change through political and economic crises. This has been the fundamental paradigm of theorists such as Marx, Engles and Lenin. Theorists in the radical humanist paradigm are mainly concerned with releasing social constraints that limit human potential. They see the current dominant ideologies as separating people from their true selves. This paradigm is used in the justification of revolutionary change. Burrell and Morgan argue that one cannot operate in more than one paradigm at any given point in time, because in order to adhere to the assumptions of one paradigm, one is deemed to have defied the assumptions of all of the other paradigms.

4.2.4 An Alternative to the Burrell and Morgan Framework

Although widely recognised in the literature, the Burrell and Morgan framework is not without criticism (Chua, 1986; Rosengren, 1993; Laughlin, 1995; Deetz, 1996; Clair, 1999). For example, Clair (1999) argued that the Burrell and Morgan framework ignored both postmodernist and feminist perspectives, while the analysis offered by the functionalist paradigm assumed the absence of a psychological perspective. Chua (1986) offered an alternative classification of the philosophical assumptions underpinning accounting research. Chua (1986) identified two main problems with the Burrell and Morgan framework. First, she disagreed with the notion that all the assumptions were presented as strict dichotomies, which meant that a researcher either assumed that individuals were determined by their societal environment or they were completely autonomous and free-willed. Second, she argued that the framework embraced a strongly relativistic notion of scientific truth and reason. Chua argued that the Burrell and Morgan implication that the choice and evaluation of paradigms could not be justified on rational scientific grounds was a misrepresentation of Kuhn who argued that traditional notions of what constituted rational scientific choice were inadequate.

Chua (1986) developed her own classification of the philosophical assumptions underpinning accounting research. This classification comprised three sets of beliefs: (i) beliefs about knowledge; (ii) beliefs about physical and social reality; and (iii) beliefs concerning the relationship between theory and practice. This classification is reproduced in Table 4.2.

Table 4.2: Chua's (1986) Classification of Philosophical Assumptions

A. *Beliefs About Knowledge* Epistemological Methodological
B. *Beliefs About Physical and Social Reality* Ontological Human Intention and Rationality Social Order / Conflict
C. *Relationship Between Theory and Practice*

Reproduced from Chua (1986, p. 605)

Beliefs about the conception of knowledge were divided into two sets of epistemological and methodological assumptions. Beliefs concerning the nature of physical and social reality were based on assumptions about ontology, human intention and rationality, and social relations. One of the key differences that Chua highlighted was that her framework was intended to be used to evaluate the strengths and weaknesses of different perspectives in accounting, whereas the Burrell and Morgan (1979) framework was non-evaluatory. Further, Chua did not claim that her framework encompassed all social perspectives into a permanent classification; she merely attempted to identify current perspectives.

Tomkins and Groves (1983) maintained that conventional accounting researchers have tended to adopt and maintain a single research style drawn from the natural sciences to the exclusion of more interpretive research methods such as case studies. They added that accounting research failed to question the fundamental assumptions underlying the work and the relevance of these assumptions to the proposed area of research. Tomkins and Groves (1983) also claimed that academics interested in

studying accounting behaviour and the value of different approaches needed to place less emphasis on mathematical analyses and modelling, statistical analysis and so on. They suggested that academics should instead concentrate their efforts on more detailed fieldwork as well as the study of the perceptions and concerns of accounting practitioners.

4.3 Research Objectives and the Choice of Research Methods

This study has as its core objective an examination of the impact of FRS 13 on corporate reporting practices and accountability relationships. This is achieved by an examination of corporate annual reports before and after the implementation of the derivatives accounting standard. Preparer and user perspectives regarding the implementation of the standard are then sought in order to provide a comprehensive basis which will facilitate a better understanding of the issues associated with the introduction of an accounting standard, and the associated impact on accountability relationships. It is recognised that there may be a number of motivations for the disclosure of derivatives related information, however, this study is primarily focused on the effects of these disclosures for accountability relationships.

The philosophical viewpoint of the researcher is outlined in light of the research objectives mentioned above. The researcher does not assume that there is a concrete reality out there and thus veers toward the nominalist end of the ontology spectrum. Social science is viewed as a subjective rather than an objective exercise with knowledge not being independent of particular contexts. In this study, knowledge emanates from two principal sources. First, knowledge is gleaned from the content

analysis of FRS 13 disclosures provided in corporate financial statements. The subsequent translation of the data collected for this analysis into meaningful findings is facilitated by means of subjective interpretation. Second, knowledge emanates from individual perspectives on the implications of FRS 13 for both the preparers of financial statements and the institutional users of these documents. In line with Chua (1986), the researcher takes an intermediate standpoint on the question of assumptions concerning human nature. While humans might not be solely determined by their environment, and some degree of free will is exercisable, neither are humans completely free-willed and autonomous. The substantive environment does have the ability to exert some impact over humans. Thus, the researcher falls between the two camps of voluntarism and determinism. This is particularly important for the interview strands of the research, where it is recognised that corporate representatives, although they have the ability to make some decisions, are constrained by organisational structures and business norms. With respect to the assumptions concerning the underlying nature of society, again some degree of compromise within the Burrell and Morgan framework is needed to facilitate the researcher's own predilections. Society is perceived as being capable of social change, but the status quo needs to be thoroughly investigated in order to identify where such change, if necessary, should be focused.

As previously mentioned, the present study is exploratory in nature and no attempt is made to focus on the setting up of detailed hypotheses for subsequent testing. The aim is to provide a descriptive account of derivatives-related disclosures, and the perspectives of treasurers as preparers of the information, and the perspectives of fund managers as potential users of the information provided by FRS 13. The philosophical

assumptions of the author as previously outlined point towards the use of ideographic methodologies, which would seek exploration and description of the perceived reality of the interviewees and annual report preparers. The combination of a nominalist ontology, an anti-positivist epistemology, an intermediate position on the assumptions concerning human nature, and the use of ideographic methodologies locate the researcher within the interpretive paradigm as identified by Burrell and Morgan (1979). The location of the research within an interpretive paradigm in addition to the use of ideographic methodologies tends to lead to the use of qualitative research methods, such as those employed in the current study.

4.4 Research Methods

4.4.1 Qualitative Research Methods

Qualitative methodology is based on the ideographic approach to social science research. Creswell (1998) argued that qualitative research is based on an inquiry process "that explores a social or human problem". It is concerned with meanings, patterns of behaviour and the way people understand things (Patton, 1990; Denscombe, 1998). Creswell added that the researcher "builds a complex, holistic picture, analyzes words, reports detailed views of informants, and conducts the study in a natural setting" (p. 255). In other words, qualitative methods are ways of finding out what people do, how they think, feel and acquire knowledge, by means of observation, interviews and the analysis of documents (Patton, 1990). The choice of qualitative methods such as content analysis and interview techniques satisfies the criteria for ideographic methodologies.

The establishment of validity and reliability are crucial elements in qualitative research (Hussey and Hussey, 1997; Creswell, 1998; Denscombe, 1998; Burns, 2000; Stenbacka, 2001). In order to demonstrate validity, the propositions under investigation must match the causal conditions which exist in human life (Burns, 2000). The researcher has to be recognised as an influence in the research process, but not a cause of biased or one-sided reporting (Denscombe, 1998). The subjects for investigation have to be chosen on explicit or reasonable grounds in terms of the research aims and objectives (Hussey and Hussey, 1997; Denscombe, 1998). The main thrust of methodological development in qualitative research during the last century has been toward greater validity (Kirk and Miller, 1986). Reliability needs to be established in two ways. First, the study must be capable of replication. Utilising the same categories as those used in the original study, following the same procedures, employing the same criteria of correctness and originating from the same perspectives, other researchers must be able to replicate the steps of the original research (Burns, 2000). Second, two or more people must be capable of similar interpretations based on the use of defined categories and procedures. In order to place an observation in perspective, within a theoretical context, the reader needs to be aware of the cognitive idiosyncrasies and theoretical standpoint of the researcher (Kirk and Miller, 1986). Issues relating to the validity and reliability of each of the chosen methods in this study will be highlighted in the description of content analysis and interviews in Section 4.4.2 and Section 4.4.3 respectively.

Qualitative analysis has many advantages. A particular strength associated with qualitative research is that the descriptions and theories that such research generates are grounded in reality (Hussey and Hussey, 1997; Denscombe, 1998). Miles and

Huberman (1994) argued that the focus on "naturally occurring, ordinary events in natural setting" resulted in the researcher gaining "a strong handle on what 'real life' is like" (p. 10). There is a richness and detail to the data (Denscombe, 1998). To the extent that social existence involves uncertainty, accounts of that existence need to be able to tolerate ambiguities and contradictions; qualitative research is better suited to this (Denscombe, 1998).

However, qualitative research does have its disadvantages. The data may be less representative, thus limiting its generalisability (Denscombe, 1998). However, provided sufficient detail is provided about the circumstances of the research it may be possible to gauge how far the findings relate to other instances (Denscombe, 1998). There is a possibility of decontextualising the meaning whereby the meaning of the data is lost or transformed by taking it from its current location (Denscombe, 1998).

Given the underlying philosophical assumptions of the researcher (as outlined in Section 4.3) and the broad objectives of the research, qualitative research methods were deemed to be most appropriate. This research study employs two methods of qualitative data collection in order to satisfy the objectives of the study: (i) the content analysis of corporate annual reports; and (ii) interviews with treasury disclosure preparers and institutional users of corporate financial statements.

4.4.2 Content Analysis

The first research method employed in this study is a form of content analysis. This method is used in order to collect data on the disclosures relating to derivatives usage

provided in UK corporate annual reports[102]. More details on the specific application of the technique in the present study are provided in Chapter 5. However, this section provides a broad outline of the content analysis method and its appropriateness in the present study.

A number of definitions of content analysis have been articulated in the substantive social science literature. For example, Abbott and Monsen (1979) defined it as:

> "... a technique for gathering data that consists of codifying qualitative information in anecdotal and literary form into categories in order to derive quantitative scales of varying levels of complexity" (p. 504).

Meanwhile, Krippendorff (1980) characterised content analysis as:

> "... a research technique for making replicable and valid inferences from data according to their context" (p. 21).

The basic premise behind the technique is that verbal behaviour, as communicated through written text, can help explain human behaviour; the communication process is an aspect of the total historical process – with both a meaning and the ability to be quantified (Lindenmann, 1983; Merten, 1996). Thus, content analysis is a method of codifying the text (or content) of a piece of writing into various groups (or categories) depending on selected criteria (Weber, 1985). Content analysis has the potential to disclose many "hidden" aspects of what is being communicated through the written text (Denscombe, 1998, p. 168).

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[102] Content analysis is just one of several established research techniques which may be used in the analysis of text (Silverman, 1993). Other techniques used to examine text include: (i) semiotics, which involves an in-depth analysis of the construction and structure of texts, and the relationships between different words within each text; and (ii) ethnography and linguistic methodology, which examine the behaviour of people interacting and reacting to text. Because of the in-depth nature of these techniques they are not appropriate for the analysis of large volumes of text, such as that envisaged by the current study.

Denscombe (1998) highlighted some of the key attributes of content analysis; Table 4.3 is adapted from his analysis.

Table 4.3: Denscombe's (1998) Key Attributes of Content Analysis

Content analysis ... reveals	**... by measuring**
1. What the text establishes as *relevant*	What is contained (e.g. particular words, ideas)
2. The *priorities* portrayed through the text	How frequently it occurs; in what order it occurs
3. The *values* conveyed in the text	Positive and negative views on things
4. How ideas are *related*	Proximity of ideas within the text, logical association

Reproduced from Denscombe (1998, p. 169).

The main strength of content analysis is that it provides a means for quantifying the contents of a text, and it does so by using a method that is clear and, in principle, repeatable by other researchers (Denscombe, 1998). Further, the method is "unobtrusive" (Krippendorff, 1980, p. 29), because documents can be evaluated without the knowledge of the communicator (Jones and Shoemaker, 1994; Breton and Taffler, 2001).

According to Krippendorff (1980), the first well-documented case of quantitative analysis of printed material occurred in eighteenth-century Sweden. Content analysis was originally devised for purposes of literary detection; for example, it was used in cases of disputed authorship (Carney, 1971). With the development of mass media, the technique grew in popularity, as newspaper articles were considered to be very amenable to this form of analysis. It was used widely during World War Two for the study of propaganda (Carney, 1971; Lindenmann, 1983). In 1952, Berelson produced

a text in which he offered a rigorous quantitative approach to the content analysis of media messages. This work was immediately challenged by Kracauer (1953), who called for qualitative content analysis techniques, drawing on hermeneutical and textual procedures (Merten, 1996). During the 1960s, advances in computer technology led to the process becoming more automated, which added a new level of complexity to the analysis being undertaken (Stone et al., 1966; Krippendorff, 1980; Manning and Cullum-Swan, 1994)[103,104]. This technology led to the development of 'critical' content analysis, which attempted to penetrate the surface and superficialities of communication (Carney, 1971; Krippendorff, 1980).

4.4.2.1 Stages in the Content Analysis Process

There are several stages in the content analysis process (Carney, 1971; Kassarjian, 1977; Krippendorff, 1980; Lindenmann, 1983; Hussey and Hussey, 1997). The research method "involves establishing categories and then counting the number of instances when those categories are used in a particular item of text" (Silverman, 1993, p. 29). This process can be broken down into stages as follows. First, a suitable representative sample is needed (Carney, 1971; Kassarjian, 1977; Krippendorff, 1980). The sample needs to be manageable (Kassarjian, 1977). In addition to a sample population, a sampling unit also needs to be chosen (Krippendorff, 1980). Potential accounting sampling units include annual reports, accounting standards or exposure drafts, letters to shareholders, and so on. The corporate annual report is the most popular sampling unit in accounting content analysis studies (Neimark, 1992; Jones

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[103] Stone et al. developed the 'General Inquirer' computerised system of content analysis at Harvard University in 1966. This system is still the most sophisticated, fully automated, computerised system of content analysis available.

[104] NUD*IST was developed by QSR to assist computerised content analysis. It aids in the coding of data, searching text and identifying coding patterns. NUD*IST (now called NVivo) launched its sixth version (N6) in 2002.

and Shoemaker, 1994; Gray et al., 1995a; 1995b; 1996; Adams and Harte, 1998; Unerman, 2000)[105].

Second, the unit of measurement or coding unit needs to be determined (Kassarjian, 1977; Krippendorff, 1980). Examples of coding units include word, theme, character, item, and space and time measures such as inches of text, line, paragraph, and so on. Debate rages in the content analysis literature on the most suitable unit of analysis (Gray et al., 1995b). Hackston and Milne (1996) suggested that measurement error between various quantification techniques was likely to be negligible. In their study they illustrated how counting sentence data, in terms of the number of sentences or proportions of pages to the nearest hundredth, made little difference to the subsequent analysis performed on the coded data.

Third, a suitable categorisation needs to be developed (Kassarjian, 1977; Krippendorff, 1980). A suitable theoretical framework is necessary in order to prevent inadvertent bias and to filter out the researcher's own idiosyncrasies (Carney, 1971). The element of subjectivity is difficult to control and impossible to eliminate entirely, but the presence of accurately defined categories, established at the outset

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[105] A number of reasons have been suggested for the exclusive focus of accounting content analysis studies on the annual report and accounts as the primary sampling unit. According to Bowman and Haire (1976) annual reports contain much written material that permits the researcher to perform content analysis. Many others argue that the annual report is the main form of corporate communication (Gray et al., 1995a; 1995b; Bartlett and Chandler, 1997; Adams and Harte, 1998). Neimark (1992) argues that the annual report presents "the world of corporate concerns in microcosm" and is both "comprehensive and compact" (p. 100). Further, it is considered to be virtually impossible to identify all sources of corporate communication which makes it difficult to be sure how complete non-annual report data are, and therefore how consistent the results of the content analysis will be (Gray et al., 1995a; 1995b). However, there is some recognition in the literature that this exclusive focus on the annual report might result in "an incomplete picture of disclosure practices" (Roberts, 1991, p. 63) and some studies have examined documents other than the annual report (Guthrie and Parker, 1989; Harte and Owen, 1991).

help to facilitate the correct classification of instances of disclosure (Kassarjian, 1977; Krippendorff, 1980).

Fourth, a pilot study or pre-test is necessary in order to examine the robustness of the decision rules and research instrument (Carney, 1971). Adjustments to the decision rules may be needed in the light of this pre-testing. Several coders should retest a sample of the material to ensure consistency in terms of decision rule application (Krippendorff, 1980; Andren, 1981).

Fifth, data coding and recording enables specific instances of defined disclosure to be classified according to the pre-determined decision rules. Potter and Levine-Donnerstein (1999) claim that the coding task changes with different types of content. Much of the content is coded by means of clerical recording or counting; when a particular issue is covered either a check is made, or a number added to the count, or a measurement is made of the amount of text devoted to the subject. For some less straightforward content, the coding task focuses primarily on constructing judgements from one's own schema based on the detailed decision rules. Krippendorff (1980) identified several essential elements for reliable recording of data in content analysis. The researchers must have experience of the type of data to be analysed; decision rules should also be set out in basic terms to avoid ambiguities. Each researcher must undergo some form of specific training to ensure all researchers engaged in a particular content analysis project are consistent in their classification of data into categories.

Finally, the data should be transferred to a computerised database to facilitate subsequent statistical or numerical analysis. Thus, the technique imposes a structure suitable for statistical analysis on essentially unstructured documents (such as annual reports) by means of reasonably well defined and consistent measurement categories which can be used to compare the content of each document analysed (Unerman, 2000). Having summarised the numerical data, the next step is to use the data to draw inferences by analysing it in relation to its wider context.

4.4.2.2 Reliability and Validity

To act as an effective research tool, content analysis must encompass certain key characteristics: the process must be reliable and valid (Holsti, 1969; Krippendorff, 1980; Andren, 1981; Weber, 1985; McTavish and Pirro, 1990)[106]. Reliability or reproducibility is one of the distinguishing characteristics of content analysis, in contrast to other techniques that are often used when describing the content of communication (Kassarjian, 1977; Krippendorff, 1980). Krippendorff (1980) identified three types of reliability for content analysis: stability, reproducibility and accuracy[107]. Stability refers to the ability of a judge to code data the same way over time (Krippendorff, 1980; Milne and Adler, 1999). The aim of reproducibility is to measure the extent to which coding is the same when multiple coders are involved (Kassarjian, 1977; Krippendorff, 1980; Weber, 1985; Milne and Adler, 1996). Intercoder reliability is the percentage of agreement between several judges processing the same communications material (Holsti, 1969; Andrén, 1981;

[106] Computer approaches to content analysis (available since the 1960s) permit more systematic and reliable coding of themes and meanings in text but these have not been widely adopted in social science research; computer content analysis procedures process a given text file reliably, in accordance with instructions in a specific program (Roberts, 1989; McTavish and Pirro, 1990).
[107] In order to measure the reliability of content analysis, several calculations can be undertaken. For example, Scott's (1955) pi, Cohen's (1960) kappa and Krippendorff's (1980) α have all been used.

Kassarjian, 1977; Krippendorff, 1980; Milne and Adler, 1996)[108]. The accuracy measure of reliability involves assessing coding performance against a pre-determined standard, or against previous studies. There is a need for explicitly formulated rules and procedures to minimise the possibility that findings reflect the analyst's subjective predispositions rather than the content of the documents under analysis (Kassarjian, 1977; Krippendorff, 1980)[109]. Validity relates to how well the results of a study mirror reality (Jones and Shoemaker, 1994). To improve validity one needs to develop a coding scheme that guides coders in the analysis of content (Krippendorff, 1980; Potter and Levine-Donnerstein, 1999). The coding scheme is an effort to make the coding process uniform across all coders so that the coding can be regarded as systematic (Krippendorff, 1980; Potter and Levine-Donnerstein, 1999). This process helps to eliminate partial or biased analysis, ensures that data relevant to a problem or hypothesis is secured and that the findings have theoretical relevance and are generalisable (Kassarjian, 1977; Krippendorff, 1980). To be characterised as content analysis, the data collated must be quantitative and thus amenable to statistical methods for summary purposes, as well as for interpretation and inference (Kassarjian, 1977; Krippendorff, 1980). Methodology reporting is critical for discerning the quality and usefulness of content analysis studies as well as for allowing replication. Researchers should emphasise objectivity and reliability issues in discussions outlining research findings (Kolbe and Burnett, 1991).

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[108] To address issues associated with reliability, Andrén (1981) recommends that another person re-code a random sample of the investigated material. Disagreements should be identified and analysed to determine if the disagreement is due to an error by the original coder or an error by the test-coder. In order to demonstrate objectivity, the categories of analysis must be defined so precisely such that different analysts could apply them to the same body of content and secure the same results (Kassarjian, 1977; Krippendorff, 1980; Milne and Adler, 1996).

[109] To ensure that the technique is employed in a systematic and valid fashion, the inclusion/exclusion of communications content or analysis categories must be done according to consistently applied rules (Kassarjian, 1977).

4.4.2.3 Use of the Content Analysis Method in Accounting and Finance

Content analysis has been widely used in many areas of accounting and finance research. However, the subject area where the content analysis technique has been utilised most frequently is in the area of social and environmental reporting (Bowman and Haire, 1976; Ernst and Ernst, 1978; Abbott and Monsen, 1979; Ingram and Frazier, 1980; Trotman and Bradley, 1981; Neimark, 1983; Frazier et al., 1984; Guthrie and Mathews, 1985; Cowen et al., 1987; Tinker and Neimark, 1987; Freedman and Jaggi, 1988; Guthrie and Parker, 1989; Zeghal and Ahmed, 1990; Roberts, 1991; Patten, 1992; Adams et al., 1995; Gray et al., 1995a; 1995b; Hackston and Milne, 1996; Deegan and Gordon, 1996; Deegan and Rankin, 1996; Hackston and Milne, 1996; Thomas and Kenny, 1996; Buhr, 1998; Neu et al., 1998; Milne and Adler, 1999; Unerman, 2000). Content analysis has frequently been employed in research into the accounting standard setting process (Kelly-Newton, 1980; Buckmaster and Hall, 1990; McKee et al., 1991; Guenther and Hussein, 1995). The methodology has also been used to investigate financial analyst recommendations and reports (Govindarajan, 1980; Previts et al., 1994; Rogers and Grant, 1997; Breton and Taffler, 2001) and to analyse narrative disclosures regarding bankruptcy (Tennyson et al., 1990).

Kohut and Segars (1992) focused on one part of the annual report, by examining the content of a sample of presidents' letters in high and low performing companies, in an effort to discover patterns in communication strategy. The contexts of financial accounting narrative have been studied on several occasions (Neimark, 1983; Jones and Shoemaker, 1994; Sydserff and Weetman, 1999; Smith and Taffler, 2000; Aerts,

2001; Beattie et al., 2001; Beattie et al., 2002), while other studies have looked at the readability of annual reports (Sydserff and Weetman, 1999; 2002; Clatworthy and Jones, 2001). Stone (2001) employed content analysis to formulate a portfolio-screening model for socially responsible mutual funds, while Gaumnitz and Lere (2002) analysed the contents of the codes of ethics of 15 US organisations. The technique has been used in accounting education studies (Beattie and Collins, 2000; Ferguson, 2002). Recently, the content analysis technique has been employed to investigate the content of corporate web sites (Perry and Bodkin, 2000).

4.4.2.4 Limitations of the Content Analysis Method

Whatever the setting, what emerges from analysis of these different studies is (i) the growth in the usage of this technique over time, and (ii) the breadth in the range of issues addressed using this method. A further conclusion is that this technique is increasingly employed in many different countries that have varying regulatory regimes for controlling financial information disclosures. However, it is recognised that content analysis is subject to a number of limitations. There is a substantial element of subjectivity involved with the use of the content analysis technique. Difficulties associated with content analysis are frequently based on the questions asked and source materials available (Carney, 1971). Choice of categories is often a tricky business in content analysis (Carney, 1971). The technique has an in-built tendency to dislocate the units and their meaning from the context in which they were made, and even the intentions of the writer (Denscombe, 1998). Qualitative assessment is always somewhat subjective, but the reporting of both category and intercoder reliability should provide some measure of comfort to the reader. Content analysis is frequently accused of being quite susceptible to the effects of researcher

biases, which in turn, can affect decisions made in the collection, analysis and interpretation of data (Jones and Shoemaker, 1994); the existence of these biases can affect a study's contribution to knowledge (Kolbe and Burnett, 1991). The presence of appropriate, reliable, valid and accurate coding scheme that guides coders through the analysis of content and the use of multiple coders helped to reduce this bias. Another crucial assumption of content analysis is that frequency of occurrence directly reflects the degree of emphasis accorded a theme (Kelly-Newton, 1980; Krippendorff, 1980; Gray et al, 1995b; Unerman, 2000).

4.4.2.5 Use of Content Analysis in the Current Study

Within the present study content analysis is viewed primarily as a qualitative research method. However, the quantitative nature of the data collected in the process is recognised. It should be noted, that despite content analysis's claims to objectivity, some subjectivity is involved in the choice of disclosure classification. However, the level of subjectivity is minimised through the development and pre-analysis of a rigorous set of decision rules. This subjectivity is in line with the philosophical assumptions of interpretive research.

The present content analysis initially requires the selection of companies to be included in the investigation. The next stage involves the development of an appropriate coding structure. The central part of the research involves analysing company annual reports and deriving thematic variables. Statistical analysis will be used to enable some explanation of the dataset. More details on the specific application of the technique in the present study are provided in Chapter 5.

4.4.3 Interviews

The second research method employed in this study involves semi-structured interviews. This method is used in order to collect data on the perspectives of preparers and users of financial statements concerning disclosures relating to derivatives usage provided in UK corporate annual reports in response to FRS 13. More details on the specific application of the technique in the present study are provided in Chapter 6 and Chapter 7. However, this section provides a broad outline of the interview method and its appropriateness in the present study.

Interviewing is one of the most common forms of data collection and comes in a variety of forms (Fontana and Frey, 1994; Maykut and Morehouse, 1994). Many reasons are given for the need for interviews. However, qualitative interviewing begins with the assumption that the perspective of others is meaningful, knowable, and able to be made explicit (Patton, 1990; Easterby-Smith et al., 1991). Indeed, in discussing the use of interviews in management research, Macdonald and Hellgren (1998) point out that interviewing top managers is often seen to add credibility to scientific inquiry. Whatever the motivation for the interview, the task for the interviewer is to make it possible for the person being interviewed to bring the interviewer into his or her world (Patton, 1990). The interviewer should set the guidelines in order for the interviewees to tell their stories (Osteraker, 2001). The interviewees should be allowed to talk within those guidelines, without interruption, interference or influence (Patton, 1990; Smith, 1995; Osteraker, 2001; Rapley, 2001). However, the quality of the information obtained during an interview is largely dependent on the skills of the interviewer (Patton, 1990; Rapley, 2001).

The use of semi-structured interviews allows the researcher to have a clear list of issues to be addressed and questions to be answered (Denscombe, 1998; Keats, 2000). However, flexibility is assured in terms of the order in which the topics are considered, and with respect to time allowed in order to enable the interviewee to speak more widely on the issues raised in the interview (Denscombe, 1998). Thus, answers are open-ended, and there is more emphasis on the interviewee elaborating on particular points of interest (Patton, 1990; Denscombe, 1998).

As with all forms of research, the twin cornerstones of validity and reliability need to be adequately demonstrated with respect of interview techniques (Hussey and Hussey, 1997; Creswell, 1998; Denscombe, 1998; Burns, 2000; Stenbacka, 2001). Stenbacka (2001) argued that because the purpose of qualitative interviewing is to generate knowledge of the phenomenon based on the understanding of another person's reality concerning a specified problem area, the question of validity is easily addressed. She argues that validity is achieved if the interviewee is immersed in the problem area under investigation, and is afforded the opportunity to speak freely. One method of reducing bias and thereby increasing reliability is to ask the same question several times in an interview. However, it is acknowledged that such an approach may antagonise the interviewee, who may think that the interviewer is incompetent or not listening (Vinten, 1995)

The use of tape-recorders in research interviews provides a permanent, more accurate rendition of events (Yin, 1994; Patton, 1990; Denscombe, 1998). However, tape-recorders only capture speech; they miss non-verbal communication as well as other

contextual factors (Patton, 1990; Denscombe, 1998). The use of the tape-recorder does not eliminate the need for taking notes (Patton, 1990). Taking notes facilitates later analysis, as well as providing a backup data source if the tape fails. Full transcriptions are expensive and time consuming (Patton, 1990), and are not always necessary. Thus, the interviewer can work back and forth between interview notes and sections of the tape; only those quotations that are particularly important for data analysis and reporting need to be transcribed (Patton, 1990).

The are several advantages of using interviews. First, interviews are particularly good at producing data which deal with topics in depth, and in detail (Denscombe, 1998). Subjects can be probed, issues pursued and lines of investigation followed over a relatively lengthy period. Second, valuable insight can be gained into the topic under investigation based on the different perspectives offered by the interviewees (Easterby-Smith et al., 1991; Denscombe, 1998). Third, interviews are a good method for producing data based on informants' priorities, opinions and ideas (Taylor and Bogdan, 1984; Easterby-Smith et al., 1991; Denscombe, 1998). With semi-structured interviews, the interviewees have the opportunity to expand on their ideas, explain their views and identify what they regard as the crucial factors (Denscombe, 1998). Fourth, interviews are very flexible. Adjustments to the lines of enquiry can be made during the interview itself (Denscombe, 1998). Fifth, direct contact at the point of the interview means that data can be checked for accuracy and relevance as they are collected (Patton, 1990; Denscombe, 1998). Some of the interview data may corroborate with the use of information available in the annual reports of interviewee companies (Yin, 1994).

The use of interviews in order to obtain subjective accounts and experiences in relation to the introduction of FRS 13 is in line with the underlying philosophical assumptions underpinning this study. The method facilitates the collation of various individual perspectives on the effects of the introduction of a derivatives accounting standard, and the exploration of issues raised by interviewees with respect to likely implications of the accounting standard for corporate accountability and corporate governance. Therefore, interviews with preparers and users of financial statements facilitate a flexible and wide-ranging exploration of the issues associated with the introduction of a derivatives accounting standard, which provides a useful and informative accompaniment to the analysis of the changes the standard has visited on corporate financial statements.

4.4.3.1 Limitations of the Interview Method

One limitation of the interview as a research method is that it relies heavily on interviewees' recollections of events (Yin, 1994). A second limitation is one that applies to most interview-based studies, namely that it does not permit any systematic generalisations. The interview method tends to produce non-standard responses (Denscombe, 1998). The impact of the interviewer and of the context means that consistency and objectivity are hard to achieve. The data collected are, to an extent, unique owing to the specific context and the specific individuals involved. This has an adverse effect on reliability (Taylor and Bogdan, 1984; Denscombe, 1998). There are also problems of bias (Yin, 1994), whereby the data is based on what people say they do, rather than on what they do (Taylor and Bogdan, 1984; Denscombe, 1998), as well as the difficulties posed by poor or inaccurate articulation (Yin, 1994). Interviewees may not want to appear lacking in knowledge or awareness and thus

may elaborate on perspectives which they believe the researcher might perceive they might have which could lead to self-serving responses. However, the technical nature of the present interviews and the choice of interviewees for the current study make that less likely in the present research. Finally, analysis of interview data can be difficult and time consuming. The transcribing of interview data is a major task that occurs after the data have been collected (Patton, 1990; Denscombe, 1998). Further details of the use of interviews in the current study will be outlined in Chapter 6 and Chapter 7. Many of the specific limitations and their avoidance will be illustrated in those chapters.

4.5 Conclusion

This chapter has considered the philosophical assumptions, the research methodology and the methods underpinning the present research. General core philosophical assumptions were outlined employing the Burrell and Morgan (1979) framework. The research objectives of the present study were identified and the researchers philosophical assumptions were stated. This led to a discussion of appropriate qualitative research methods. The content analysis and interview research techniques were outlined. Chapters 5, 6 and 7 will outline the empirical stands of the research. The methods outlined in this chapter will be considered in greater detail and limitations in light of the particular issues under investigation in the current research will be discussed.

Chapter 5

A Content Analysis of FRS 13 Disclosures

Chapter 5 – A Content Analysis of FRS 13 Disclosures

5.1 Introduction

Chapter 2 detailed the extant literature relating to the usage of derivative financial instruments and the role for accounting standards in the regulation of these products. Chapter 3 presented the theoretical underpinning of the present study, namely the role of corporate governance and accountability. Chapter 4 outlined the methodology and methods to be used in the present analysis. This chapter examines the impact of FRS 13 on the financial statements of UK quoted companies. In particular content analysis is used to investigate: (i) UK companies' reporting on derivatives in their annual financial statements prior to the introduction of FRS 13; and (ii) changes in UK companies' reporting practices for derivative instruments since the standard was mandated. The study conducts this analysis for the total level of disclosure, as well as for different categories of disclosure. In addition, the analysis is performed for a wide variety of firms, such that the findings should not be specific to any one type of company.

The chapter therefore assesses whether the introduction of FRS 13 has had a material effect on the quantity of information about derivative usage included in financial statements; such an assessment is important as the main aim of the standard was disclosure. In addition, the present analysis helps to see where companies have responded to the standard in terms of the category of information for which disclosure has increased. Also, the results of this chapter should supply a picture about which companies have increased their disclosure most in response to the standard being adopted.

The remainder of the chapter is organised as follows. Section 5.2 outlines the data and method of analysis utilised in the present study. Section 5.3 reports the findings of the content analysis survey. Finally, some conclusions are offered in Section 5.4.

5.2 Data and Analysis

Content analysis has been used in numerous accounting and finance research studies (see Section 4.4.2.3). Many of these studies have investigated instances of social and environmental related disclosures. The present analysis draws on this work; it is based on the instrument developed by Gray et al. (1995b) to examine Corporate Social Reporting (CSR) practices in UK companies. Whatever the subject of the investigation, there are a number of essential stages in any content analysis (Section 4.4.2.1). Choices have to be made and the next few sub-sections outline the reasoning behind the decisions taken when employing content analysis in this thesis.

5.2.1 Sample Choice and Sampling Unit

Financial companies were excluded from the analysis, as FRS 13 has a separate application for these companies[110]. The annual reports of the remaining 78 FTSE 100 companies were therefore chosen to represent the largest non-financial companies in the UK[111]. Five of these large companies had to be excluded from the analysis because of difficulties in obtaining their annual reports, resulting in a final sample of

[110] The disclosures required by FRS 13 depend on the type of reporting entity involved. The FRS distinguishes three types of reporting entity: Part A deals with reporting entities other than financial institutions, while Part B is applicable to banks and similar institutions. Part C is suitable for other financial institutions. Insurance companies are excluded from the scope of FRS 13. This was to allow the ASB to consider the disclosures to be provided by insurance companies in the context of developments in insurance company accounting generally.

[111] The sample is based on the FT ranking available online at www.ft.com. This listing is based on the market capitalisation of companies.

73 FTSE 100 companies. One hundred randomly chosen FTSE Other[112] non-financial companies were selected to represent a sample of UK medium-sized companies[113]. In addition, 37 randomly chosen non-financial Alternative Investment Market (AIM) listed companies' annual reports were scrutinised in order to provide some indication about reporting by smaller companies[114]. This process resulted in a final sample of 210 companies[115].

Pre-samples are employed in content analysis to develop the set of categories to be used in the analysis of the main sample (Krippendorff, 1980). These samples should ideally come from the same population as the main sample. However, as all the FTSE 100 non-financial companies' whose annual reports were available were included in the study, it was necessary to look to the companies just outside the FTSE 100, but not included in the random FTSE Other sample, as well as an additional sample of FTSE Other and AIM companies. This pre-sample was used to develop the categorisation to be used in the content analysis.

In any content analysis, decisions have to be made regarding the units of analysis to be used for the observation and collection of the data (Krippendorff, 1980; Gray et al., 1995b; Unerman, 2000). The annual report was used as the sampling unit for the present content analysis, primarily because FRS 13 is aimed at disclosures in the financial statements (ASB, 1998). Further, the annual report is viewed as the main form of corporate communication (Gray et al., 1995a; 1995b; Adams and Harte, 1998). Therefore, these documents may have a strong influence on perceptions of the

[112] The FTSE Other companies refer to a sample of all companies listed on the main market but not included in the FTSE 100 list.
[113] These companies were chosen by means of a random number sequence generated from Excel.
[114] Again, these companies were chosen by means of a random number sequence generated from Excel.
[115] Further details for the 210 sample companies are provided in Appendix 5.1

organisation (Hines, 1991). Tilt (1994) claimed that corporate annual reports afforded a high degree of credibility to the information reported within them. Therefore, the first annual report produced after the introduction of the standard, plus the last report issued before the standard, for each company, were used for the analysis[116, 117]. The proportion of a page devoted to FRS 13 disclosure was used as the unit of analysis. However, as the total number of pages of the annual report were also noted, the percentage of the total annual report was also calculated. A clear standard A4 acetate grid[118], divided into one hundred boxes, was placed over the text to be analysed and the number of boxes containing FRS 13-related text was recorded manually on the record sheet.

5.2.2 Proportion of a Page as Coding Unit

The coding unit (also called the enumeration unit) determines how content is measured or defined (Kassarjian, 1977; Krippendorff, 1980; Unerman, 2000); in other words how the data is to be captured and measured. A number of different coding units have been used in previous investigations that have employed content analysis: number of words (Zeghal and Ahmed, 1990; Deegan and Gordon, 1996), number of sentences (Guthrie, 1982), proportion of a page (Guthrie and Parker, 1989, 1990; Gray et al., 1995a, 1995b), percentage of a document (Gray et al., 1995a, 1995b). Gray et al. (1995b) and Milne and Adler (1999) summarised the debate concerning

[116] This allowed me to compare the reports pre- and post-FRS 13 adoption, to evaluate the magnitude and order of the differences in company reporting following the introduction of the standard. It is recognised that the use of the year leading up to and the year immediately following the introduction of FRS 13 does not take into account early adopters of the standard. This is a limitation of the current analysis. The present work could be extended by looking at early adopters of the standard for a few years prior to the implementation of the standard.
[117] UK annual reports were used in the analysis. Companies with an additional US listing were included in the analysis if their financial statements were in compliance with UK GAAP. These companies typically produced a reconciliation statement with US GAAP. Further, the US Standard (FAS 133) did not become mandatory until June 2000, which was after the time period covered in the present analysis.
[118] A standard A4 margin was used in the template.

the most suitable coding unit for content analysis; they concluded that the proportion of a page devoted to a particular topic was the preferred coding unit, as this measurement reflected the amount of space given to the issue and, by inference, the importance of that issue to the preparer of the document. This coding unit was therefore employed in the current dissertation[119]. It is recognised that there are difficulties associated with the use of proportion of a page as the coding unit: font size, margins, the use of graphics and partially blank pages (Tilt, 1997). However, the use of this measure takes into account information presented in tabular and graphic formats, which accounts for much of the FRS 13 information; it would be difficult to take account of such information if one chose to adopt words or sentences as potential coding units. Further, if the volume of disclosures is deemed to be an indication of the importance of a particular subject (Krippendorff, 1980; Gray et al., 1995b; Unerman, 2000), then it would seem inappropriate to exclude information presented in a form other than words and numbers.

5.2.3 Categories of Disclosure

In any content analysis, a precise classification and definition of disclosure categories is required (Kassarjian, 1977; Krippendorff, 1980). The development of explicit decision rules relating to each category is necessary in order to ensure mutually exclusive, exhaustive and independent categorisation of all derivatives related disclosures (Krippendorff, 1980; Gray et al., 1995a; 1995b; Unerman, 2000). The categorisations need to possess "shared meanings" (Gray et al., 1995b, p. 85) and the data collection and analysis must be capable of replication, in order to satisfy

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[119] Information relating to the number of pages in each annual report was also noted. This information enabled a relative measure - the percentage of the annual report devoted to FRS 13 disclosure – to be used also.

Krippendorff's criterion for reliability. For these reasons, the definitions utilised with the FRS 13 accounting standard were employed. FRS 13 classifies the required disclosures into 11 categorisations. These categories were chosen as the basic structure for the content analysis, because it was thought that companies would be most likely to use this structure for their reporting practice. In addition, the categories were 'externally determined' by the ASB and should thus provide an objective basis for the analysis. One categorisation used in the standard "Disclosures about financial assets and financial liabilities held or issued for trading" was excluded from the content analysis, because this categorisation was more likely to be relevant for financial companies that had been omitted from the present study. This selection procedure resulted in 10 categories: Objectives, Policies & Strategies; Interest Rate Risk; Currency Risk; Liquidity Risk; Fair Values; Financial Instruments for which Hedge Accounting is Used; Certain Commodity Contracts; Market Price Risk; Accounting Policies; and General Other. Further breakdown of the items to be included under the 10 broad category headings mentioned in the standard was determined partly by the classifications included within the standard and partly through an iterative process facilitated by the pilot analysis. The resulting detailed decision rules are presented in Appendix 5.2. Examples of typical disclosures provided under FRS 13 are provided in Appendix 5.3.

A further classification was undertaken based on the type of disclosure provided by the companies. The first additional classification concerned the nature of such disclosures – narrative or numerical - as this division was employed in the standard. The second concerned whether the disclosures were 'auditable'; if given access to the organisation, would it be possible for an external party to confirm the statements. This

classification had been used in previous content analysis studies (Gray et al., 1995a; 1995b). Third, a 'news' categorisation was initially used to classify the reported information into 'good' 'bad' and 'neutral' data types. However, as the vast majority of the information reported was in compliance with the standard and fairly uniform in terms of its content, the 'auditable' and 'news' categorisations were considered less relevant and were thus excluded from the subsequent analysis. Fourth, the location of the disclosure within the annual report was noted[120]. A memo field was included to note any additional information or to documents any disclosures of particular note.

5.2.4 FRS 13 Data Coding

During the pre-analysis stage the student and her two supervisors coded the pre-analysis sample of annual reports and differences were noted and reconciled. Some refinement of the decision rules was necessary in light of the disclosures by companies in the pre-analysis sample. Such adjustments were needed to categorise disclosures where an overlap of categories was found, or to clarify coders' decisions. When agreement between coders was above 90 per cent, the main content analysis began[121, 122].

All of the 420 (210 pre- and post-FRS 13) annual reports were then coded according to the detailed decision rules devised in the pre-analysis stage. A clear acetate template divided into one hundredths of a page (25 rows of equal height and 4

[120] For the purposed of determining location, the following categorisations were used: Chairman's Statement (CS), the Operating and Financial Review or equivalent (OFR), the Corporate Governance statements (CG), the Directors Report (DR), the Financial Statements (FS), Notes to the Accounts (NAC) and Other (O). This information was not utilised within the present study because no significant differences arose from the analysis.
[121] This agreement was calculated on the basis of agreement across the 70 or so categories identified in the decision rules presented in Appendix 5.2.
[122] Kassarjian (1977) advocated that intercoder reliability of less than 80 per cent should be treated with suspicion.

columns of equal width) was used to measure disclosure amounts (Appendix 5.4). The volume was recorded as the number of cells on the grid taken up by the relevant disclosure with any blank sections of a page being counted as part of the communication[123]. For each annual report, the amount of disclosure devoted to all categories detailed in the decision rules was noted on the specially-designed record sheet (Appendix 5.5). The contents of the record sheets were then transferred to an Excel spreadsheet in order to permit subsequent analysis and to facilitate statistical manipulation. This statistical analysis was conducted using Minitab and SPSS. Some background data concerning market listing and industry sectors on all the companies included in the content analysis was collected in order to test for relationships between this information and the amount of FRS 13 related disclosures[124].

5.3 Results

This section reports on the results of the content analysis of FRS 13 related disclosures contained in corporate annual reports. Results for the entire sample are reported, followed by a breakdown of the results based on market type and industry sector. Finally, the results of an Analysis of Variance which was conducted in order to determine which factors might explain the increase in derivatives disclosure post-FRS 13 implementation are reported.

5.3.1 Results for the Total Sample

[123] This was in accordance with Gray et al. (1995b) who argued that blank parts of a page were chosen as part of design layout and were thus part of the communicative process. Further, additional non-related information could have been included in the blank space, but such choices were not exercised.
[124] This information was collected from FTSE and Datastream sources.

Table 5.1: Total Sample - Number of Pages of FRS 13 Disclosure

Panel A – Means and Standard Deviations

Type of Disclosure	Pre FRS 13		Post FRS 13		Difference in Means	P-Value
	Mean	SD	Mean	SD		
Objectives, Policies & Strategies	0.4530	0.5975	0.7870	0.6546	0.3340	0.0000
Interest Rate Risk	0.2584	0.4563	0.6182	0.5511	0.3598	0.0000
Currency Risk	0.0955	0.1987	0.2466	0.2741	0.1510	0.0000
Liquidity Risk	0.3358	0.3305	0.5093	0.3951	0.1735	0.0000
Fair Values	0.1120	0.2465	0.2911	0.3082	0.1791	0.0000
Hedge Accounting Used	0.0549	0.1110	0.2071	0.2836	0.1523	0.0000
Certain Commodity Contracts	0.0176	0.1114	0.0176	0.1114	0.0000	1.0000
Market Price Risk	0.0180	0.1184	0.0210	0.1314	0.0030	0.4780
Accounting Policies	0.1209	0.2337	0.2576	0.3666	0.1367	0.0000
General Other	0.0047	0.0385	0.0118	0.0887	0.0071	0.1520
TOTAL	1.4710	1.7080	2.9700	2.1680	1.4990	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.2200	0.6600	0.4400	0.0000
Interest Rate Risk	0.0800	0.5200	0.4400	0.0000
Currency Risk	0.0000	0.1800	0.1800	0.0000
Liquidity Risk	0.2400	0.4400	0.2000	0.0000
Fair Values	0.0000	0.2400	0.2400	0.0000
Hedge Accounting Used	0.0400	0.0400	0.0000	0.0000
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.9305
Accounting Policies	0.0400	0.1700	0.1300	0.0000
General Other	0.0000	0.0000	0.0000	0.5573
TOTAL	0.7600	2.5600	1.8000	0.0000

Table 5.2: Total Sample – Percentage of Annual Report

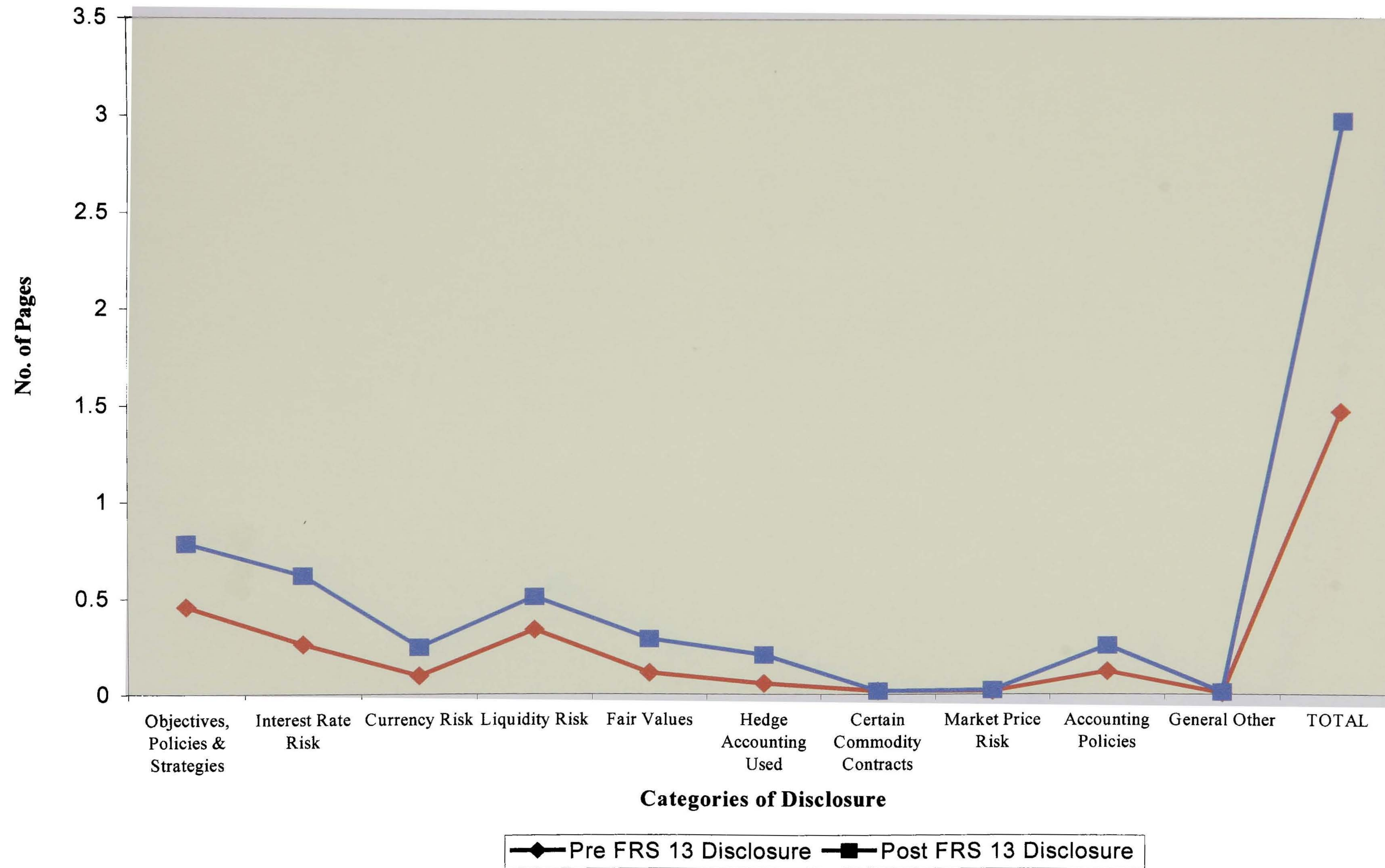
Panel A – Means and Standard Deviations

Type of Disclosure	Pre FRS 13 (%)		Post FRS 13 (%)		Difference in Means	P-Value
	Mean	SD	Mean	SD		
Objectives, Policies & Strategies	0.6110	0.6945	1.1930	0.7834	0.5821	0.0000
Interest Rate Risk	0.3631	0.5616	0.9193	0.7166	0.5562	0.0000
Currency Risk	0.1241	0.2483	0.3902	0.4462	0.2661	0.0000
Liquidity Risk	0.5962	0.5645	0.8470	0.6396	0.2509	0.0000
Fair Values	0.1293	0.2701	0.4157	0.4372	0.2864	0.0000
Hedge Accounting Used	0.0846	0.1564	0.2825	0.3506	0.1979	0.0000
Certain Commodity Contracts	0.0222	0.1403	0.0232	0.1533	0.0010	0.5190
Market Price Risk	0.0180	0.1068	0.0199	0.1047	0.0019	0.6940
Accounting Policies	0.1703	0.2590	0.3698	0.3685	0.1994	0.0000
General Other	0.0052	0.0428	0.0143	0.1018	0.0091	0.1150
TOTAL	2.1240	1.8440	4.4790	2.2790	2.3550	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.4316	1.1528	0.7212	0.0000
Interest Rate Risk	0.1524	0.8904	0.7380	0.0000
Currency Risk	0.0000	0.2500	0.2500	0.0000
Liquidity Risk	0.4795	0.7071	0.2276	0.0000
Fair Values	0.0000	0.3636	0.3636	0.0000
Hedge Accounting Used	0.0571	0.1250	0.0679	0.0000
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.9305
Accounting Policies	0.1081	0.3092	0.2011	0.0000
General Other	0.0000	0.0000	0.0000	0.5549
TOTAL	1.6182	4.5670	2.4628	0.0000

Figure 5.1: Total Sample - Mean Number of pages of FRS 13 Disclosure



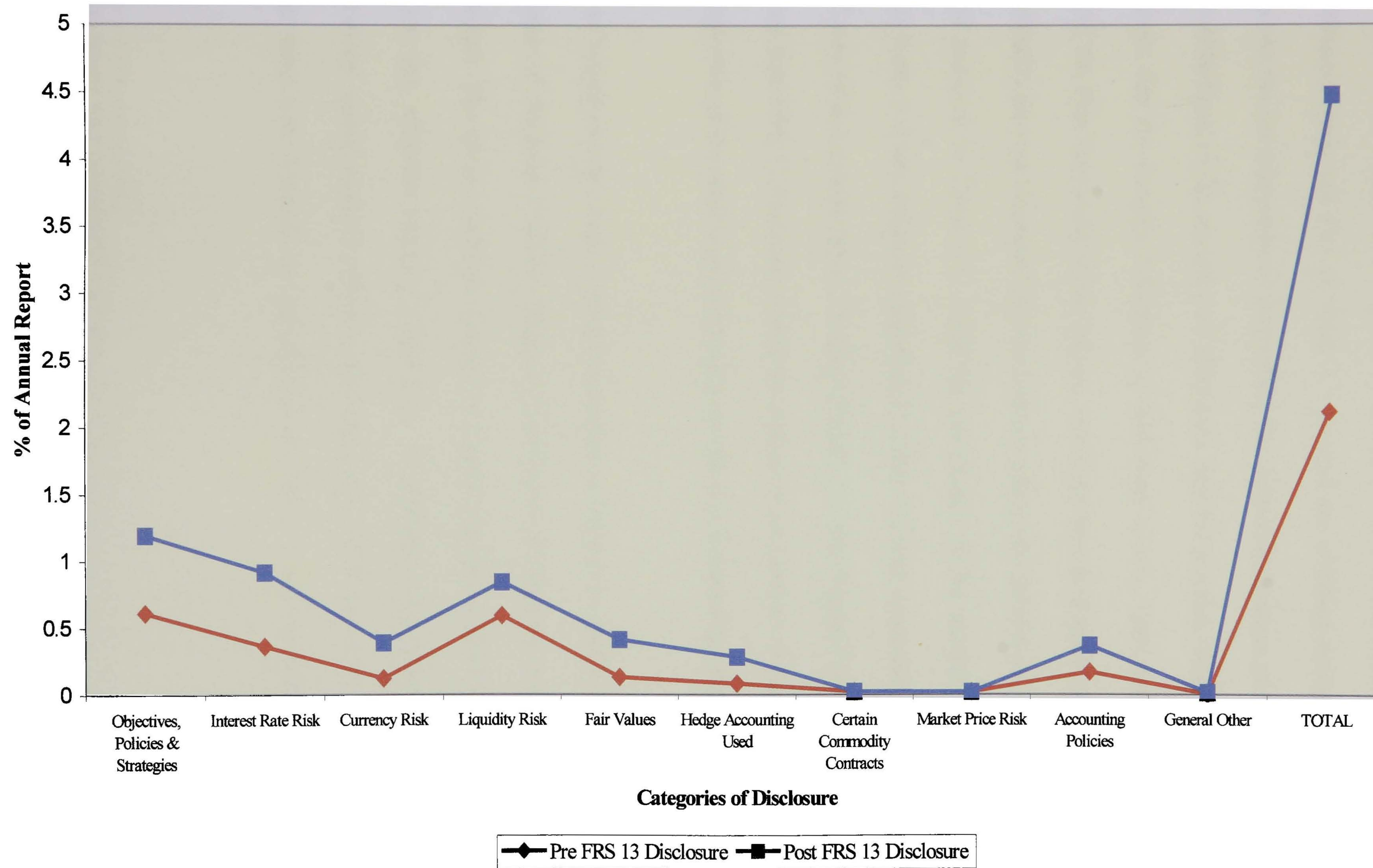


Figure 5.2: Total Sample - Mean Percentage of Annual Report
% of Annual Report
5
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
Objectives, Policies & Strategies
Interest Rate Risk
Currency Risk
Liquidity Risk
Fair Values
Hedge Accounting Used
Certain Commodity Contracts
Market Price Risk
Accounting Policies
General Other
TOTAL
Categories of Disclosure
Pre FRS 13 Disclosure
Post FRS 13 Disclosure

Columns two and four of Table 5.1 and columns two and three of Table 5.2 show the mean disclosure for 10 different categories both before and after the introduction of FRS 13. Columns three and five of Table 5.1 present the standard deviations from these means for the ten categories of disclosure. The final two columns of both tables display the difference in the quantity of disclosure and the p-value, which tests the null hypothesis that the average difference in disclosure is zero. Each table has two panels where the first shows the mean values, while the second displays the median figures[125]. Disclosure was measured in two different ways: the number of pages were counted and reported in Table 5.1, while the percentage of the annual report was employed in Table 5.2; the disclosure numbers in Table 5.2 were expressed relative to the overall size of the annual report. Further, Figure 5.1 and Figure 5.2 display the mean pre and post FRS 13 disclosure levels by means of the number of pages and the relative proportion of the annual report concerned with this information respectively.

A number of points emerge from a visual inspection of Tables 5.1 and 5.2. First, the actual volume of disclosure on the usage of derivatives in financial statements is relatively small. The mean (median) number of pages was only 1.4710 (0.7600) in 1998, before the standard became mandatory. In addition, the mean (median) percentage of the annual report devoted to this topic was 2.1240 per cent (1.6182 per cent) in the same year. Second, the introduction of FRS 13 was associated with an

[125] The median figures were calculated in addition to the means because of evidence of non-normality in the disclosure data. Specifically, Anderson-Darling statistics of 14.310, 6.370, 3.395 and 0.751 were obtained when testing the normality of pre-disclosure number of pages, pre-disclosure percentage of annual report, post-disclosure number of pages and post-disclosure percentage of annual report respectively. In each case the null hypothesis of a normal distribution was rejected at the 5% level.

increase in the total disclosure of risk-related information[126, 127]. The total number of pages devoted to such information doubled from a mean of 1.4710 to a mean of 2.9700. The average difference of 1.4990 was significant at the 5 per cent level since the p-value was less than 0.05. Thus, one of the aims of the standard setters seems to have been achieved as users of annual reports were supplied with more information about companies usage of derivative products.

Third, this increase in the total disclosure was spread across all ten sub-categories. However, the size of the increase varied from one category to another. The increase was largest for the 'Objectives, Policies & Strategies' and 'Interest Rate Risk' categories (0.3340 and 0.3598 respectively) and smallest for the 'Certain Commodity Contracts' and the 'Market Price Risk' categories (0.0000 and 0.0030 respectively). Fourth, for seven of the ten sub-categories the level of disclosure was greatly enhanced after the standard became mandatory; these seven sub-categories have differences in the mean number of pages of disclosures with p-values of less than 0.05. The exceptions to this generalisation are 'Certain Commodity Contracts', 'Market Price Risk' and 'General Other', where the null hypothesis that the mean difference was equal to zero could not be rejected at the 5 per cent level. Interestingly, these three categories have the lowest levels of disclosure across the different groupings. This trend is easily identifiable in Figure 5.1 and in Figure 5.2.

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[126] This was also true at the individual company level where only 20 of the sample companies experienced a decrease in absolute disclosure following the introduction of FRS 13. The average reduction in FRS 13 disclosure for these 20 companies was found to be 0.40 of a page (Appendix 5.6). The company with the biggest reduction in derivatives related disclosure was Cadbury Schweppes who devoted 11.08 pages to the topic in their 1998 annual report, while in 1999 this disclosure was reduced to 8.80 pages. From Appendix 5.7, we can see that 1.30 of this reduction was attributable to a decrease in the amount of space devoted to Interest Rate Risk information, while 0.50 related to a reduction in the amount of Currency Risk information provided.

[127] Disclosure was also divided into narrative and numerical information as per the FRS 13 standard. This breakdown is provided for all companies post FRS 13 implementation in Appendix 5.8.

Fifth, the median results in Panel B of Table 5.1 confirm the mean findings of Panel A. Although, the median total disclosure before FRS 13 was only about 50 per cent of the mean figure, the post-FRS 13 numbers were more similar[128]. Again, the p-values for the Mann-Whitney test that the median differences were zero could be rejected for seven of the ten sub-categories. This finding suggests that there was a good deal of variability in disclosure across companies before the standard, with the mean value being pulled up by a few companies which published relatively large quantities of information about derivatives usage. For example, before the standard, some companies were big disclosers (Cadbury Schweppes with 11.08 pages and ICI with 7.62 pages)[129]. In fact these two companies accounted for 6 per cent of all derivatives-related information published for the sample firms prior to the introduction of FRS 13. After the standard, this variability in disclosure may have been reduced since the mean and median figures are fairly similar. For example, the two companies with the largest mean number of pages, following the introduction of the standard, were EMAP and BHP Billiton, who had 9.68 and 9.30 pages devoted to FRS 13 related disclosure respectively. Sixth, the analysis in Table 5.2 supports the investigation findings in Table 5.1. Therefore, irrespective of whether disclosure is measured in

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[128] This result suggests that the level of disclosure before FRS 13 was skewed because of a small number of high disclosers, resulting in a sizeable gap between the mean and median figures. After the adoption of FRS 13 however, publication of information about derivatives seems to have been more uniform with the two summary measures yielding similar numbers.

[129] See Appendix 5.9 for details of the total disclosure for all sample companies before and after the introduction of FRS 13.

absolute terms (using the number of pages) or in relative terms (as a percentage of the annual report) the impact of FRS 13 was both sizeable and statistically significant.

5.3.2 Analysis by Market Type

Table 5.3: Number of Pages of FRS 13 Disclosure – Analysis by Market Type

Panel A – Means

Type of Disclosure	FTSE 100				FTSE Other				AIM			
	Pre FRS 13	Post FRS 13	Difference	P-Value	Pre FRS 13	Post FRS 13	Difference	P-Value	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.9958	1.3411	0.3453	0.0000	0.2187	0.5874	0.3687	0.0000	0.0151	0.2330	0.2179	0.0000
Interest Rate Risk	0.5559	1.0392	0.4833	0.0000	0.1226	0.4518	0.3292	0.0000	0.0384	0.2373	0.1989	0.0000
Currency Risk	0.2052	0.3334	0.1282	0.0000	0.0506	0.2356	0.1850	0.0000	0.0005	0.1049	0.1044	0.0008
Liquidity Risk	0.4688	0.7181	0.2493	0.0000	0.2834	0.4320	0.1486	0.0000	0.2151	0.3065	0.0914	0.0110
Fair Values	0.2833	0.5510	0.2677	0.0000	0.0284	0.1874	0.1590	0.0000	0.0000	0.0589	0.0589	0.0020
Hedge Accounting Used	0.0975	0.4099	0.3124	0.0000	0.0396	0.1286	0.0890	0.0000	0.0119	0.0194	0.0075	0.2550
Certain Commodity Contracts	0.0507	0.0605	0.0098	0.4510	0.0000	0.0000	0.0000	1.0000	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0479	0.0542	0.0063	0.6080	0.0028	0.0046	0.0018	0.2090	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.2581	0.4805	0.2224	0.0000	0.0528	0.1595	0.1067	0.0000	0.0341	0.0827	0.0486	0.0010
General Other	0.0137	0.0301	0.0164	0.2430	0.0000	0.0028	0.0028	0.0700	0.0000	0.0000	0.0000	1.0000
TOTAL	2.9770	5.0160	2.0390	0.0000	0.7990	2.1900	1.3910	0.0000	0.3150	1.0430	0.7280	0.0000

Panel B – Medians

Type of Disclosure	FTSE 100				FTSE Other				AIM			
	Pre FRS 13	Post FRS 13	Difference	P-Value	Pre FRS 13	Post FRS 13	Difference	P-Value	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.8400	1.1400	0.3000	0.0004	0.0800	0.5000	0.4200	0.0000	0.0000	0.1600	0.1600	0.0000
Interest Rate Risk	0.4400	1.0000	0.5600	0.0000	0.0400	0.4000	0.3600	0.0000	0.0400	0.0800	0.0400	0.0016
Currency Risk	0.1200	0.2800	0.1600	0.0013	0.0000	0.2000	0.2000	0.0000	0.0000	0.0000	0.0000	0.0007
Liquidity Risk	0.4000	0.7000	0.3000	0.0001	0.2400	0.3600	0.1200	0.0005	0.1200	0.1600	0.0400	0.1781
Fair Values	0.2000	0.5200	0.3200	0.0000	0.0000	0.0800	0.0800	0.0000	0.0000	0.0000	0.0000	1.0000
Hedge Accounting Used	0.0400	0.3200	0.2800	0.0000	0.0400	0.0400	0.0000	0.0002	0.0000	0.0000	0.0000	0.7520
Certain Commodity Contracts	0.0000	0.0000	0.0000	0.7692	0.0000	0.0000	0.0000	1.0000	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.8152	0.0000	0.0000	0.0000	0.4225	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1600	0.4000	0.2400	0.0000	0.0400	0.1200	0.0800	0.0000	0.0400	0.0400	0.0000	0.0115
General Other	0.0000	0.0000	0.0000	0.3834	0.0000	0.0000	0.0000	1.0000	0.0000	0.0000	0.0000	1.0000
TOTAL	2.6400	4.7800	2.0400	0.0000	0.4800	1.9700	1.4900	0.0000	0.2000	0.7600	0.5600	0.0000

Note: This table presents the disclosures in all 10 disclosure categories for the FTSE 100, FTSE Other and AIM companies respectively, before and after the introduction of FRS 13.

The sample was divided by market listing to discover whether there was any pattern in terms of the amount of disclosure in particular markets. Table 5.3 shows the disclosures in all 10 categories for the FTSE 100, FTSE Other and AIM companies respectively, before and after the introduction of FRS 13. Columns two and three within each box again provide the disclosure pre- and post-FRS 13 implementation. The fourth column for each box shows the difference in the quantity of disclosure, while the final column highlights the p-value, which tests the null hypothesis that the average difference in disclosure is zero. As with Tables 5.1 and 5.2, this table has two panels, where Panel A displays the mean values, while Panel B shows the median figures. Disclosure as measured by the number of pages is included here[130].

First, it seems that the introduction of FRS 13 was associated with an increase in the volume of derivatives-related disclosure across all markets. The number of pages devoted to FRS 13 related information rose from a mean (median) of 2.9770 (2.6400) to 5.0160 (4.7800) for FTSE 100 listed companies. For FTSE Other companies the number of pages increased from a mean (median) of 0.79990 (0.4800) to 2.1900 (1.9700). This same pattern was noticeable for AIM listed companies where the mean (median) rose from 0.3150 (0.2000) to 1.0430 (0.7600). Second, the total mean and median disclosure pre- and post- the implementation of FRS 13 was larger for FTSE 100 companies than for either FTSE Other or AIM listed companies. This is not surprising as the extant literature indicates that larger companies are more inclined to use complex derivatives, which would require additional disclosure (Berkman and Bradbury, 1996; Dunne et al., forthcoming).

[130] Disclosure as measured by the percentage of the total annual report is available in Appendix 5.10. An analysis of the data in this appendix revealed no differences with the information contained in Table 5.3.

Third, in line with the results presented for the total sample, the increase in disclosure for the different markets was spread across all ten sub-categories. This increase was most pronounced for the 'Objectives, Policies & Strategies', 'Interest Rate Risk' 'Hedge Accounting Used' sub-categories for FTSE 100 companies. For FTSE Other and AIM companies again the 'Objectives, Policies & Strategies' and the 'Interest Rate Risk' reflected the largest increases in disclosure pre- and post-FRS 13 implementation, while the 'Hedge Accounting Used' subcategory reflected a much less pronounced increase in disclosure. Fourth, the mean and median results reported in Panels A and B respectively both offer similar results which indicate that the average findings for the data are not unduly influenced by a sizeable disclosure for any one company. Finally, a similar breakdown by market type was conducted using the percentage of annual report devoted to FRS 13 disclosures (Appendix 5.9). This analysis confirms that irrespective of whether disclosure is measured in absolute terms (using the number of pages) or in relative terms (as a percentage of the total annual report), the impact of FRS 13 appears to be pronounced.

5.3.3 Analysis by Sector

A sectoral analysis was conducted to ascertain if there was a preponderance of large (or small) disclosers in particular sectors. The analysis by industries also facilitated a test of whether disclosure changes were more pronounced in some sectors rather than others.

Table 5.4: Total Disclosure by Sector - Number of Pages of FRS 13 Disclosure

Panel A - Means

Sector	Number of Companies	Pre FRS 13	Post FRS 13	Difference	P-Value
Basic Industries	20	1.8580	2.7870	0.9290	0.0010
Cyclical Consumer Goods	11	0.6000	2.4220	1.8220	0.0001
Cyclical Services	80	1.1990	2.6840	1.4850	0.0000
General Industrials	21	1.2900	2.9020	1.6120	0.0000
Information Technology	18	0.4930	1.4840	0.9920	0.0000
Non-Cyclical Consumer Goods	25	2.4880	3.7390	1.2510	0.0000
Non-Cyclical Services	10	2.2540	4.6580	2.4040	0.0010
Resources	12	1.9460	3.8020	1.8560	0.0120
Utilities	13	1.9340	4.1010	2.1670	0.0000

Panel B - Medians

Sector	Number of Companies	Pre FRS 13	Post FRS 13	Difference	P-Value
Basic Industries	20	1.0200	2.5100	1.4900	0.0961
Cyclical Consumer Goods	11	0.4400	2.1200	1.6800	0.0006
Cyclical Services	80	0.5600	2.4100	1.8500	0.0000
General Industrials	21	0.7000	2.8600	2.1600	0.0011
Information Technology	18	0.4200	1.5200	1.1000	0.0010
Non-Cyclical Consumer Goods	25	1.6400	3.3200	1.6800	0.0388
Non-Cyclical Services	10	2.2800	4.7100	2.1000	0.0091
Resources	12	0.7000	2.6500	1.9500	0.2364
Utilities	13	1.7600	4.2600	2.5000	0.0003

Note: This table shows the total disclosure for companies in the nine FTSE sector classification before and after the introduction of FRS 13.

Table 5.4 displays the total disclosure for companies in nine FTSE 'economic groups' before and after the introduction of FRS 13[131]. Column two indicates the number of companies from each sector included in the content analysis sample. Columns three and four again provide the disclosure pre- and post-FRS 13's implementation. The fifth column shows the difference in the quantity of disclosure, while the final column

[131] There are 10 'economic groups' in the FTSE Global Classification System. They comprise: (i) Resources (including Mining, Oil and Gas companies); (ii) Basic Industries (including Chemicals, Construction and Building Materials, Forestry and Paper, Steel and Other Materials companies); (iii) General Industrials (including Aerospace and Defence, Diversified Industrials, Electronic and Electrical Equipment, Engineering and Machinery companies); (iv) Cyclical Consumer Goods (including Automobiles and Parts, Household Goods and Textiles companies); (v) Non-Cyclical Consumer Goods (including Beverages, Food Producers and Processors, Health, Personal Care and Household Products, Pharmaceuticals and Biotechnology, Tobacco companies); (vi) Cyclical Services (including General Retailers, Leisure, Entertainment and Hotels, Media and Photography, Support Services and Transport companies); (vii) Non-Cyclical Services (including Food and Drug Retailers, Telecommunication Services); (viii) Utilities (including Electricity, Gas Distribution and Water companies); (ix) Financials (including Banks, Insurance, Life Assurance, Investment Companies, Real Estate, Speciality and Other Finance companies); and (x) Information Technology (including Information Technology Hardware, Software and Computer Services). Companies from the ninth category, Financials, were excluded from this analysis because of the differing requirements of FRS 13 for these companies.

highlights the p-value, which tests the null hypothesis that the average difference in disclosure is zero. This table has two panels, where Panel A displays the mean values, while Panel B shows the median figures[132].

A visual inspection of Table 5.4 reveals that the introduction of FRS 13 was associated with an increase in the volume of FRS 13-related disclosure across all sectors. The number of pages devoted to FRS 13 related information rose from a mean (median) of 2.2540 (2.2800) to 4.6580 (4.7100) for companies in the Non-Cyclical Services sector (which includes Food and Drug retailers such as Tesco plc and Telecommunication Services such as Vodafone Group plc and so on). A similar pattern was noticeable for General Industrial companies (which comprises companies such as BAE Systems plc and Associated Engineering plc) and Utility firms (such as Scottish Power plc and Thames Water plc) where the mean (median) difference was 1.612 (2.160) and 2.167 (2.500) respectively. At the other end of the spectrum, companies from the Basic Industries sector (which comprises Chemical companies such as ICI plc, and Steel companies such as Corus Group plc) had the smallest increase in total disclosure in absolute terms, as measured by the mean pre- and post-FRS 13 implementation, only rising by 0.9290.

A study of the mean differences indicates that all were significant since the p-values were less than 0.0500 in each instance. An analysis of the median figures however, suggests that the changes for the Resources sector (which includes Mining companies such as Lonmin plc and Oil and Gas companies such as BG Group plc) and Basic Industries sectors may not have been significant. With both of these sectors, the

[132] Disclosure as measured by the number of pages is included here, while disclosure as measured by the percentage of the total annual report can be found in Appendix 5.11.

typical company would have been using large quantities of derivatives before the introduction of the standard and publishing information about this usage in advance of such disclosures becoming mandatory. While, the mean difference may have been influenced by a small number of firms changing their disclosure patterns, the median figures are not affected by such 'outlier' observations. Finally, a similar breakdown by sector was conducted using the percentage of annual report devoted to FRS 13 disclosures (Appendix 5.11). This analysis confirms that irrespective of whether disclosure is measured in absolute terms (using the number of pages) or in relative terms (as a percentage of the total annual report), the impact of FRS 13 appears to be pronounced.

5.3.4 ANOVA Results

An Analysis of Variance was conducted in order to determine which factors might explain the increase in derivatives disclosure post-FRS 13 implementation.

$$\text{Difference}_{ijk} = \alpha_{ijk} + \beta_{ij} (\text{SECTOR}_{ij}) + \delta_{ik} (\text{MARKET}_{ik}) \qquad [5.1]$$

where Difference_{ijk} is the difference in the number of pages of disclosure on derivatives usage for company i in sector j (SECTOR_j) whose shares are traded on market k (MARKET_k). The results of this exercise are presented in Table 5.5.

Table 5.5: Analysis of Variance Results

Dependent Variable	Sector		Market Type		R-Sq
	F-Ratio	P-Value	F-Ratio	P-Value	
Objectives, Policies & Strategies	1.48	0.165	2.00	0.138	0.069
Interest Rate Risk	0.63	0.750	4.58	0.011	0.074
Currency Risk	2.67	0.008	2.04	0.132	0.112
Liquidity Risk	0.86	0.552	2.68	0.071	0.076
Fair Values	1.75	0.088	8.15	0.000	0.146
Hedge Accounting Used	1.07	0.385	21.34	0.000	0.229
Commodity Contracts	2.36	0.019	0.07	0.928	0.091
Market Price Risk	1.32	0.233	0.07	0.932	0.052
Accounting Policy	1.40	0.199	7.93	0.000	0.147
General Other	1.67	0.108	0.49	0.612	0.072
TOTAL	1.41	0.192	9.79	0.000	0.153

Table 5.5 displays results of the analysis of variance technique. This technique attempts to explain the differences in disclosure pre and post FRS 13 implementation by means of sector or market type. Columns two and four indicate the F-Ratio. Columns three and five highlight the p-value, which tests the null hypothesis that the average difference in disclosure explained by each factor is zero. The final column documents the R-Squared, which measures the goodness of fit of the model.

A number of points emerge from a visual examination of Table 5.5. First, the model explains 15.3 per cent of variability in the difference of *total* disclosure before and after the introduction of FRS 13. However, market type is shown to be the only significant factor with a p-value of 0.000. Second, the R-Squared statistics for the individual categories of disclosure display substantial variability, ranging from 5.2 per cent (for disclosures relating to Market Price Risk) to 22.9 per cent (for disclosures relating to the use of Hedge Accounting techniques). For differences in disclosures about the use of Hedge Accounting techniques therefore, the two variables can explain just under a quarter of the variations in the amount of information published. Third, the sector in which a firm operates is found to be significant in explaining the differences in disclosure for two categories of information (Currency Risk and Certain

Commodity Contracts), whereas market type is significant on four occasions (disclosures relating to Interest Rate Risk, Fair Values, the use of Hedge Accounting and Accounting Policies). One feature of these results is therefore, that sector and market type, successfully explain the variability in mutually exclusive sets of disclosure categories. Finally, total assets, total sales and market capitalisation were also used as explanatory variables in the development of the model, but were excluded as these were found to give similar results to those produced using market type[133]. One implication of this tendency is that market type may act as a proxy for firm size; this in turn may explain why, for example, Interest Rate Risk and the use of Hedge Accounting are strongly influenced by market type.

5.4 Discussion and Limitations

This chapter has examined the FRS 13-related disclosures made by 210 companies before and after the implementation of FRS 13 in March 1999. The results indicate that the implementation of FRS 13 was associated with a relatively large increase in derivatives-related information available in corporate annual reports. This association appears to hold irrespective of whether the actual number of pages of FRS 13-related information disclosed, or the relative measure of the percentage of the annual report containing FRS 13 information are used. The doubling of derivatives related information reported in this study probably understates the true rise in disclosure as several firms increased their derivative information content in the run-up to the implementation of FRS 13. This understatement is recognised as a limitation of the

[133] Specifically, a Principal Components Analysis was applied to the lagged values of the three variables of market value, total assets and total sales for all the companies in the sample and one component with an eigenvalue of 2.8346 explained 94.5 per cent of the variations in the three measures. When this principal component was introduced as a covariate into the General Linear Model outlined in equation [5.1] multicollinearity arose with the parameters for SIZE and MARKET being poorly determined with bigger standard errors leading to large p-values.

present analysis. Not surprisingly, the largest disclosers are FTSE 100 listed companies. The industry grouping with the biggest average disclosure comprised companies from the Non-Cyclical Services. Thus, the implementation of FRS 13 has had a significant impact on the content of annual reports, although the scale of its impact has varied across companies. This additional disclosure may have provided stakeholders with useful information about these companies. If one accepts the argument that the amounts of space devoted to a particular issue was indicative of importance to management (Krippendorff, 1980; Gray et al., 1995b; Milne and Adler, 1999), then the increased disclosures provided by FRS 13 could be viewed as a welcome improvement in the discharging of corporate accountability. The increased financial transparency afforded by the disclosures should advance the cause of overall accountability.

However, it should be noted that the use of content analysis does have some disadvantages. Difficulties associated with content analysis are frequently based on the questions asked and source materials available (Carney, 1971). However, the choice of the annual report as the medium of analysis, adds a degree of comparability across companies, because of the similar layout, design and content of these documents. Choice of categories is often a tricky business in content analysis (Carney, 1971). However, in the present case, this was less of a problem, because the standard was explicit in terms of the categories of disclosure required, and this structure was adopted for the content analysis. It is acknowledged that qualitative assessment is always somewhat subjective, but the reporting of both category and intercoder reliability should provide some measure of comfort to the reader.

Content analysis is frequently accused of being quite susceptible to the effects of researcher biases, which in turn, can affect decisions made in the collection, analysis and interpretation of data; the existence of these biases can affect a study's contribution to knowledge (Kolbe and Burnett, 1991). The presence of appropriate, reliable, valid and accurate coding scheme that guides coders through the analysis of content and the use of multiple coders helped to reduce this bias. In addition, the usage of external categories, which were identified in FRS 13, possibly reduced the impact of this limitation. Therefore, the confidence in the findings that FRS 13 achieved its aim about increasing disclosure of derivative related information is high.

5.5 Conclusion

This chapter has examined the derivatives-related disclosures made by 210 companies before and after the implementation of FRS 13 in March 1999. The results indicate that the implementation of FRS 13 had a significant impact on the content of annual reports, with a doubling of derivatives-related information provided in corporate annual reports following the implementation of the standard. This finding probably understates the true rise in disclosure as several firms increased their derivative information content prior to the introduction of FRS 13. The scale of the impact of the disclosure standard varied across companies, however, larger companies were found to be greater disclosers of derivatives-related information. The increase in financial transparency provided by the FRS 13 disclosures should enhance overall corporate governance and accountability.

Chapter 6 will examine the application of FRS 13 from the perspective of those required to prepare the information necessary under the standard. The attitudes of UK treasury department staff towards the introduction of FRS 13, as well as the impact of the standard on corporate treasury operations will be examined. Chapter 7 will examine the impact of FRS 13 on the users of corporate financial statements. This will be facilitated by means of a series on interviews with large institutional investors in order to ascertain their general attitudes towards treasury management and derivatives usage since the introduction of FRS 13. The implications for corporate governance practices and procedures following the introduction of FRS 13 will also be examined.

Chapter 6

FRS 13: A Treasury Perspective

CHAPTER 6 - FRS 13: A Treasury Perspective

6.1 Introduction

This chapter examines the impact that the implementation of FRS 13 has had on the preparers of annual reports, both in terms of obtaining and formatting data for the Financial Statements, as well as reviewing, in general, the changes that have been required to daily treasury management practices and procedures. In particular an interview survey is used to investigate: (i) the attitudes of UK treasury department staff towards the introduction of FRS 13; (ii) whether the introduction of FRS 13 has had any implications for hedging activities; and (iii) the impact that other accounting standards may have on corporate treasury operations.

6.2 Interview Survey Method

This section outlines the use of in-depth interviews as the second research method employed in this study. In order to assess the impact of FRS 13 on treasury practice, 15 semi-structured interviews were conducted with treasury department staff in large UK companies over a three-month period from May 2001 to July 2001. All of these interviewees were heavily involved in the treasury functions within their respective firms. Two further semi-structured interviews were conducted with company advisors. The decision to interview treasury personnel rather than other company representatives was based on the researcher's perception that these individuals were most affected by the standard. The vast majority of the commentary reported at the time of the standard reflected the fact that treasury personnel were likely to have been most affected by the standard and its implications. They were considered to most likely to have been preparing the information for disclosure. It is acknowledged that

differing perspectives on the implementation of FRS 13 may have been gained by interviewing other corporate representatives. For example, a more strategic overview on the implementation of the standard from a corporate viewpoint may have been gained from interviewing Financial Directors or Chief Executives.

The use of a semi-structured interview technique imposed some formality on the interview proceedings in terms of providing a list of topics to be discussed at all of the interviews in order to ensure consistency and to allow for cross-interview comparisons. The use of the semi-structured technique also provided flexibility in terms of allowing the interviewees to elaborate on points of particular interest.

The interviews generally lasted for between one hour and one hour and thirty minutes. The nature of the research project was outlined at the commencement of the interview and confidentiality was guaranteed. A request to tape the interview in order to enhance the accuracy of the recording of the conversation was made and all but one individual agreed to this. Detailed notes were also taken to provide additional backup to the taped conversations and to note key points and issues which the researcher wished to return to at a later stage (Patton, 1990). These notes were written up immediately together with the researcher's general observations regarding the interview. The 16 tape-recorded interviews were subsequently transcribed[134]. A grid was created in Microsoft Excel to aid in the analysis of the interviews. The question numbers were noted in different columns while the interviewees were listed in different rows. The distilled answer to each question was noted in all the cells for every interviewee. This process facilitated an aggregation of answers in order to

[134] The 17th interview was not recorded so transcribing was not necessary.

assess overall reactions to particular issues. Representative quotations were noted and reported in Section 6.3[135].

The questions used concerned the impact of FRS 13 on treasury department activities both in terms of collating the information necessary to make the required disclosures and the impact on firms' hedging activities. The issues included in the interview were partially shaped by a review of the literature relating to derivatives usage and reporting practices (Chapter 2). Detailed discussions with supervisors and research colleagues also influenced the questions to be asked. The interview itself was divided up into sections covering the following broad themes: data collection, the reporting standard, the impact on treasury practice, FAS 133/138 and IAS 39, and finally the impact of FRS 13 on corporate governance and accountability issues[136].

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[135] Reported quotations came from taped interviews. Although quotations from non-taped interviews were not reported, distilled answers these interviews were also included in the analysis.
[136] Appendix 6.1 provides a list of the questions asked to the preparers of financial statements. This list is by no means exhaustive, but provided a basis for discussions. The use of a semi-structured interview technique allowed follow-up questions to be asked and areas of particular interest to be explored.

Table 6.1: Profile of the Treasury Interviewees

Treasurer	Location	Sector	Market Listing	Job Description
A	London	Real Estate	FTSE Other	Finance Director
B	London	Media & Photography	FTSE Other	Group Treasurer
C	London	Health	FTSE Other	Group Treasurer
D	London	Support Services	FTSE Other	Treasurer
E	Scotland	Transport	FTSE 100	Group Treasurer
F	Midlands	Food Producers & Processors	FTSE Other	Group Treasurer
G	London	Leisure, Entertainment & Hotels	FTSE 100	Director of Treasury
H	Scotland	Beverages	FTSE 100	Deputy Group Treasurer
I	Scotland	Electricity	FTSE 100	Group Treasurer
J	London	Health	FTSE Other	Finance Manager
K	London	Media & Photography	FTSE 100	Group Treasurer
L	South East	Tobacco	FTSE Other	Group Treasurer
M	London	Tobacco	FTSE 100	Group Treasurer
N	London	Chemicals	FTSE 100	Group Risk Manager
O	Midlands	Construction & Building Materials	FTSE Other	Group Treasurer

Advisor	Organisation
P	Accounting Firm
Q	Industry Body

Notes: Sectors are based on FTSE categories. Market listing refers to the firm's listing at the time of the introduction of FRS 13.

6.3 Interview Survey Results

This section reports on the results of 17 interviews with treasury department staff and advisors (Table 6.1). These interviewees were drawn from a wide number of sectors and worked in a good geographical spread of firms. The companies varied in size although their job descriptions were relatively uniform. It was hoped that this mix of interviewees would provide a broad cross-section of views on the issues raised. The results are divided into the following broad themes: data collection, the reporting standard, the impact on treasury practice, FAS 133/138 and IAS 39, and finally the impact of FRS 13 for corporate governance and accountability.

6.3.1 Data Collection

The first part of the interview covered the processes and procedures involved in collating the information required by FRS 13. Three-quarters of the interviewees indicated that they waited until FRS 13 became mandatory in March 1999 to adopt the standard. Nevertheless, many pointed out that some procedures and mechanisms had been put in place prior to this date. The early adopters indicated that they regarded the early adoption as a 'trial run', allowing them to iron out potential difficulties in their information processes and reporting operations.

All of the companies in the sample stated that the treasury department staff had been responsible for collating the data, while 11 indicated that finance/financial accounts departments were also involved in the process. Most of the interviewees explained that one particular individual had been assigned to collect the information (typically the treasurer) although some indicated involvement from other functional areas (e.g. the financial controller). Thirteen of the interviewees stated that the information tended to be collected at a single point in time (typically the year-end) rather than on a rolling basis throughout the year.

Twelve of the treasury department staff interviewed indicated that the information required was not new and it frequently formed part of the internal reporting practices of the firms. These firms suggested that the data typically required reformatting or re-analysing in order to meet reporting requirements. Two treasurers pointed out that the fair value information required by the standard was new. When asked whether the additional data was used for other purposes, 11 of the interviewees indicated that the information was there purely to meet FRS 13 requirements; however, Treasurer A

indicated that "nothing is ever purely there to meet the standard". Treasurer D indicated that the additional disclosures required by FRS 13 afforded them the opportunity to collect data that was not previously collated, resulting in the creation of a database of subsidiaries' banks, which they considered to be potentially useful. However, Interviewee H stated that his company's treasury decision making was "not driven by this reporting", and claimed that his firm did not "use any of this information". Treasurer N noted that they did not use the information provided by the FRS 13 disclosures for other purposes at present. He claimed that although the company had plenty of expertise to use the information, their treasury systems were not adequate at present to allow greater use of the information. He stated that he was "itching" to get his hands on the system and that the extra information would help his department "to understand what is happening with regard to our book of debt and derivatives".

Thirteen of the interviewees indicated that it was very straightforward to obtain the additional data required by FRS 13. However, Treasurer N highlighted that ensuring all the information was correct was a "lengthy" and "frustrating process". Treasurer F stated that his organisation had difficulty obtaining bank information:

> "The hassle seems to relate to the banks being really reluctant to provide the information ... one of them required an indemnity ... the other has qualified the information ... and another ... (required) a formal request in writing."

Two of the interviewees envisaged that the gathering of the information would become more onerous in future years, particularly with the introduction of FAS 133 and IAS 39. None of the interviewees indicated that they had needed to build or acquire new systems in order to comply with FRS 13, and most stated that the creation of a new spreadsheet was all that had been required. Most of the treasurers

claimed that they had not been charged for the fair value information from their banks, and as most had business information systems such as Reuters and Bloomberg already in place, they did not incur any additional related costs. One significant expense was the management time involved in collecting the data. Although, this was minimal for some companies, it was more time-consuming for others, with Treasurer L describing the process as "like I was being sent to jail for a week; it was like a penance."

Another cost mentioned by interviewees related increased audit fees. Treasurer K indicated that "there must be some element of cost reflected in the audit fee". Treasurer E claimed that the additional disclosure increased the profile of the treasury department. He added that the auditors "are probably making lots of money out of it".

6.3.2 The Reporting Standard

This section of the interview concerned the interviewees' perception of FRS 13. Views were again mixed amongst the interviewees when asked about the clarity of FRS 13. Treasurer B was particularly vociferous claiming that the lack of clarity in FRS 13 was "the nub of the problem". He claimed that as FRS 13 did not make it clear how to account for derivatives, detailed reporting of such instruments would not help improve financial accountability. Treasurer I indicated that he "got the impression that the standard setters weren't fully clear what they were asking (for)". Other interviewees, although less vocal, did have some initial confusion at the level of detail required. The most common problem identified by the interviewees was with respect to the table of unrecognised gains and losses - one of the numerical

disclosures, required by FRS 13. Treasurer L described this table as "the biggest load of codswallop I have ever seen." He added that

> "The entire table is difficult … we invented our own table in the end because we couldn't agree with the table … it just doesn't work … I spent ages looking at it, trying to work out how should I do this, and in the end you come up with a fudge, which sort of gives you what you think they are trying to get at … it was a nightmare, an absolute nightmare."

Treasurer L stated that the appendices to FRS 13 were "not worth the paper they are written on". However, two companies had made use of the examples included in the appendix to the standard and found that this had aided their interpretation.

Half of the interviewees sought some outside assistance on the interpretation of FRS 13. This assistance typically came from the organisations' auditors, usually in the form of a disclosure checklist and involved "ratification from the auditors that they were happy with it" (Treasurer G). Several companies presented their auditors with the planned disclosures and asked for opinions on inclusions and formatting. Those who did not engage external assistance tended to consult other annual reports and look for best practice. Treasurer E noted that "you will find some very common wording in the FRS 13 (disclosures)". Treasurer L saw "no point in asking anybody else - I was the so-called expert!"

6.3.3 The Impact on Treasury Practice

The next part of the interview dealt with the implications of FRS 13 for treasury practice. Thirteen of the interviewees indicated that they had not altered their hedging practices in any way following the adoption of FRS 13, with only two indicating some changes. Treasurer K claimed that he "took a pragmatic view" and that he had closed some contracts out as a result of having to prepare information for disclosure under

the standard. Treasurer L stated that his company was "less aggressive now". Treasurer L indicated that his company had set up a Treasury Committee as a direct result of FRS 13; their auditors thought it would be a "good idea to have one". When questioned on the use of specific financial instruments such as options, caps, collars or floors, the interviewees who admitted usage, claimed that FRS 13 would not stop them, or make them think about, the use of such instruments. Treasurer J stated "the commercial requirements are over-riding", while Treasurer O claimed that "if you need to use derivatives to hedge a position, then the way you account for them wouldn't impact."

The interviewees appeared to be divided with respect to their opinions on whether the information mandated under the standard allows them some degree of control over treasury activities. For example, Treasurer A indicated that:

> "If we didn't have to do it for FRS 13, we would probably still do it anyway, because it is useful to have; it is part of the whole monitoring process."

Treasurer E, who felt that such information should have been within the remit of treasury departments anyway, reinforced this point; he claimed that such information "puts in place a discipline" and "focuses our minds a little bit". Treasurer L indicated that the information required under FRS 13 opened up the possibility for greater control, but "whether that control is exercised or not is probably a moot point". He added that "the control is (probably) not implemented" claiming that:

> "The interest from senior management and the board, to treasury's mark-to-market valuation is typically very low."

However, Treasurer B put forward a different view. He claimed that "the board generally have the solid ability to ask the right questions." Treasurer K also indicated

that his department "always disclosed treasury activity internally quite extensively" which meant "the directors and the non-executives and our reporting accountants are fully briefed on treasury activities, so they understand what is going on." Treasurer I stated that the board got:

> "a bit of a fright the first year, when we came up with a £81m unrecognised loss, but we were able to explain that it (the loss) is what you get when you fix your interest rates to make sure your interest charge is certain."

When asked about the potential consequences of the new information that is now provided to users of the financial statements, the responses were again mixed. Treasurer A claimed that the information:

> "Provides people with the information to make an informed decision about what the real net asset value of the company is."

Treasurer G indicated that bad decisions could potentially be highlighted but added:

> "I think there is some good information in the disclosures."

Two of the interviewees expressed some mild concern about the impact of the standard on strategy and operations, citing issues such as confidentiality and commercial sensitivity as potential consequences of the increased amount of information placed in the public domain. However, as Treasurer O highlighted "everybody is going to be in the same boat". Treasurer I stated that he had some initial reservations about the potential use of the information by counter-party banks. He had concerns that the banks would be able to glean information about what their competitor banks were doing from the company accounts. However, the treasury department came to the decision that due to the large numbers of contracts undertaken by this particular company, counter-parties would have difficulty splitting deals up.

The potential consequences of the fair value and hedge accounting information were a cause for concern. Treasurer E argued that this information was not understandable and "pretty meaningless". This point was also mentioned by Treasurer J who indicated that:

> "I don't think it is all that useful to both competitors or to investors ... I'm not sure to what extent they will use it frankly."

Treasurer L indicated that:

> "Even though there is this much disclosure, it still can be quite hard to know exactly what is going on."

Mixed reactions were again received when the interviewees were asked for their overall impressions of FRS 13. Treasurer A indicated that "it was fine ... it is information that ought to be readily available, if you are managing your business you ought to know it." Treasurer G was in agreement and stated:

> "I actually quite like it ... I can understand the information that is being disclosed. There is some good information in there."

Treasurer J was a little more unsure but could see some merit in the standard:

> "I think there are bits of it that are very useful. I think its objective is very good ... but I think there is quite a lot of room for interpretation ... I think it is far more useful for a financial institution than it is for a company whose primary objective is not lending or other financial activities."

Other positive benefits of FRS 13 mentioned by the interviewees included the provision of a more formal framework and the concentration of thoughts. Treasurer K stated that "something needed to be done on treasury disclosure and treasury accounting" but FRS 13 was "about as far as it should go". Treasurer I indicated that the disclosure was useful internally within the treasury department; he added that it

"concentrates your thoughts" and provides a "framework that is more formal". Treasurer N noted that the disclosure provided a welcome focus for discussion with company management, he claimed that:

> "It is much easier to have that discussion with them, than have some esoteric conversation about risk management"

Several of the interviewees highlighted the positive benefits of the narrative disclosures, while condemning the numerical sections. Treasurer E stated that while "the principle of the narrative section is very valid", he did not find "any value" in the numerical disclosures. The other main criticisms of FRS 13 related to its ease of understanding. The information provided under the standard was felt to be too complex for the average user of financial accounts. For example, Treasurer F felt that:

> "For most corporates all it will do is muddy the waters ... the only people who would benefit from it is the sensible credit analyst in a bank possibly, and other treasurers ... for the average person, and I suspect an awful lot of shareholders, it is completely meaningless."

Treasurer L agreed with this view stating that he could not imagine that the extra information would "make a difference to the investment decision." Further, Treasurer E commented that the standard afforded corporates the flexibility to be "very vague" about their derivatives' usage.

6.3.4 FAS 133/138 and IAS 39

Eleven of the companies interviewed were also subject to US reporting requirements, and all the companies would be subject to IAS 39 in 2005. Of those that complied with US regulations, many had the procedures in place to document their use of derivatives. Treasurer I indicated that FAS 133 had affected the derivatives looked at by his company:

> "We haven't looked really at any complicated structures because of the problems for putting them through our primary statements, because the rules on hedge accounting are so strict. Any complicated structure is just a no-no as far as reporting is concerned. Economically, it might be the best thing since sliced-bread, but, the reporting constraints have stopped us doing quite a bit."

FAS 133 was viewed by Treasurer C as being "off the wall" while Treasurer L claimed:

> "We just laugh at the US GAAP adjustment in the accounts ... we just put a number in, but we don't care if it is plus twenty or minus twenty, we just ignore it, it is a joke."

Treasurer E claimed that "because it is not our primary reporting, we don't really care", while Treasurer O described the standard as "terrifying" and Treasurer N stated that "it was an absolute and utter nightmare". He added that the problem would be highlighted only if a number of large US companies got into financial difficulties or reported huge losses because of the effects of FAS 133.

Treasurer F indicated that he was "not impressed" with IAS 39 claiming it would offer "an arbitrary valuation on an arbitrary date". Treasurer H suggested that IAS 39 would result in companies making decisions about hedging based on the *accounting implications* rather than on *economic reasoning*. He added that in his opinion "common sense seems to have gone out the window". Treasurer J claimed "our time horizons are not that far ahead" when questioned on the proposed mandatory adoption of IAS 39 by 2005.

Treasurer I was in the minority, in preferring IAS 39 to FAS 133. He claimed that for his company, the main difference between the two standards was that IAS 39 recognised foreign currency swaps as a hedging instrument, whereas FAS 133 did not.

This, he claimed, was because FAS 133 "was written by Americans for Americans, and they don't have foreign currency debt."

When questioned on the adoption of hedge accounting there was again a mixed response. Treasurer F stated that his firm was not planning any changes while Treasurer G claimed his company would adopt hedge accounting when they could. Meanwhile, Treasurer K took the view that his company was not going to use hedge accounting whatsoever, claiming they would "take it on the nose". Treasurer J agreed, stating that "I can't really see a point in time where we will adopt hedge accounting." Treasurer L indicated that the "allocation and matching of hedges" requirement would cause "great difficulty" and claimed that:

> "We have almost circumvented it in a way ... we haven't formally matched and we don't intend to for the time being."

Treasurer L went on to describe the Joint Working Group proposals as "a bit of a nonsense" and claimed that:

> "It makes a nonsense of hedging in the first place, and if you are effectively putting the mark-to-market through (the Profit and Loss Account) as well ... the net effect may not be as large as if you had stayed variable ... it doesn't strike me as being particularly sensible."

Treasurer D also criticised the JWG proposals. He claimed that putting everything through the Profit and Loss account would impact not only the Earnings Per Share, but would also have a negative effect on tax charges. Treasurer I was the only interviewee in favour of the JWG proposals. He claimed that the JWG proposal to abolish hedge accounting, so that "all financial instruments are carried at fair value" which he said was "arguably better" than the current situation.

6.3.5 The Impact of FRS 13 on Corporate Governance and Accountability

Arguably, one of the main purposes of financial reporting standards is to provide information to stakeholders in a company, to improve governance processes and satisfy accountability requirements. The final section of the interviews therefore sought to illicit the views of treasury department staff on their potential role in corporate accountability and governance, and to ascertain whether or not FRS 13 was seen as an integral element of the corporate accountability process. Suggestions for possible improvements to future accounting standards as well as overall impressions of the standard were also ascertained.

When questioned on the "usefulness" of the information required under FRS 13, the responses were very mixed. Treasurer A indicated that the fair value information provided by FRS 13 disclosures was an essential part of the investment decision-making process. Treasurer L thought the FRS 13 disclosures were useful and that it was "nice to know what other people are doing". Treasurer C concluded that the point-in-time information provided by the standard was not useful to decision-makers and further added that accounting standards should not drive commercial requirements. Some interviewees thought that the narrative disclosures could provide potentially important information, but that the numerical disclosures were too complex to be of much use to all but the more sophisticated users. Treasurer E advocated the narrative section, but noted that although the numerical disclosures ought to be of interest to investors and analysts, they were probably not, due to their complexity. Treasurer N thought that the standard could be useful to "investors who understand it, because it gives them an idea about what financial risks the company is

incurring". Others felt that the information provided was only of use to banks and other financial institutions.

Only three of the treasurers stated that they had been asked for further information about their FRS 13 disclosures. Treasurer A had discussed their disclosures with some banks and rating agencies. Treasurer K revealed that some banks had required further information on the interest rate position of the company since disclosing it in the annual report. Treasurer I indicated that his organisation had received a letter from an individual shareholder seeking clarification on some of the FRS 13 disclosures. Other interviewees indicated that they had expected further questioning of their disclosures by analysts and institutional investors, but that this had never happened.

All of the interviewees indicated that they viewed accountability and governance, to some extent at least, as being their responsibility. For most, this accountability was assumed to be to the board, who in turn were seen as accountable to the providers of finance. As indicated by Treasurer F:

> "My accountability is to the board, I suppose ultimately it is to the shareholders."

Treasurer A stated that:

> "Do I think we have huge accountability to Joe Public if he isn't a shareholder, probably not, because I don't think he is hugely relevant."

For interviewee E, accountability was viewed as being purely a financial concept, and was defined only in terms of treasury management:

> "I am purely accountable for the financial impact of whatever treasury is doing, and treasury has the function of liquidity management, risk management and overall compliance."

However, another treasurer assumed that a wider notion of responsibility was necessary, if only for commercial reasons. Other interviewees took this wider notion of accountability and governance, for both treasury departments and the companies they represent, to mean the community as a whole. Treasurer H indicated that:

> "Accountability goes much beyond shareholders ... it goes to all the people who have an interface with the company."

The interviewees were asked to define accountability. Again the responses were somewhat varied, although most chose to define accountability in purely financial terms. Treasurer A defined his accountability as follows:

> "Our accountability to our shareholders is that they have entrusted us with their money, to actually make them money."

However Treasurer A did acknowledge a wider responsibility to employees:

> "In terms of employees it is much more difficult because you have two sides to that, one, the issue of security and those sorts of issues, you have also got the good employment and providing good training, whether with us or someone else."

Treasurer F viewed his responsibility as:

> "To manage the treasury function, to advise the board through the Financial Director or through the treasury committee on financial risk management, reducing the risks to the company ... and for ensuring the company has adequate liquidity."

Treasurer G highlighted the public responsibility aspects of accountability:

> "As a company we have to be responsible for what we put into the public domain ... we do have to be accountable for what we do."

The interviewees were asked if they perceived FRS 13 as having had any unanticipated consequences. For the vast majority of the interviewees the answer was "no". Treasurer F noted that the difficulties associated with the forecasting of likely

gains and losses had not been anticipated by him, while Treasurer I stated that he had not foreseen the time taken to prepare the information required by the standard. Many of the interviewees noted that FRS 13 had increased awareness of treasury issues within the overall finance function, with Treasurer L noting that "it has made the treasury audit much more grotesque, much more difficult".

There were several potential benefits of FRS 13 outlined by the interviewees. Treasurer E indicated that the presence of FRS 13 added an extra level of governance. He noted that as the information was included in the statutory audit, the disclosures acted as an "added control mechanism". Treasurer F noted the benefits of FRS 13 disclosures for internal company operations:

> "Internally ... it will improve our reporting and possibly our awareness of measuring the results of historic actions during a period, rather than necessarily just at the end."

Treasurer I noted that FRS 13 helped to "concentrate minds" and provide more focus at both treasury and board level. The issue of greater awareness of financial instruments and indeed the role of the treasury function in general was cited as a possible benefit of FRS 13 by many of the interviewees. "Comparability" was another possible benefit of the standard noted by Treasurer L. Treasurer K stated that "something definitely needed to be done and I think disclosure was the right way". He added that:

> "People should not be frightened to disclose out in the open how they manage their risks and the sort of contracts they enter into".

Interviewee N, who noted that the additional disclosure "increased the visibility of risks that the company was incurring", reiterated this point. However, Treasurer D failed to see any benefit to the standard. He noted that "it hasn't stopped what it was

intended to stop". He added, that in his opinion it added to the problems, due to its complexity.

When questioned on possible amendments to the standard, two of the interviewees suggested that the standard should not have been written at all. Treasurer I noted that there was too much information for users of accounts and he remarked that it was "getting harder to hide things from auditors!" Treasurer O felt that a small and medium company exemption would have been appropriate. Treasurer B suggested that the standard needed a clearer definition of its area of concern. The issue of clarity was also raised by Treasurer E. He thought that the hedge accounting disclosures were not sufficiently clear and quite narrowly defined. Treasurer F again raised the issue of clarity, and also pointed to the need for more consistency particularly with respect to the different approach to quoted and unquoted fixed rate debt. Treasurer L took the opportunity to again mention his displeasure at the derivatives maturity table. Interviewee N expressed his dissatisfaction with accounting standards in general. He indicated that:

> "The more standards that are imposed upon business that they have to comply with, the more difficult it is going to become for investors to actually see the wheat from the chaff."

6.3.6 The View of the Advisors

Interviewee P was a representative from a large accountancy firm, who was frequently consulted by many clients for assistance on applying FRS 13. He provided details of his experience in this capacity, as well as some personal observations about accounting for derivatives and other financial instruments.

In Advisor P's experience, most companies waited until FRS 13 became mandatory to apply the standard. He indicated that treasury departments compiled most of the information required, particularly with respect to the narrative information. Advisor P indicated that the ease with which companies collated the necessary data required for compliance with FRS 13 varied enormously. Those companies that had a centralised treasury function, with adequate treasury policies and had an efficient mark-to-market system in place found the process to be relatively straightforward. In his experience, companies did not build or buy expensive new systems to deal with FRS 13 compliance. Most made do with extra spreadsheets and some tailoring of existing systems. Some help was sought from financial accounting departments on the numerical disclosures. He stated that the "better companies" had done "dry runs" of the information needed for the standard before it became mandatory. Some of the companies found the additional information useful for other purposes, however the tables tended to be produced for purely compliance reasons. Advisor P thought that the extra information necessary under the standard facilitated an improvement in overall financial risk management in certain corporations.

Advisor P provided some clients with advice and expertise in implementing the standard. He ran several seminars to keep clients abreast of all pertinent details on implementation. He acknowledged that the standard was "hard to understand". The two biggest difficulties that companies had were (i) the table of unrecognised gains and losses; and (ii) the net monetary assets table, both of which he described as "meaningless".

Overall, he felt that the narrative disclosures provided as a result of the standard were "very very weak and boilerplate". He added that "everyone says the same thing." He indicated that although weak, the narrative could provide some potentially useful information to investors. He added that in his opinion, the numerical information would be less useful, because of its complexity. Advisor P argued that "for your average good corporate" FRS 13 would have little impact on hedging practices. He claimed that FRS 13 had little impact on the perception of using derivatives. He could not envisage any unanticipated consequences of FRS 13, either from the company point of view, or from the standard-setters viewpoint.

Advisor P conducted a survey of clients' views about FRS 13. He indicated that his client companies were mostly concerned about issues relating to confidentiality and the potential difficulties associated with a non-centralised structure. However, some positive reactions were gleaned. The standard was viewed as forcing companies to clarify their derivative holdings and improve their decision-making and corporate governance practices and procedures.

However, it was a different story for FAS 133 and IAS 39. Advisor P called FAS 133 "the big one". He claimed that it had changed US corporate behaviour "tremendously" already. He added that to start changing the financial statements "that is when people step up and take notice". He noted that the reaction to date to IAS 39 was less pronounced, but added that "when those kick in, that is when the big change will occur in the UK". He described the JWG project as being "counter-intuitive".

Advisor Q was an advisor in an industry body. She summarised the response of the industry association to accounting standards in general, and to the derivative accounting standards in particular, as her organisation had made representations to the ASB about FRS 13. Representations were traditionally made via letter or email, at the discussion paper stage in the standard setting process and the ASB normally did not respond to individual representations, except to acknowledge receipt. The industry body had not made representations to the FASB about FAS 133, or to the IASB about IAS 39, but Advisor Q indicated an on-going involvement with the JWG proposals.

Advisor Q was generally in favour of FRS 13. She indicated that "transparency and the provision of information is something that we always support". However, she added that she felt that it was more appropriate to confine this information to the notes section of the accounts. She stated that a couple of technical enquiries about FRS 13 implementation had been received from members.

Advisor Q described IAS 39 as a "highly deficient standard". She was not aware of any company in the UK that had applied the standard, but added that the new standards were making extra work for accounting firms, and they therefore, were unlikely to object to them.

Advisor Q considered the traditional purposes of accounting standards as "to keep the score". However, she argued that the recent attempts to turn accounts into what she termed "statements of value", was "misguided". She added that this was "an impossible objective" and that accounts would never be able to provide such information, because of the presence of so many "intangibles". She stated that FRS 13

was a perfect example of this change; people had little understanding of what the information produced, or what the standard was about. She remarked that accounting standards were written for accountants by "accountants cum academics who have a very ivory-tower view of the world"

6.4 Discussion

The treasury department staff interviewed in this study indicated that most of the information required by FRS 13 was already being produced internally as part of the management reporting process. Frequently, a re-analysis or reformatting of the data was all that was needed for compliance with the standard. The collection of additional data was found, on the whole, to be a straightforward process. The companies interviewed were large multinationals and they were willing to acknowledge that the collating of the necessary information was likely to be a more difficult process for smaller firms who perhaps did not produce such detailed information as a matter of course. This may be especially so, as previous research indicates that larger firms use more derivative products (Bodnar et al., 1995; 1996; 1998; Berkman and Bradbury, 1996; Helliar, 1997; Dunne et al., forthcoming). The interviewees indicated that although the information produced for FRS 13 compliance was rarely used for other purposes now, it was found to be of value in terms of providing a focus for treasury activities. It was also noted that FRS 13 provided a much-needed formal framework for treasury accounting and disclosures.

One of the interviewees' main criticisms of FRS 13 was with respect to the clarity of the standard and the information required for compliance; this finding is consistent with the analysis of Bircher (1999) who also points to a lack of clarity on the part of

FRS 13. Views on the lack of clarity were particularly pronounced with respect to the table showing unrecognised gains and losses, which was considered by the interviewees to be unclear and lacking purpose. The narrative and notes were found to be of more use, and the treasurers appeared generally comfortable with these disclosures. The interviewees indicated a great deal more concern with the potential impact of FAS 133 and IAS 39, particularly with respect to fair value accounting. The fact that adjustments were made through the financial statements was highlighted as a potential difficulty. Treasurers' operational practices were considered to be more likely to change as a result of the international disclosure developments (De Marzo and Duffie, 1995; Di Paola and Cattoor, 2000).

Another finding of note is that the presence of FRS 13 does not appear to have improved the firms' overall accountability or corporate governance. The views expressed with respect to accountability indicate that treasury departments appear to be concerned solely with the narrow financial aspects of accountability. The main focus was on satisfying the requests of board members with respect to the perceived needs of the providers of finance (Bebbington and Gray, 1993; Forbes and Watson, 1993; Gamble and Kelly, 2001). The maximisation of shareholder wealth was of paramount importance (Friedman, 1970). Several interviewees viewed accountability as a limitation on their activities, in line with the Roberts (2001) notion of accountability as a constraint on the powerful. They only appeared to accept their responsibility to manage the financial resources entrusted to them by the shareholders and the need to account for their management of these resources (Tornqvist, 1999), thus echoing Stewart's (1984) "performance" and "programme" levels of accountability. A role was acknowledged for FRS 13 disclosures in terms of

providing an account of treasury practices and procedures to interested shareholders and board members (Broadbent et al., 1996). However, the disclosures themselves were viewed as being too complex to be understood by anyone other than fellow treasury experts.

FRS 13 was viewed as a mechanism for improving organisational control by means of providing more focus on treasury activities at board level, which could potentially, aid governance. Accounting disclosures were viewed as one means of expanding control within organisations (Hopwood, 1976; Otley, 1980; Ouchi, 1980; Birkett, 1988). The disclosures provided by FRS 13 were seen to have the power to influence board members perspectives on what was important and concentrate their thoughts on treasury activities (Burchell et al., 1980; Hopwood, 1983; Carnaghan et al., 1996; Gallhofer and Haslam, 1996). The disclosures are also viewed as legitimating the actions of both treasury departments and corporate boards with respect to the usage of derivative financial instruments. Derivatives reporting was seen to allow the treasury and finance functions to exercise a greater degree of control over outcomes, thereby preventing recurrences of previous financial scandals (Roberts and Scapens, 1985; Dunne and Helliar, 2002; Helliar and Dunne, 2004). The philosophical and moral rights and responsibilities of additional stakeholders were rarely acknowledged (Gray et al., 1996; Stanton, 1997).

6.5 Summary and Conclusion

The results of this chapter appear to indicate a lack of homogeneity with respect to the treasury interviewees' views on FRS 13. The treasurers had very different views both on the impact of FRS 13 for treasury activities and on the potential benefits or

otherwise from the introduction of the standard. However, most treasurers considered FRS 13 to be beneficial to stakeholders. They indicated that the implementation of the standard had not been too onerous and considered that most treasurers should have been preparing most of the data before the standard was introduced. Their views about FAS 133 and IAS 39 were not so positive; many of the interviewees were very unhappy about the potential impact that any future standard would have on their reported earnings and any likely disruptions to treasury operations and hedging activity. In general, the interviewees considered the narrative disclosures to be far more useful for users than the numerical disclosures for investors and other stakeholders. The views of investors as users of financial statements are examined in Chapter 7.

Although several limitations have been noted with the use of the interview technique (Section 4.4.3.1) the analysis in this chapter has provided valuable insight into the perspectives of preparers regarding the issues associated with the introduction of a derivatives reporting standard. Such perspectives provide a useful accompaniment to the analysis of the changes the standard has visited on financial statements. The interview method tends to produce non-standard, context-dependent responses (Taylor and Bogdan, 1984; Yin, 1994; Denscombe, 1998) and is heavily dependent on the interviewees' recollection of events (Yin, 1994). However, the use of a semi-structured technique imposes some discipline on the process and ensures the same questions are asked to all interviewees. All of the interviewees were experts in their field so the technical questions asked did not pose much difficulty for them. The more abstract questions concerning issues associated with corporate governance and accountability were explained where difficulties were encountered.

Chapter 7

FRS 13 and Corporate Governance - A Fund Management Perspective

Chapter 7 - FRS 13 and Corporate Governance: A Fund Management Perspective

7.1 Introduction

The aim of this chapter is to examine the impact of FRS 13 on issues relating to corporate governance. Chapter 2 highlighted a number of corporate scandals that had occurred in the past few years relating to treasury and derivatives activities. The introduction of a Financial Reporting Standard that made treasury activities more transparent might have implications for corporate governance. In particular, it might result in large investors asking questions about treasury policy and procedures, thereby making management more accountable to their stakeholders. A series of interviews was therefore undertaken with large institutional investors to investigate whether: (i) UK institutional investors' general attitudes towards treasury management and derivatives usage had changed since the introduction of FRS 13; and (ii) the introduction of FRS 13 had any implications for corporate governance practices and procedures.

7.2 Interview Survey Method

In order to assess the impact of FRS 13 on institutional investors' decision-making, fifteen semi-structured interviews were conducted with fourteen large institutional investors and one stockbroker over a seventeen-month period from November 2000 to March 2002 (See Table 7.1). All of the institutional investor interviewees were heavily involved in the corporate governance functions within their respective investment institutions. As noted in Chapter 6, the use of a semi-structured interview technique imposed some formality on interview proceedings in terms of providing a list of topics to be discussed at all interviews in order to ensure consistency and to

allow for cross interview comparisons. A similar method was used to that discussed in Section 6.2. Interviews generally lasted for between one hour and one hour and thirty minutes and ranged from interviewing one person to interviewing three people. Most of the interviews were recorded and notes were taken. The questions concerned the impact of FRS 13 on annual report disclosures and the perceived impact of such disclosures on investment decision-making and corporate governance issues. While it is problematic to generalise from the interviewees, it is worth noting that the fourteen fund managers interviewed controlled a large proportion of the total funds under management by UK and Irish institutional investors. The interviewees represented large fund management houses, insurance companies, investment trusts and investment banks from all parts of the UK and Ireland. The issues included in the interview were partially shaped by a review of the literature relating to derivatives usage and reporting practices (Chapter 2). Each interview was divided into questions covering the following broad themes: Risk Management, Fund Management, FRS 13 and Corporate Governance[137].

[137] Appendix 7.1 provides a list of the questions asked to the users of financial statements. This list is by no means exhaustive, but provided a basis for discussions. The use of a semi-structured interview technique allowed follow-up questions to be asked and areas of particular interest to be explored.

Table 7.1: Profile of the Institutional Investor Interviewees

Fund	Location	Interviewees	Type of Institution	Funds Under Management
A	Scotland	A.1, A.2	Insurance Company	£75 billion
B	Scotland	B.1, B.2	Investment Trust	£2 billion
C	Scotland	C	Fund Management	£200 billion
D	London	D	Fund Management	£200 billion
E	London	E	Fund Management	£50 billion
F	London	F	Insurance Company	£150 billion
G	London	G	Fund Management	£54 billion
H	London	H	Investment Bank	£130 billion
I	London	I.1, I.2, I.3	Investment Bank	£300 billion
J	London	J	Fund Management	£19 billion
K	London	K	Investment Bank	£35 billion
L	North of England	L.1, L.2	Insurance Company	N/A
M	Ireland	M	Investment Bank	£1 billion
N	Ireland	N	Stockbrokers	N/A
O	Scotland	O	Fund Management	£22 billion

7.3 Interview Survey Results

This section reports the results of 15 interviews with fourteen institutional investors and one broker (Table 7.1). These interviewees were drawn from a wide variety of funds and worked in a good geographical spread of firms. The fund managers worked in a variety of institutions although their job descriptions were relatively uniform. It was decided that the differing perspective of a broker might also be informative given their interest in corporate practices. It was hoped that this mix of interviewees would provide a broad cross-section of views on the issues raised. The results are divided into the following broad themes: Risk Management Practices, Fund Management Practices, The FRS 13 Reporting Standard and finally, the impact of FRS 13 for corporate governance and accountability.

7.3.1 Risk Management Practices

The first part of the interview related to the importance which institutional investors attached to the hedging policies and risk management practices of their investee companies. Eleven of the fifteen fund managers indicated that their investee companies' management of risk and hedging was an element in their investment decision making, although, none of the interviewees ever actually asked to see any documented policies. One fund manager claimed:

> "We don't look specifically at a company's hedging policy ... we do look at the type of decisions management take on these sorts of (hedging) issues as an indication of the quality of management."

Interviewee I indicated that hedging issues only became important when such decisions went wrong and added that they would ask to see documentation only if they suspected a potential problem. Fund Manager K claimed that hedging policies and financial risk management were taken into consideration, although such matters were not seen as "crucial", while Fund Manager O suggested that financial risk management concerns were "quite high up the agenda".

With respect to the types of financial instruments used and the reasons for using them, most fund managers agreed that this varied from company to company. However the most common instruments cited included interest rate swaps[138] and currency forwards[139], while the most commonly hedged risk was thought to be related to currency volatility. This suggests that fund managers may focus more on currency risk than on interest rate risk, which is in contrast to the findings of most academic studies (Bodnar et al. 1995; 1996; 1998; Helliar, 1997). Fund Manager O indicated

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[138] An interest rate swap is an agreement whereby two parties (called counterparties) agree to exchange periodic interest payments (Fabozzi and Modigliani, 1992).

[139] A currency forward contract is one in which one party agrees to buy a currency, and another party agrees to sell that same currency at a designated date in the future (Fabozzi and Modigliani, 1992).

that, in his experience, companies tended to shy away from using exotic derivatives[140], because of their lack of understanding of how these complex products worked.

The fund managers interviewed did not place a great deal of emphasis on the amount of hedging carried out or the range of products used. For example, fund manager A.1 claimed:

> "In terms of the significance we attach to what type of instruments are used, we will generally defer to the judgement of the company and the board concerned, unless there is something that comes to our attention that suggests that the instruments are clearly inappropriate."

This latter point was also mentioned by Interviewee K who suggested that questions would be asked where "it looks like they (the investee company) have disproportionately used an odd (instrument)". Fund Manager B.2 indicated that "the focus is on the fundamentals of the business … hedging is almost still a peripheral issue." This general attitude was further evidenced by the comments of Fund Manager D:

> "I don't think investment institutions actually do take this into account as much as you would imagine."

The fund managers expressed quite divergent views on the importance of the completeness of their investee company disclosures, although six indicated that greater disclosure was preferred. Fund Manager E placed a great deal of emphasis on

[140] Exotic derivatives are more difficult to price and are often model dependent. The risks tend to be more obscure and can often lead to unexpected losses (Wilmott, 1998). Examples include: (i) barrier options (whose payoff is contingent on the underlying asset reaching some specified level before expiry); (ii) Asian options (the payoff is dependent on the average value of the underlying over some period before expiry); and (iii) lookback options (whose payoff depends on the realised maximum or minimum of the underlying asset over some period prior to expiry) (Wilmott, 1998).

the completeness of company disclosures by highlighting the fact that more complete disclosures:

> "indicate a willingness on the part of management to explain what it is they are doing and why if something has gone wrong, or particularly right, that has happened."

However, Fund Manager C claimed that:

> "It's our belief that there is very little information and so it is a small part of the decision-making ... it is not really a major part of how we would come to a view of a company."

Two of the interviewees suggested that the completeness of company disclosures was less of an issue for them because of the "quality" of investments handled by their particular firms. This suggested that financial reporting standards and disclosure issues were less likely to be of concern for holdings in large global companies, which is surprising given the use of more exotic derivatives within these companies (Bodnar et al., 1995; 1996; 1998; Wilmott, 1998) and the preponderance of scandals affecting predominantly large companies (Culp and Miller, 1995; Overdahl and Schachter, 1995; Jayaraman and Shrikhande, 1997). Several of the interviewees mentioned that the lack of timeliness of annual reports was a potential drawback for using them in their decision-making, irrespective of the volume of disclosure in them. Interviewee J indicated that any questions arising from disclosures in the annual report would be discussed in the one-on-one meetings with company management.

7.3.2 Fund Management Practices

All of the fund managers interviewed organised their activities on either a geographic or sectoral basis and none employed a particular individual member of staff to deal with the task of gathering portfolio risk information about their investee firms, such as exposures to certain currency movements. When asked if they considered the

financial risk exposure of a potential investment, the responses from the sample of fund managers again differed. For example, Fund Manager A.1 indicated that his firm was "more concerned with the underlying activities of the company", while Fund Manager I.2 stated that "when financial risk becomes business risk it becomes absolutely key". Fund Manager C claimed that they looked at risk "very closely in the way that we think risk is important ... the actual impact of derivatives really doesn't come in to that."

Only one of the fund managers interviewed indicated a preference for their investee companies to hedge all their overseas earnings back into sterling. He stated that "yes, any finance directors that didn't would be daft" (Interviewee J). However, for the other interviewees, such decisions were deemed to be the preserve of company management.

Most of the fund managers stated that they were given specific mandates to manage portfolios relative to defined benchmarks and that it was the responsibility of the trustees to ensure an appropriate investment policy. Some of these mandates specifically prohibited the fund manager from hedging any net exposures, possibly because the trustees had a limited understanding of treasury practice. For example, when questioned about making hedging overlay decisions on their own investment portfolios, based on information about individual company strategies, the response from the fund managers was again fairly mixed with less than half of the interviewees indicating that such decisions might even be taken on an occasional basis, and usually by their Asset Allocation Team. Fund Manager A.1 stated that:

> "We will, and have, from time to time made hedging decisions, mainly on currency hedging, where we feel that one particular currency is significantly out of line and where we think our best interests lie."

However, these hedging overlay decisions were typically taken on a portfolio basis rather than on the basis of underlying company hedging policies and strategies. For example, Interviewee I.2 claimed that "we would do that on an economic view. We wouldn't do that, based on individual companies", while Interviewee M was even more adamant claiming that taking such decisions "would be clearly moronic, just insane to try to second guess the level of hedging which the companies themselves are doing."

7.3.3 The Impact of FRS 13

When questioned as to why some companies chose to disclose their derivatives usage prior to the mandatory introduction of FRS 13, most of the fund managers highlighted the scandals associated with derivatives usage, such as Barings, Orange County, and so on. For example, Fund Manager A.1 commented that:

> "The Barings situation brought into sharp focus, particularly for the financial companies but also in a wider sense, some of the risk consequences of derivative transactions."

Fund Manager C put forward a similar view:

> "There has been such controversy about the use of derivatives ... Equitable Life, Orange County ... (companies) want to be seen as whiter than white if possible and to report what they have."

Another perceived reason for the early disclosure of FRS 13 information concerned the relative importance of the finance function within the firm and the finance departments' attitude towards openness and transparency. According to the interviewees, some companies might have had tactical reasons for not disclosing such information until it was absolutely necessary.

Fund Manager E adopted more of an accountability perspective when she stated that:

> "Some companies believe that this is part of the reasonable information that they should share with people who are interested in the company."

Meanwhile, Fund Manager A.1 cited the influence of changing corporate governance regulation as a possible reason for disclosing the non-mandated information prior to the introduction of FRS 13:

> "Whilst FRS 13 was chugging along ... the Turnbull Report was starting to prompt boards and audit committees to ask certain questions and anticipate changes that would be required of a disclosure and risk control nature."

Stockbroker N argued that:

> "If a company is managing their risks and running their business properly they shouldn't have any problem or hesitancy in terms of meeting disclosures and meeting them early. I think it avoids people speculating as to what might not be in place or how bad things might be. I think investors wholly welcome it."

Fund Manager O indicated that some companies simply "like to be ahead of the game in terms of disclosure", adding that such a strategy "gives them time to sort out any problems". Interviewee M was more cynical, claiming that companies tended to disclose early for "commercial reasons", while Interviewee I.2 suggested that a "lack of information tends to be construed quite badly" and went on to argue that:

> "by making disclosures they (individual companies) can increase certainty and information flow to the capital markets and that can only be a good thing from the company's point of view".

Interviewee K noted that the use of such information was meant to "reassure investors" of true underlying exposures.

Most interviewees were unable to identify strong sectoral trends in this voluntary disclosure of FRS 13 type information, although a couple of interviewees identified banks as being proactive due to the nature of their business. Fund Manager K

suggested that those with large underlying exposures were more likely to report early. In addition, one fund manager argued that where one company in a particular industry disclosed particular information, others tended to follow. Fund Manager E stated that:

> "If management are happy that they are doing a good job, they are more than happy to put that in public ... (there is) no better disinfectant than sunlight."

In general, however, larger companies were viewed as being more likely to comply early with FRS 13 requirements than were smaller companies, often because the former had the resources required for early compliance more readily available.

Some of the interviewees posited reasons for not disclosing early. Fund Manager A.1 felt that there could potentially be:

> "an attitude of enlightenment, or otherwise, to disclosure, whereby perhaps some companies at that time, and maybe still today, tend to take a minimalist approach."

Fund Manager C.1 reiterated this point:

> "A lot of companies have to be dragged screaming before they do anything, until it is mandatory they will not do anything at all in any area."

Interviewee M felt that many companies waited until it was absolutely necessary before disclosing such information; he cited the extra work involved and the various disclosure options as possible reasons for early non-disclosure and added that most waited to see what others were doing. Fund Manager K was more cynical, claiming that in some cases companies were using financial instruments in an "inappropriate manner" and often lacked a clear understanding about the usage of derivatives. Interviewee H claimed that many companies were reluctant to disclose such information "on competitive grounds".

The majority of the fund managers interviewed relied on annual reports and their regular meetings with investee company management as their primary sources of hedging information. To this end, FRS 13 was seen as being of benefit. For example, Fund Manager F noted that the standard "can help in alerting you to some of the risk areas". For some interviewees, information about derivatives usage was a regular part of the company presentation to institutional investors. For other interviewees, information about derivatives usage would not be presented to institutional investors unless requested - which would presumably occur when there was felt to be some concern. Two of the interviewees mentioned using brokers as the primary source of this type of information.

Although the interviewees were generally very positive about wider disclosure, only two of the fifteen interviewees indicated that their investment houses had had an input into FRS 13; one had a colleague on the ASB, while the other commented directly to the ASB and through a representative industry body.

When asked about the perceived general impact of forced disclosure, the responses were mixed, with five interviewees indicating that forced disclosures had little or no major impact. Fund Manager C suggested that his fund had little use for annual reports as sources of information:

> "They (annual reports) are in written form which makes it much more difficult to compare one company with another, we can get all of the cash flow numbers on databases … the Report and Accounts are out of date by the time we get them … all of the information in those reports has already been digested by the market … you don't know what the company has done since the Balance Sheet date, the whole risk exposure may have changed."

However, in contrast to the views expressed by Fund Manager C, Fund Manager A.1 noted that although "it wasn't as if we felt the earth move suddenly when it came in"

it did help to "create a level playing field" in terms of disclosure. Fund Manager K indicated that FRS 13 had forced companies to clarify their position about their motivations and reasons for hedging, as well as the precise methods adopted.

A majority of those interviewed felt that FRS 13 had not changed their investee companies' managerial behaviour towards hedging policy, their operating procedures or the methods of hedging employed. However, Fund Manager E, felt that they, as fund managers, wanted firms to be aware of their risks and commented that:

> "If disclosing how you are dealing with risk ... is seen as portraying yourself as risk averse, that might be a good thing, it might actually encourage management to communicate better what they are doing ... to be more comfortable with risk."

There was a mixed response from the fund managers when they were asked if they had learned any more about their investee companies' derivatives usage since the introduction of FRS 13. In general, they claimed not to have gained any vital new information, although one potential benefit the fund managers identified was the internal impact that such disclosures might produce. This aspect was mentioned by Fund Manager B.2 who felt that a positive impact could be gleaned by "making sure that finance departments are being put through all the hoops and hurdles." Fund Manager A.1 felt that what is often more important is what information is not disclosed:

> "Sometimes the biggest risk is actually what is not there, and because there may not be particular disclosures in particular areas, that might be as concerning as what might be disclosed."

The majority of the interviewees considered that the narrative information provided by FRS 13 contained potentially important information, but that the numerical disclosures were too complex. The interviewees acknowledged that information

concerned with financial risk should potentially be of interest to institutional investors, however, fund managers typically paid more attention to the key management personnel and strategic decision-making than to risk management practices and procedures.

Fund managers did not appear to be aware of how frequently their investee companies re-valued their derivatives portfolio or of the particular methods they used in evaluating the riskiness of specific derivatives transactions. Only Fund Manager A.1 claimed that such information gave him "that degree of cuddly comfort". Others felt that this was an area where they, as shareholders, had poor visibility – although the information was not something they particularly needed.

One area where it was felt that FRS 13 could possibly have gone further was with respect to 'counter-party risk'[141]. This issue was mentioned by six of the interviewees. Another area for further potential development was with respect to the valuation of derivatives. Fund Manager C in particular felt that:

> "The most important thing, rather than pushing the actual disclosure further, is to try to get an agreed method of valuing derivatives."

The majority of the fund managers interviewed felt that there was a difference between large and small companies with respect to their FRS 13 disclosures. Many thought that this was because larger firms were more likely to use and understand derivatives; small firms were less likely to have the in-house expertise to deal effectively with more complex financial instruments. Fund Manager K indicated that,

[141] The risk that the other party in an agreement will default. In an option contract, this is the risk to the option buyer that the writer will not buy or sell the underlying as agreed. In general, counterparty risk can be reduced by having an organisation with extremely good credit act as an intermediary between the two parties.

post FRS 13, the gap between large and small companies' disclosure had narrowed. He further argued that, with respect to derivatives, disclosure was even more important for these smaller companies. The perceived pressure from institutional investors was also cited as a possible reason for the predominance of larger firms in derivatives usage. However Fund Manager E noted that, in terms of disclosure:

> "Some of the smaller companies, who ... have obvious exposures because their main market is a foreign market ... tend to say something."

With regard to adhering to the spirit rather than the form of FRS 13, most interviewees felt that their investee companies "try to be as succinct as possible" (Fund Manager B.2) and "do it because they have to" (Fund Manager B.2). Fund Manager O argued that most companies "will do the minimum" for two reasons:

> "One, generally disclosure is an administrative annoyance to them and they would rather get it over with, so they take a pretty boiler-plate approach to the whole process; and (second) most large companies are advised, probably by their auditor, on how to deal with these disclosures and they are given sample text, to insert the information."

He added that this process resulted in a "minority of companies" providing "flexible and interesting disclosure". However, Fund Manager A.1 appeared to be willing to give their investee companies the benefit of the doubt by suggesting that:

> "There has been a sea change over the last decade in terms of enlightenment to disclosure. Companies are, by and large, prepared to make greater disclosures."

When asked to comment on the relative costs and benefits of forced disclosure both for their investee companies and for themselves, all of the fund managers were of the opinion that the benefits outweighed the costs. The costs of lack of transparency, albeit tending to arise on an exceptional basis, were seen as being "distinctly painful" for shareholders to bear (Fund Manager A.1). Some interviewees questioned why corporates had incurred extra costs in producing the required information, claiming

that such information should have been readily available "and if not, why not?" (Fund Manager E). Even for the interviewees who doubted the merits of such disclosures from an investment management perspective, the exercise was deemed to be both useful and necessary:

> "There is an obligation on companies that they should be reporting on what their operations are all about and the risks involved in them on a regular basis ... as a matter of historical record I think they should be doing this ... I think the benefits certainly justify the work that is involved."

Fund Manager O questioned the use of all accounting standards; although he acknowledged a need for them, he indicated a preference for investee companies to follow "best practice disclosure" rather than follow mandated requirements. He added that mandatory disclosure was "very inflexible" and often resulted in unintended or unanticipated consequences.

7.3.4 Implications for Corporate Governance and Accountability

When questioned about whom the financial risk management department head was accountable to within their investee firms, the interviewees recognised that procedures varied from company to company. In the majority of cases, the risk management department (where present) tended to report to an audit committee or directly to the Finance Director or Chief Executive. Most believed (although rarely confirmed with their investee companies) that relevant issues were reported to the Board or to one of its sub-committees. As Fund Manager E articulated:

> "(funds) hope there is someone at Board level who has ultimate responsibility for ensuring that there are proper procedures and structures in place."

The majority believed that the risk management department was normally a cost centre within their investee companies. Fund Manager E claimed that a large difficulty for risk management departments was "proving they add value". She

likened risk management departments to corporate governance departments in general claiming that they "add value by preventing value being destroyed, which is a very difficult thing to prove" (Fund Manager E).

All of the interviewees believed or assumed that non-executive directors had an input to the risk management function. However, the fund managers never attempted to discover if this assumption or belief was merited. The interviewees did not meet with the non-executive directors to discuss their role with respect to risk management. The fund managers believed that treasury committees tended to be a "blend of executive and non-executive participants" (Fund Manager A.1). However, for one interviewee this input was of slightly less importance. Fund Manager C felt that it was:

> "difficult for a non-executive to know all about those (derivatives) and really get to the bottom of what is going on in the company … the most important thing to us is to know the guys who are running the company … we are in many ways buying them."

Fund Manager M argued that in his opinion "non-executive directors are not a very impressive bunch as a group". He questioned their financial literacy, before adding that "executive directors don't want impressive non-executive directors unless they are very confident".

When asked to assess whether FRS 13 disclosures helped in the evaluation of corporate governance and accountability within their investee companies, the interviewees were again split. For those that viewed FRS 13 disclosures as an integral part of corporate governance evaluation, it was felt that good disclosures were indicative of a well-governed company. Fund Managers that did not find them a useful indication of good corporate governance practices acknowledged that the

disclosures provided a good measure of consistency across companies that use derivatives. Many interviewees did not feel qualified to answer when asked how well FRS 13 requirements fitted in with or satisfied the Turnbull requirements[142]. The others thought that, on the issue of whether FRS 13 detracted or added to the spirit of Turnbull, it depended upon the approach adopted by individual companies.

7.4 Discussion

The results of this chapter indicate that institutional investors are aware of an increase in their investee companies' use of derivatives. The explanations offered by firms, namely that the increased use of derivatives was related to the globalisation of their operations and the consequent impact on their risk profile, was accepted by the interviewees as valid. Most of the fund managers suggested that the amount of interest taken in risk management and treasury department derivatives activities had increased recently in light of the Barings, Allied Lyons and other highly publicised scandals. Despite the fact that the various codes emphasised the important role to be played by institutional investors in the corporate governance and risk management of their investee companies (Cadbury Report, 1992; Greenbury Report, 1995; Hampel Report, 1998; Turnbull Report, 1999; Myners Report, 2001), the interviewees in our sample did not see this as their responsibility. Instead, the fund managers placed a greater emphasis on their investee companies' strategic and operational activities than on

[142] The Turnbull guidance indicates the company's internal control system should: (i) be embedded within its operations and not be treated as a separate exercise; (ii) be able to respond to changing risks within and outside the company; and (iii) enable each company to apply it in an appropriate manner related to its key risks. The guidance requires companies to identify, evaluate and manage their significant risks and to assess the effectiveness of the related internal control system. Boards of directors are called on to review regularly reports on the effectiveness of the system of internal control in managing key risks, and to undertake an annual assessment for the purpose of making their statements on internal control in the annual report (ICAEW, 1999).

financial risk management concerns. The fund managers pointed out that they were most interested in the fundamentals of the business. They were keen to determine the individual strategies adopted by, and the general operations of, their investee companies. They placed less emphasis on detailed financial management and financial engineering. An indication of this was provided by the minimal emphasis placed by the institutional investors on actually viewing an individual company's documented policies with respect to derivatives and other financial instruments. The evidence supplied by Solomon (1999) which suggested that institutional investors required their investee companies to disclose information relating to their foreign exchange risk management policies was not confirmed by the present research. Although the fund managers saw some benefits to the extra information provided by the standard (Weetman et al., 1996), they did not see such information as vital to their decision making. However, good treasury practice and compliance with FRS 13 was viewed as being indicative of good quality management.

To be able to judge the relative performance of management and operations of their many investee companies, institutional investors need a vast array of information. One role of accounting standards in this context is to provide such information to these 'owners' on a consistent basis so that comparison between different companies and across time periods can be made. As an accounting standard, FRS 13 attempts to decrease the "large disparity" (Adedeji and Baker, 1999, p. 51), existing across corporate disclosure practices prior to the introduction of the standard. With the greater role played by hedging in company operations, interest rate and currency exposures can be changed quickly and easily, making it difficult for institutional

shareholders to assess the overall financial risk associated with owning shares in any particular company. FRS 13 provides information on this risk and enables fund managers to assert control by use of the 'exit and voice' framework postulated by Hirschman (1970) [143].

One of the most notable findings of the present study relates to the lack of consistency in the views expressed by institutional investors. This finding supports the results of Sherman et al. (1998) who documented significant heterogeneity amongst institutional investors. However, it appears that this variability is not recognised by the investee firms who frequently categorise institutional investors as a homogenous group possessing identical objectives and behaviours. The current research highlights the diverse range of opinions expressed by institutional investors with respect to the potential impact of derivatives usage. Such divergent requirements make it difficult for companies to meet the informational needs of all constituents. Accounting standards, such as FRS 13, provide a common basis for discussion and may help to make it easier for companies to meet such diverse needs.

A considerable amount of empirical evidence supports the notion that non-executive directors have a vital role to play in corporate governance through the monitoring of management and the protection of shareholder interests (Coles et al., 2001; Myners Report, 2001; Weir and Laing, 2001; Barratt and Korac-Kakabadse, 2002). The present study indicates that the role played by non-executive directors may not be correctly understood by institutional investors. The fund managers all indicated an assumption or a belief that non-executive directors played an essential role in the risk

[143] Although voice would be more commonly exercised given the emphasis placed by fund managers on indexed/tracker funds.

management practices of their investee companies. However no evidence was sought of this involvement and the non-executive director's role was not questioned by the institutional investors, who indicated that risk management was not a topic that was discussed in their meetings with company management. The views of the institutional investors appeared to be more in line with a theoretical ideal that non-executive directors had an input to the risk management function, but no evidence was sought by the institutional investors to determine actual practice. This indicates a need for institutional investors to be more aware of some of the implications of accounting standards and to communicate with both executive and non-executive directors on these issues, within a corporate governance framework.

A surprising finding of the present study was the perception amongst institutional investors that currency risk was the most frequently hedged exposure in their investee companies. This is contrary to recent evidence that suggests that interest rate risk is the most commonly hedged exposure by companies (Bodnar et al. 1995; 1996; 1998; Helliar, 1997). Institutional investors therefore appear to have an incorrect view of their investee firms' potential exposures. Perhaps this narrow view is based on their own institutions' operations; the nature of these is to invest in shares in different countries, thereby focusing themselves on currency risk. Fund managers do not normally borrow or lend (unless a hedge fund), thereby resulting in little exposure to interest rate risk. Perhaps fund managers are assuming the same exposures for their investee companies? FRS 13 provides more information on the broad range of potential company exposures, therefore making institutional investors more aware of the potential risks faced by their investee companies.

7.5 Summary and Conclusion

In contrast to the analysis offered in Chapter 6 where the views of the preparers of FRS 13 information were sought, in this chapter institutional investors were interviewed to provide a user perspective on the implementation of this accounting standard. The introduction of accounting standards may often lead to the improvements of corporate governance in corporations, and fund managers views were sought to discover whether these powerful institutional shareholders regarded the standard as advancing the governance at their investee firms. The results of this research indicate that institutional investors are aware of an increase in their investee companies' use of derivatives. In general, the interviewees support the main aims of the standard; they think that the more detailed annual reports allow them to gauge the hedging and derivatives activity of their investee companies more accurately. However, the fund managers place a greater emphasis on their investee companies' strategic and operational activities than on detailed financial risk management concerns.

As noted in Chapter 4 and Chapter 6 several limitations have been noted with the use of the interview technique (Section 4.4.3.1 and Section 6.5). This chapter outlined the perspectives of institutional investors as users of annual reports regarding the impact of the introduction of a derivatives reporting standard. Such perspectives provide necessary feedback to standard-setters on the implications of the standard for investment decision-making and corporate governance and accountability relationships. Although, the use of the interview technique results in non-standard, context-dependent responses (Taylor and Bogdan, 1984; Yin, 1994; Denscombe, 1998) and is heavily dependent on the interviewees' recollection of events (Yin,

1994), the use of a standard list of questions imposes some discipline on the process and ensures that the same topics are covered in all interviews. All of the interviewees were experts in their field so the technical nature of the questions asked did not cause them much difficulty.

Chapters 5, 6 and 7 comprised the empirical elements of the current research. Chapter 5 provided a description of the FRS 13 related disclosures found in corporate annual reports prior to, and following, the introduction of FRS 13 in March 1999. Chapter 6 provided details of the perspectives of preparers of derivatives related information for these annual reports, while Chapter 7 presented an analysis of the users reaction to the increased disclosures resulting from the accounting standard. Chapter 8 will provide a summary of the main findings, details of the limitations of the research and will offer some suggestions for future research and extending the present analysis.

Chapter 8

Summary and Conclusions

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8.1 Introduction

The primary objective of this study has been to examine the impact of FRS 13 on corporate reporting practices as well as on corporate governance and accountability relationships. An assessment of the impact of FRS 13 on corporate reporting practices was facilitated by an examination of corporate annual reports before and after the implementation of this derivatives accounting standard. The financial statements for different-sized firms drawn from a wide variety of sectors were consulted to trace the impact of the standard on a diverse mix of companies. Once this was complete, both preparer and user perspectives regarding the implementation of the standard were sought in order to provide a better understanding of the issues associated with the introduction of an accounting standard. The impact of the resulting disclosures for corporate governance and accountability were then highlighted.

The philosophical assumptions of the researcher pointed towards the use of qualitative methods of investigation. To this end, the study used two principal research methods: (i) interviews with both the preparers and the users of corporate financial statements; and (ii) the content analysis of 210 annual reports both before and after the implementation of FRS 13. The investigation employs information from sources such as corporate annual reports and Datastream as well as the views of practitioners distilled from interviews. The aim is to provide a descriptive account of derivatives-related disclosures, as well as an examination of the perspectives of both treasurers (as preparers of the information needed by FRS 13), and fund managers (as potential users of the information provided by FRS 13). Therefore, the study is exploratory in nature and no attempt is made to focus on hypothesis testing.

The remainder of the chapter is organised as follows. Section 8.2 provides a summary of the three empirical chapters: (i) overviews of the content analysis as conducted in Chapter 5; (ii) the perspectives of preparers of derivatives related information as detailed in Chapter 6; and (iii) the views of users of financial statements as described in Chapter 7. The main findings and their implications are restated in Section 8.3. Section 8.4 offers some limitations of the current research. Section 8.5 provides summary details of avenues for further developments and future research.

8.2 A Summary of the Empirical Chapters

The derivatives reporting project was precipitated by several well-known corporations suffering large losses from using these novel financial products. The emergence of new, more complex, financial instruments was seen as a challenge to existing financial accounting practices. Prior to the introduction of FRS 13, these products were not included in company balance sheets and were thus a source of risk for stakeholders who were often unaware of such products being employed by a company. However, their recognition in company financial statements, as mandated by IAS 39, increases volatility in earnings, because the value of derivative products varies as the price of the underlying security changes, and such changes now need to be reflected through the Profit and Loss account.

Chapter 5 presents the results of a content analysis survey of the annual reports of 210 companies prior to, and following, the implementation of FRS 13. The findings of this analysis suggest that the implementation of FRS 13 had a significant effect on the amount of derivatives-related disclosures presented in corporate annual reports. In

many cases the disclosure doubled between the pre- and post- FRS 13 annual reports. Such a finding probably understates the true rise in disclosure as several firms increased their derivative information content in the run-up to FRS 13's adoption. The change in disclosure was examined for 10 categories of disclosure mandated by the standard; all categories reported a rise but the increase was found to be especially pronounced for the 'Objectives, Policies & Strategies' and the 'Interest Rate Risk' categories of disclosure. The largest disclosers were found to be FTSE 100 listed companies while the industry grouping with the biggest average disclosure included companies from the Non-Cyclical Services sector. It was concluded, therefore, that the introduction of FRS 13 had a significant impact on the content of annual reports. The scale of this impact varied across companies, with some industrial sectors supplying more information than others.

Seventeen treasurers were interviewed to investigate what impact the new accounting standard had upon the preparers of accounts and the results were discussed in Chapter 6. Treasurers were deemed to have been most affected by the changes associated with the introduction of the standard, as they were the ones typically preparing the information for disclosure. The treasurers were, in general, very supportive of the standard, especially the narrative disclosures required. However, some did wonder whether such disclosures would be of much use to non-expert readers of the financial statements as they assumed some knowledge about what the instruments were and how they were used. In addition, most treasurers had not encountered any problems with the implementation of the standard and considered that the information required by the standard should have been produced by treasury departments anyway. There was far more dissatisfaction with the proposed new International Accounting

Standard, IAS 39; most treasurers thought that the requirements in this standard would give rise to a lot of changes to existing financial reporting and treasury systems and operating procedures in order to gather the necessary information needed for compliance. Discussions that centred around the implementation of IAS 39 reflected the treasurers' concerns about fair value accounting and the difficulty of putting systems and procedures in place to document how derivative transactions were "effective" hedges against operational activities, so that hedge accounting could be adopted. The treasurers were worried that if hedge accounting was not adopted, the bottom line earnings figure would be so volatile as to make comparisons between companies, and over time, meaningless.

Institutional investors were interviewed to provide a user perspective on the implementation of FRS 13. Accounting standards are often introduced to improve the corporate governance of corporations, and fund managers' views were sought to discover whether these large shareholders regarded the standard as improving the governance at their investee companies. Institutional shareholders were selected for this purpose because (i) they are thought to be sophisticated users of financial statements (Mallin, 1996; Solomon and Solomon, 1999), (ii) they own a sizeable percentage of all shares on the London Stock Exchange (Gaved, 1997; Holland, 1998; Pike and Neale, 1999), and (iii) recent corporate governance reports have attributed a 'special' monitoring role to them to ensure that companies comply with the highest standards of corporate governance (Cadbury Report, 1992; Greenbury Report, 1995; Hampel Report, 1998; Turnbull Report, 1999; Myners Report, 2001; Higgs Report, 2003). In general, the interviewees were supportive of the standard, and thought that the annual reports allowed them to gauge the hedging and derivatives activity of their

investee companies more accurately. However, despite the emphasis placed on the important role to be played by institutional investors in the corporate governance and risk management of their investee companies as highlighted in the aforementioned codes, the interviewees in our sample did not see this as their responsibility. They placed little emphasis on the detailed financial management and financial engineering practices of their investee companies and concentrated instead on the fundamentals of the business. The current research also highlighted the diverse range of opinions expressed by institutional investors with respect to the potential impact of derivatives usage. Such diverging viewpoints are rarely taken into account by companies, who typically classify all investors together and direct their communications accordingly.

8.3 Major Findings and Implications

Three major findings emerge from this dissertation. First, following the implementation of FRS 13 there was a doubling of derivatives-related information presented in corporate annual reports. The scale of the impact varied across companies, with some industrial sectors and market groupings supplying more information than others. Second, both preparers and users of financial statements generally welcomed the adoption of FRS 13. They suggested that the increased transparency in financial reporting improved the corporate governance framework by means of providing a focus on treasury activities at board level, thereby improving internal control processes. The disclosures concerning companies' objectives and policies for using derivative instruments were particularly welcomed. However, the more complex numerical information provided under the standard was greeted less favourably due to the perceived complexity of the information disclosed. Third, although the interviewees broadly supported the implementation of FRS 13 and did

not find the process too onerous, there was far more dissatisfaction with the proposed new International Accounting Standard due to be implemented in the UK by 2005. The majority of the interviewees indicated that the requirements of this standard would give rise to a lot of changes in existing financial reporting and treasury systems as well as operating procedures in order to gather the necessary information needed for compliance.

Clearly, both the users and the preparers of the annual report that were consulted for this study have welcomed the adoption of FRS 13 to some extent. The additional disclosure provided by the standard may have provided stakeholders with useful information about companies, thereby increasing levels of both corporate governance and accountability. Moreover, the increased transparency in the reporting of derivatives activity may have improved the corporate governance framework existing in the UK. The narrative disclosures covering companies' objectives, policies and strategies for holding or issuing financial instruments was especially welcomed, and companies doubled their reporting on these issues after complying with the standard. This additional disclosure might provide stakeholders with useful information about these companies. There was less enthusiasm for the quantitative tables required by FRS 13, because the preparers thought that it would be difficult for non-treasurers to understand this information. Both the users and preparers of financial statements who were interviewed found these tables difficult to understand and did not consider that their inclusion added anything extra to the accountability of the organisations' narrative disclosures.

The treasury interviewees indicated that the presence of FRS 13 information did not improve the overall accountability or corporate governance of their firms. Treasury departments appear to be concerned solely with the narrow financial aspects of accountability; they only appeared to accept their responsibility to manage the financial resources entrusted to them by the shareholders and the need to account for their management of these resources. However, a role was acknowledged for FRS 13 in terms of providing more focus on treasury activities at board level, a situation which had the potential to improve organisational control and thus aid governance. Institutional investors, on the other hand, viewed increased disclosures as potentially indicative of a well-governed company. The FRS 13 disclosures provided a level of consistency across companies in terms of providing information about a broad range of company exposures and making investors more aware of potential risks.

The dissatisfaction expressed over the proposed new International Accounting Standard, due for implementation in the UK by 2005, should be a major concern for policy makers. The findings of the current research suggest that the requirements of this standard will give rise to a lot of changes to existing financial reporting and treasury systems and operating procedures to facilitate the gathering of necessary information needed for compliance. Companies are worried about the increased volatility that may result from not adopting hedge accounting techniques; this may in turn make firms appear riskier than they really are. Furthermore, the findings of the present research indicate that both the preparers and users of financial statements value the narrative disclosures provided under FRS 13. The more complex numerical information is considered too complex for all but the expert reader. The international developments are geared towards a further increase in the quantity of complex

numerical information. This development may, paradoxically, have an adverse effect on corporate accountability, rendering the financial statements even more incomprehensible to all but the most sophisticated of readers.

8.4 Limitations of the Study

This thesis has tried to elicit the views of users and preparers of annual reports on the introduction of Financial Reporting Standard 13. The findings are based on a number of interviews with institutional fund managers and treasurers. Clearly, the views of around 40 individuals may not represent the views of all treasurers and all shareholders, or indeed, all stakeholders in an organisation. Thus, the results of the interview strands of the research do not permit any systematic generalisations. The decision to interview treasury personnel rather than other company representatives was based on the researcher's perception of those most affected by the standard. It is acknowledged that differing perspectives on the implementation of FRS 13 may have been gained by interviewing other corporate representatives. Likewise, the views of the institutional investors obviously do not reflect the views of all users of financial statements. For example, stakeholder groups such as the professions, banks, the government, customers, suppliers, employees, non-governmental organisations and society at large are not represented in the present analysis. The views of smaller investors are likewise not taken into consideration in the current analysis. However, because institutional investors own a large majority of the equity issued by quoted firms, it was considered reasonable, for the purposes of this study, to consult just large shareholders. The purpose of this study was not to examine whether accounting standards are aimed at target audiences, but to study the impact of the introduction of a new standard on some preparers of accounts and members of one major user group -

the institutional shareholders. The data collected are, to an extent, unique owing to the specific context and the specific individuals involved, but do provide a flavour of the differing views expressed on the introduction of an accounting standard.

The decision to examine the annual reports published in the years prior to, and following, the introduction of FRS 13 can be considered a limitation of the present research. The finding about the doubling of derivatives related information presented in annual reports probably understates the true rise in disclosure as several firms increased their derivative information content in the run-up to FRS 13's adoption. An analysis of these early adopters' annual reports for three or four years prior to the introduction of FRS 13 could potentially yield valuable insight into the decision process and motivations for disclosure of derivatives usage information.

Other limitations relate to the research methods employed in the investigation. The aim is to provide a descriptive account of derivatives-related disclosures, and the perspectives of selected treasurers as preparers of the information, and the views of a number of fund managers as potential users of the information provided by FRS 13. The underlying philosophical assumptions of the researcher, as well as the broad objectives of the research, dictated the use of qualitative research methods. This research study employed two methods of qualitative data collection in order to satisfy the objectives of the study: (i) the content analysis of corporate annual reports; and (ii) interviews with treasury disclosure preparers and institutional users of corporate financial statements. Both of these research methods emanate from a subjectivist approach to social science whereby on-going processes are observed in order to gain a fuller understanding of individual behaviour.

There is a substantial element of subjectivity involved with the use of the content analysis technique. For example, the analysis of the annual reports of the 210 companies is a lengthy process, and may be subject to human error in calculating the amount of disclosure in each annual report. The use of multiple coders helped in this regard. Difficulties associated with the use of the content analysis technique typically relate to the questions asked or the source materials available. However, the presence of an appropriate, reliable, valid and accurate coding scheme that guided the coders through the analysis of content, in addition to the use of a frequently utilised and well defined document such as the corporate annual report, helped to reduce this element of error.

The use of the interview survey method is also subject to limitation. These limitations range from the possible inaccuracies and inconsistencies associated with the interviewee's recollection of events to the inability to make systematic generalisations. However, the use of the interview method in the present study facilitated the collation of various individual perspectives on the effects of the introduction of a derivatives accounting standard. This investigation provided a useful and informative accompaniment to the analysis of the changes the standard visited on corporate financial statements.

8.5 Avenues for Future Research

Six extensions of the work examined in this thesis are possible; two of these are currently underway. The first relates to the impact of FRS 13 on stock market participants. The introduction of a new Financial Reporting Standard often brings new

information to the market about corporate activities. An event study methodology will be employed to ascertain whether the publication of the exposure draft, and the standard itself, or the publication of the first annual report that complied with FRS 13, produced any market reaction. The preliminary results of this analysis by Dunne et al. (forthcoming) have shown that the stock market responded adversely to the news of the standard. This effect seems to be particularly pronounced for large FTSE 100 companies.

The second extension of the present work, which is also currently underway, will examine whether companies use derivatives for particular purposes and whether there were any factors that enhanced corporate use of, and disclosure about, these products. The preliminary results of this evaluation by Dunne et al. (forthcoming) have found that larger companies, with complex overseas operations, often with weak financial ratios, are much more likely to be large disclosers with more active use of derivative products.

Other possible extensions might also be considered. A third extension could extend the present analysis to investigate the potential consequences of other derivatives accounting standards. The views of the preparers of financial statements consulted for this thesis concerning the potential implications of IAS 39 were very negative; discussions typically reflected the treasurers' concerns about the use of fair value accounting techniques. Many of the interviewees were very unhappy about the potential impact that any future standard would have on their reported earnings and any associated disruptions to treasury operations and hedging activity. The European Commission requirement that all EU listed companies prepare their accounts under

international accounting standards by 2005 means that these issues will come to the fore over the next couple of years. Examining changes in corporate annual reports subsequent to the introduction of the new complex rules concerning fair value accounting would be an important extension of the present analysis.

A fourth extension might be a cross-country comparative analysis in order to examine the application of IAS 39 in a European context; such an examination would facilitate an analysis of the impact of differing cultural norms on the implementation of an international standard such as IAS 39. A further content analysis could be conducted to examine the implementation of the standard at a European level. A questionnaire survey would give additional insights on the difficulties associated with applying an international standard in a variety of different economic and cultural environments.

A fifth extension could expand the scope of the present analysis to include implications of the standard for other stakeholders. One of the limitations of the present research is that the users of financial statements were defined quite narrowly to only include large institutional shareholders. The justification for this definition was that these shareholders represented a large majority of UK shareholdings and were seen as important in the current corporate governance process. However, FRS 13 and its international counterparts might also have implications for other users of financial statements, such as banks, retail investors, and so on. A questionnaire, or further interviews, with these interested parties might give further insight into the consequences of accounting standards for wider audiences.

A sixth extension might involve examining the consequences of derivative reporting standards for financial institutions. The implications of FRS 13 for this group of preparers were specifically excluded from the present analysis, because of the differing application of the standard for this group. These organisations typically trade in, and make much greater use of these instruments. A further study could however, usefully examine both the differing affects of the derivative reporting requirements on these organisations' financial statements, and survey these preparers on the unique environment faced by them in their preparation of these documents.

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Appendices

Appendix 2.1

Summary of FRS 13 - Derivatives and Other Financial Instruments: Disclosures

General Application of the Standard

FRS 13 was issued in September 1998, for implementation in accounting periods commencing on or after March 23rd, 1999. Earlier adoption is encouraged but not required. Corresponding amounts should be disclosed for each of the disclosures required by the FRS. However, this may not be practicable in all circumstances for the first accounting period in which the FRS comes into effect. Accordingly, such disclosure is not required for that period, although it is encouraged.

Financial Reporting Standard 13 applies to all entities, other than insurance companies, that have one or more of their capital instruments listed or publicly traded on a stock exchange or market, and to all banks and similar institutions.

Objective of the Standard

The objective of this FRS is to ensure that reporting entities within its scope provide in their financial statements disclosures that enable users to assess the entity's objectives, policies and strategies for holding or issuing financial instruments. In particular, such information should enable users to assess:

(a) the risk profile of the entity for each of the main financial risks that arise in connection with financial instruments and commodity contracts with similar characteristics; and

(b) the significance of such instruments and contracts to the entity's reported financial position, performance and cash flows, regardless of whether the instruments and contracts are on balance sheet (recognised) or off balance sheet (unrecognised).

The Approach Adopted in FRS 13

The FRS requires both narrative and numerical disclosures.

Narrative Disclosures

The FRS requires an explanation to be provided of the role that financial instruments play in creating or changing the risks that the entity faces in its activities. The entity should also explain the directors' approach to managing each of those risks, including a description of the objectives, policies and strategies for holding and issuing financial instruments. Where the directors decide, before the balance sheet date, to change these objectives, policies or strategies, that change should also be explained.

The narrative disclosures are mandatory, although the FRS permits them to be given in a statement accompanying the financial statements (such as the operating and financial review or the directors' report) provided that they are incorporated into the financial statements by a suitable cross-reference.

Numerical Disclosures

The FRS requires specified numerical disclosures to be provided about:

- interest rate risk
- currency risk
- liquidity risk

- fair values
- financial instruments used for trading
- financial instruments used for hedging
- certain commodity contracts.

To avoid the numerical disclosures becoming so detailed that their message is obscured, the FRS encourages, and in some cases requires, a high degree of aggregation.

Disclosure of Objectives, Policies and Strategies

The disclosures required by the FRS focus primarily on the risks that arise in connection with financial instruments (and certain similar contracts) and how they have been managed. These risks will typically include credit risk, liquidity risk, cash flow risk, interest rate risk, currency risk and other types of market price risk although the risks may be categorised in some other way. It is envisaged, but not required, that the information provided about these risks will usually be presented in the context of a discussion, in a statement such as the operating and financial review, of the entity's activities, structure and financing. This discussion will typically also consider the financial risk profile of the entity as a whole, before focusing specifically on financial instruments. Such an approach enables the disclosures required by the FRS to be put into their proper context and it ensures that the disclosures required focus on the risks of greatest significance to the entity.

An explanation should be provided of the role that financial instruments have had during the period in creating or changing the risks the entity faces in its activities. This should include an explanation of the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives-in both cases as agreed by the directors-that have been followed during the period. This disclosure would usually

include a discussion of the nature of, and purposes for which, the main types of financial instruments and similar contracts are held or issued. Instruments used for financing, for risk management or hedging and for trading or speculation would all need to be covered, though separately from each other.

The disclosure would also typically include a description of the main financial risk management and treasury policies agreed by the directors, including the policies, quantified where appropriate, on:

(a) the fixed/floating split, maturity profile and currency profile of financial assets and liabilities;

(b) the extent to which foreign currency financial assets and financial liabilities are hedged to the functional currency of the business unit concerned;

(c) the extent to which foreign currency borrowings and other financial instruments are used to hedge foreign currency net investments; and

(d) any other hedging.

If this disclosure reflects a significant change from the explanations provided for the previous accounting period, this should be disclosed and the reasons for the change explained. If the period-end position is regarded as materially unrepresentative of the entity's position during the period or of its agreed objectives, policies and strategies, an explanation of the extent to which it is regarded as unrepresentative should be provided.

If an entity uses financial instruments as hedges, it should describe:

(a) the transactions and risks that have been hedged, including the period of time until they are expected to occur; and

(b) the instruments used for hedging purposes, distinguishing between those that have been accounted for using hedge accounting and those that have not.

Interest Rate Risk Disclosures

Financial Liabilities

The aggregate carrying amount of financial liabilities should be analysed, by principal currency, to show separately those liabilities at fixed interest rates, those at floating interest rates and those on which no interest is paid. In preparing the analysis:

(a) interest rate swaps, currency swaps, forward contracts and other derivative financial instruments whose effect is to alter the interest or currency basis of the financial liabilities should, as far as possible, be taken into account;

(b) any financial liabilities and derivative financial instruments that cannot be adequately reflected in the analysis should be excluded and a summary of their main effects provided instead.

The following should also be disclosed by reference to principal currency:

(a) the weighted average interest rate of the fixed rate financial liabilities;

(b) the weighted average period for which interest rates on the fixed rate financial liabilities are fixed;

(c) the weighted average period until maturity for financial liabilities on which no interest is paid; and

(d) the benchmark rate for determining interest payments for the floating rate financial liabilities.

The FRS requires the interest rate risk disclosures to be prepared on a gross basis, although this does not prevent entities from showing the figures on a net basis if the difference is not material. If the difference is material but an entity still wishes to show the position on a net basis, additional information showing the net position may be included in the analysis so long as the gross position is also shown.

Financial Assets

If an entity has material holdings of financial assets, the same information is required as is described for financial liabilities. The disclosures to be provided for such instruments will typically be limited to information about any currency exposures involved.

Currency Risk Disclosures

An analysis should be provided of the net amount of monetary assets and liabilities at the balance sheet date showing the amount denominated in each currency, analysed by reference to the functional currencies of the operations involved. In preparing this analysis:

(a) to avoid excessive detail, the focus should be on the principal functional currencies and on the principal currencies in which the monetary items are denominated.

(b) monetary assets and liabilities denominated in the same currency as the functional currency of the operations involved should not be included in the analysis.

(c) if an entity has used foreign currency borrowings to finance, or provide a hedge against, foreign net investments and the exchange gains or losses on those borrowings are included in the statement of total recognised gains and losses in accordance with SSAP 20, those borrowings should not be included in the analysis.

(d) account should as far as possible be taken of the effect of currency swaps, forward contracts and other derivative financial instruments that contribute to the matching of

foreign currency exposures and a summary should be provided of the main effect of any such financial instruments that have not been taken into account.

Liquidity Disclosures

A maturity profile of the carrying amount of financial liabilities should be presented, showing amounts falling due:

(a) in one year or less, or on demand;

(b) in more than one year but not more than two years;

(c) in more than two years but not more than five years; and

(d) in more than five years.

The maturity profile should be determined by reference to the earliest date on which payment can be required or on which the liability falls due.

An analysis of the maturity of any material undrawn committed borrowing facilities of the entity should also be provided, showing those amounts expiring:

(a) in one year or less;

(b) in more than two years.

If conditions precedent are attached to a committed facility, it should be included in the analysis only if all the conditions were satisfied at the balance sheet date.

Fair Value Disclosures

An entity should group its financial assets and financial liabilities (whether recognised or unrecognised) into appropriate categories and for each category should disclose either:

(a) the aggregate fair value as at the balance sheet date together with the aggregate carrying amount; or

(b) the aggregate fair value of items with a positive fair value and, separately, the aggregate fair value of items with a negative fair value, in both cases as at the balance sheet date and in each case accompanied by the relevant aggregate carrying amount.

The categories will typically follow the same structure as, but be in more detail than, that used in discussing the objectives, policies and strategies for holding or issuing financial instruments

Fair values are to be disclosed regardless of whether the financial asset or financial liability involved is held as a hedge. The method(s) and any significant assumptions used in determining fair value should be disclosed. No fair value need be disclosed if it is not practicable for the reporting entity to estimate with sufficient reliability the fair value of any financial asset or financial liability, or category of them, that is not traded on an organised market in a standard form. In such circumstances, the following should be provided instead:

(a) a description of the financial asset or financial liability (or category of them) and its carrying amount.

(b) the reasons why it is not practicable for the reporting entity to estimate the fair value with sufficient reliability.

(c) information about the principal characteristics of the underlying financial asset or financial liability (or category of them) that is pertinent to estimating its fair value-for example the factors that determine or affect the instrument's cash flow-and the market for such instruments.

Such information need not be provided if, at the level of aggregation and date at which the information would otherwise be disclosed, its disclosure is likely, in the opinion of the

directors, to be seriously prejudicial to the entity's interests. The fact that such information has not been disclosed and the reasons for the omission should be stated.

Disclosures about Financial Assets and Financial Liabilities used for Trading

If the reporting entity trades in financial assets and financial liabilities, the following information should be provided:

(a) the net gain or loss from trading in financial assets and financial liabilities that has been included in the profit and loss account during the period, analysed by type of financial instrument, business activity, risk or in such other way as is consistent with the entity's management of this activity.

(b) if the analysis provided in accordance with subparagraph (a) is other than by type of financial instrument, a description, for each line of that analysis, of the types of financial instruments involved.

(c) the period-end fair value of financial assets and, separately, of financial liabilities, held or issued for trading.

(d) if the period-end position disclosed in accordance with subparagraph (c) is regarded as materially unrepresentative of the entity's typical position during the period, the average fair value over the period of financial assets and financial liabilities held or issued for trading. The average fair value should be calculated using daily figures or, if the figures are not calculated daily, using the most frequent interval that an entity's systems generate for management, regulatory or other reasons.

Disclosures about Hedges

The following information should be provided about gains and losses on financial assets and financial liabilities for which hedge accounting has been used:

(a) the cumulative aggregate gains and losses that are unrecognised at the balance sheet date. If the item's fair value is not disclosed under the FRS, any gain or loss on the item need not be dealt with in this disclosure.

(b) the cumulative aggregate gains and losses carried forward in the balance sheet at the balance sheet date, pending their recognition in the profit and loss account.

(c) the extent to which the gains and losses disclosed under (a) and (b) are expected to be recognised in the profit and loss account in the next accounting period.

(d) the amount of gains and losses included in the reporting period's profit and loss account that arose in previous years and were either unrecognised or carried forward in the balance sheet at the start of the reporting period.

If financial assets or financial liabilities previously accounted for as hedges are reclassified during the period and no longer accounted for as hedges and, as a result, gains and losses that arose in previous years have been recognised in the reporting period's profit and loss account, the amount of those gains and losses should be disclosed.

Disclosures about Commodity Contracts

Entities within the scope of this part of the FRS should treat cash-settled commodity contracts as if they were financial assets or financial liabilities for the purposes of:

(a) the narrative disclosures described previously;

(b) the fair value disclosures described previously;

(c) the disclosures about financial assets and financial liabilities held or issued for trading described previously; and

(d) the disclosures about hedges described previously.

Additional Disclosures about Market Price Risk

Entities are encouraged, but not required, to provide numerical disclosures that show the magnitude of market price risk arising over the period for all financial instruments and cash-settled commodity contracts and, if significant, all other items carrying market price risk. This information should be provided using a technique or other basis that is consistent with the way the entity manages its risk exposures. Entities that use one approach to manage market price risk in one part of their business and a different approach in another part are encouraged to provide separate disclosures for each part.

Entities are also encouraged to provide a discussion of their approach to market price risk so as to set the numerical information in context and to assist in its interpretation.

It is important to choose a disclosure approach that gives meaningful information without oversimplifying the position or inundating the user with unmanageable amounts of data. Entities are encouraged to report in ways that reflect how the risk is managed. This could involve one of the methods described below, another method or a combination of approaches.

(a) More details about positions at the reporting date and perhaps activity during the period. However, entities that use a large number of financial instruments may find such disclosures impractical.

(b) Sensitivity analysis, i.e. the hypothetical effects on net assets or profits of various possible changes in market prices.

(c) 'Gap' analysis of interest rate repricing and/or maturity dates. This approach involves analysing assets and liabilities into time bands by reference to interest rate repricing dates or maturity dates.

(d) 'Duration' of instruments. This approach, which also deals only with interest rate risk, is a method of measuring sensitivity to interest rate changes. Duration is the

length (in years) of a hypothetical zero coupon bond whose value would change by the same amount as that of the instrument(s) in response to a change in interest rates. A shorter duration indicates a lower level of interest rate sensitivity. This approach suffers from the same drawbacks as gap analysis.

(e) Value at risk. The value at risk of a group of assets and liabilities is the expected loss that will arise on those assets and liabilities from an adverse market movement with a specified probability over a specified period of time.

If the disclosures described above are provided, they should be supplemented by:

(a) an explanation of the method used and of the main parameters and assumptions underlying the data provided;

(b) an explanation of the objective of the method used and of the limitations that may result in the information not fully reflecting the market price risk of the assets and liabilities involved; and

(c) reasons for any material changes in the amount of reported market price risk when compared with that reported for the previous period.

Disclosure of Accounting Policies

SSAP "Disclosure of accounting policies" requires financial statements to include clear, fair and concise explanations of all material or critical accounting policies adopted. Disclosing the accounting policies used for financial instruments is of particular importance in view of the wide variety of accounting treatments that are adopted. In order to comply with SSAP 2, the description of accounting policies will usually need to include (if the choice of policy applied has had a material effect) a description of:

(a) the methods used to account for derivative financial instruments, the types of derivative financial instruments accounted for under each method and the criteria that determine the method used.

(b) the basis for recognising, measuring (both on initial recognition and subsequently), and ceasing to recognise financial assets and financial liabilities.

(c) how income and expenses (and other gains and losses) are recognised and measured.

(d) the treatment of financial assets and financial liabilities not recognised, including an explanation of how provisions for losses are recognised on financial assets and financial liabilities that have not been recognised.

(e) policies on offsetting.

Where financial instruments are carried on the historical cost basis, features covered by the description of accounting policies would typically include (where the choice of policy applied has had a material effect) the treatment of:

(a) premiums and discounts on financial assets;

(b) changes in the estimated amount of determinable future cash flows associated with a financial instrument, such as a debenture indexed to a commodity price;

(c) a fall in the fair value of a financial asset to below the asset's carrying amount; and

(d) restructured financial liabilities.

Where financial instruments are used as hedges and accounted for using hedge accounting, the description of accounting policies will usually need to include (if the choice of policy has had a material effect) a description of:

(a) the circumstances in which a financial instrument is accounted for as a hedge;

(b) the recognition and measurement treatment applied to an instrument used as a hedge;

(c) the method used to account for an instrument that ceases to be accounted for as a hedge;

(d) the method used to account for the hedge when the underlying item or position matures, is sold, extinguished, or terminated; and

(e) the method used to account for the hedge of a future transaction when that transaction is no longer likely to occur.

Appendix 5.1: Basic Information for Content Analysis Sample Companies

Years	Datastream Code	Company	Listing	Sector
1998 & 1999	905695	10 Group	AIM	Cyclical Services
1998 & 1999	900780	Alexandra	FTSE Other	Cyclical Consumer Goods
1998 & 1999	312657	Allders	FTSE Other	Cyclical Services
1998 & 1999	900232	Allied Domecq	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	135209	Amco Corporation	AIM	Basic Industries
1998 & 1999	135744	Amey	FTSE Other	Cyclical Services
1998 & 1999	953193	Amstrad	FTSE Other	General Industrials
1998 & 1999	681552	Anglo Siberian Oil Co.	AIM	Resources
1998 & 1999	917534	Anite Group	FTSE Other	Information Technology
1998 & 1999	914162	Armitage Bros.	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	900631	Assoc. Brit. Engineering	FTSE Other	General Industrials
1998 & 1999	900825	Associated British Foods	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	319608	AstraZeneca	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	906416	Avesco	FTSE Other	Cyclical Services
1998 & 1999	904710	Avingtrans	FTSE Other	Cyclical Consumer Goods
1998 & 1999	953553	B A A	FTSE 100	Cyclical Services
1998 & 1999	901419	BAE Systems	FTSE 100	General Industrials
1998 & 1999	974117	Berkeley Group	FTSE Other	Basic Industries
1998 & 1999	911488	BG Group	FTSE 100	Resources
1998 & 1999	899188	BHP Billiton	FTSE 100	Resources
1998 & 1999	312763	Biotrace International	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	135750	Bloomsbury Publishing	FTSE Other	Cyclical Services
1998 & 1999	900304	Blue Circle Industries	FTSE Other	Basic Industries
1998 & 1999	900451	BOC Group	FTSE 100	Basic Industries
1998 & 1999	671549	Bond Internat. Software	AIM	Information Technology
1998 & 1999	901192	Boots Company (The)	FTSE 100	Cyclical Services
1998 & 1999	900995	BP	FTSE 100	Resources
1998 & 1999	901815	Brammer	FTSE Other	Cyclical Services
1998 & 1999	135539	Brancote Holdings	AIM	Resources
1998 & 1999	901135	Brandon Hire	FTSE Other	Cyclical Services
1998 & 1999	507342	Bristol Water	FTSE Other	Utilities
1998 & 1999	900571	Brit. Bloodstock Agency	AIM	Cyclical Services
1998 & 1999	914447	British Airways	FTSE 100	Cyclical Services
1998 & 1999	901295	British American Tobacco	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	876252	British Energy	FTSE 100	Utilities
1998 & 1999	135116	British Sky Broadcasting	FTSE 100	Cyclical Services
1998 & 1999	900888	BT Group	FTSE 100	Non-Cyclical Services
1998 & 1999	928781	Burn Stewart Distillers	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	901634	Cable & Wireless	FTSE 100	Non-Cyclical Services
1998 & 1999	900286	Cadbury Schweppes	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	900382	Cakebread Robey	FTSE Other	Basic Industries
1998 & 1999	901604	Carlton Communications	FTSE 100	Cyclical Services
1998 & 1999	319938	Celsis International	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	888276	Centrica	FTSE 100	Utilities
1998 & 1999	888469	Charlton Athletic	AIM	Cyclical Services
1998 & 1999	901016	Charter	FTSE Other	General Industrials
1998 & 1999	882671	Charterhouse Comms.	AIM	Cyclical Services
1998 & 1999	135093	Clydeport	FTSE Other	Cyclical Services
1998 & 1999	255049	Compass Group	FTSE 100	Cyclical Services
1998 & 1999	136631	COMPEL GROUP	FTSE Other	Information Technology

Years	Datastream Code	Company	Listing	Sector
1998 & 1999	892896	ComputerLand UK	AIM	Information Technology
1998 & 1999	900433	Cookson Group	FTSE Other	General Industrials
1998 & 1999	953191	CORUS GROUP	FTSE Other	Basic Industries
1998 & 1999	870916	Coutts (C.A.) Holdings	AIM	Cyclical Services
1998 & 1999	914182	Cradley Group Holdings	FTSE Other	Cyclical Services
1998 & 1999	898687	CRC Group	AIM	Information Technology
1998 & 1999	904283	Daily Mail & General Tst	FTSE 100	Cyclical Services
1998 & 1999	943973	Dana Petroleum	FTSE Other	Resources
1998 & 1999	900954	Davis Service Group	FTSE Other	Cyclical Services
1998 & 1999	901343	De La Rue	FTSE Other	Cyclical Services
1998 & 1999	900251	Diageo	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	882026	Digital Animations Group	AIM	Cyclical Services
1998 & 1999	910263	Dinkie Heel	AIM	Cyclical Consumer Goods
1998 & 1999	900906	Dixons Group	FTSE 100	Cyclical Services
1998 & 1999	901023	Elementis	FTSE Other	Basic Industries
1998 & 1999	910283	EMAP	FTSE 100	Cyclical Services
1998 & 1999	914346	Emess	FTSE Other	General Industrials
1998 & 1999	900559	EMI Group	FTSE 100	Cyclical Services
1998 & 1999	671363	Energis	FTSE 100	Non-Cyclical Services
1998 & 1999	910473	Ennstone	FTSE Other	Basic Industries
1998 & 1999	870958	Epic Group	AIM	Cyclical Services
1998 & 1999	911809	Eurodis Electron	FTSE Other	General Industrials
1998 & 1999	910229	European Colour	FTSE Other	Basic Industries
1998 & 1999	876253	Fayrewood	AIM	Information Technology
1998 & 1999	136904	Filtronic	FTSE Other	Non-Cyclical Services
1998 & 1999	911448	First Choice Holidays	FTSE Other	Cyclical Services
1998 & 1999	870219	Flomerics Group	AIM	Information Technology
1998 & 1999	888093	Fountains	AIM	Cyclical Services
1998 & 1999	906275	French	FTSE Other	Cyclical Consumer Goods
1998 & 1999	897328	Gallaher Group	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	882647	GB Railways Group	AIM	Cyclical Services
1998 & 1999	900350	George Wimpey	FTSE Other	Basic Industries
1998 & 1999	900754	GKN	FTSE 100	Cyclical Consumer Goods
1998 & 1999	900479	GlaxoSmithkline	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	681307	Goldshield Group	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	931524	Granada	FTSE 100	Cyclical Services
1998 & 1999	142283	Groupe Chez Gerard	FTSE Other	Cyclical Services
1998 & 1999	901199	GUS	FTSE 100	Cyclical Services
1998 & 1999	901932	Hanson	FTSE 100	Basic Industries
1998 & 1999	953531	Hartstone Group	FTSE Other	Cyclical Consumer Goods
1998 & 1999	876265	Hat Pin	AIM	Cyclical Services
1998 & 1999	901164	Hays	FTSE 100	Cyclical Services
1998 & 1999	911982	Hewden Stuart	FTSE Other	Cyclical Consumer Goods
1998 & 1999	910437	Hilton Group	FTSE 100	Cyclical Services
1998 & 1999	953573	Hogg Robinson	FTSE Other	Cyclical Services
1998 & 1999	900455	Imperial Chemical Inds.	FTSE 100	Basic Industries
1998 & 1999	882240	Imperial Tobacco Group	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	910911	Infast Group	FTSE Other	Cyclical Services
1998 & 1999	870011	International Greetings	AIM	Cyclical Services
1998 & 1999	928901	International Power	FTSE 100	Utilities
1998 & 1999	905110	Invensys	FTSE 100	General Industrials
1998 & 1999	910415	Jacques Vert	FTSE Other	Cyclical Services
1998 & 1999	926054	Jarvis Porter	FTSE Other	Basic Industries

Years	Datastream Code	Company	Listing	Sector
1998 & 1999	870203	Jasmin	FTSE Other	Information Technology
1998 & 1999	952536	Jenning Brothers	AIM	Cyclical Services
1998 & 1999	882323	John David Sports	FTSE Other	Cyclical Services
1998 & 1999	904486	Kelda Group	FTSE Other	Utilities
1998 & 1999	940281	Kingfisher	FTSE 100	Cyclical Services
1998 & 1999	953568	Kleeneze	FTSE Other	Cyclical Services
1998 & 1999	910215	Laura Ashley Holdings	FTSE Other	Cyclical Services
1998 & 1999	901940	Logica	FTSE Other	Information Technology
1998 & 1999	135730	London Clubs Internat.	FTSE Other	Cyclical Services
1998 & 1999	892012	Longbridge International	AIM	Cyclical Services
1998 & 1999	902232	Lonmin	FTSE Other	Resources
1998 & 1999	901352	Low & Bonar	FTSE Other	Basic Industries
1998 & 1999	905582	LPA Group	FTSE Other	General Industrials
1998 & 1999	870899	M S B International	FTSE Other	Cyclical Services
1998 & 1999	901453	Macro 4	FTSE Other	Information Technology
1998 & 1999	136515	Magnum Power	AIM	General Industrials
1998 & 1999	901155	Manganese Bronze Hldgs.	FTSE Other	General Industrials
1998 & 1999	900498	Marconi	FTSE 100	Non-Cyclical Services
1998 & 1999	901207	Marks & Spencer	FTSE 100	Cyclical Services
1998 & 1999	906137	Mayborn Group	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	900336	McAlpine (Alfred)	FTSE Other	Basic Industries
1998 & 1999	901154	McKechnie Group	FTSE Other	General Industrials
1998 & 1999	882297	Mears Group	AIM	Cyclical Services
1998 & 1999	282045	Melrose Resources	FTSE Other	Resources
1998 & 1999	362536	Metrodome Group	AIM	Cyclical Services
1998 & 1999	926005	Microgen	FTSE Other	Information Technology
1998 & 1999	914192	Misys	FTSE 100	Information Technology
1998 & 1999	905576	Morrison(WM.) Supermarket	FTSE Other	Non-Cyclical Services
1998 & 1999	870969	Mulberry Group	AIM	Cyclical Consumer Goods
1998 & 1999	870181	National Grid Group	FTSE 100	Utilities
1998 & 1999	888086	Netcall	AIM	Information Technology
1998 & 1999	135529	Nightfreight	FTSE Other	Cyclical Services
1998 & 1999	901053	Novar	FTSE Other	Basic Industries
1998 & 1999	307411	NWF Group	AIM	General Industrials
1998 & 1999	900828	Osborne & Little	FTSE Other	Cyclical Consumer Goods
1998 & 1999	870449	Oxford BioMedica	AIM	Non-Cyclical Consumer Goods
1998 & 1999	301966	Pan Andean Resources	AIM	Resources
1998 & 1999	953535	Parity Group	FTSE Other	Information Technology
1998 & 1999	914021	Pearson	FTSE 100	Cyclical Services
1998 & 1999	904302	Pendragon	FTSE Other	Cyclical Consumer Goods
1998 & 1999	901127	Peninsular & Oriental	FTSE 100	Cyclical Services
1998 & 1999	676579	Pennant International	AIM	Information Technology
1998 & 1999	904391	Pennon Group	FTSE Other	Utilities
1998 & 1999	900917	Photo-Me International	FTSE Other	Cyclical Services
1998 & 1999	953815	Pilkingtons Tiles Group	FTSE Other	Basic Industries
1998 & 1999	901433	PizzaExpress	FTSE Other	Cyclical Services
1998 & 1999	897584	Powderject Pharmaceutic.	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	901328	Powell Duffryn	FTSE Other	General Industrials
1998 & 1999	928903	Powergen	FTSE 100	Utilities
1998 & 1999	905498	Premier Farnell	FTSE Other	Cyclical Services
1998 & 1999	943709	Prowting	FTSE Other	Basic Industries
1998 & 1999	904989	QS Group	FTSE Other	Cyclical Services
1998 & 1999	905501	Queens Moat Houses	FTSE Other	Cyclical Services

Years	Datastream Code	Company	Listing	Sector
1998 & 1999	907522	Rage	FTSE Other	Cyclical Services
1998 & 1999	870956	Railtrack Group	FTSE 100	Cyclical Services
1998 & 1999	940297	Ramco Energy	AIM	Resources
1998 & 1999	900484	Reckitt Benckiser	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	901080	Reed Elsevier	FTSE 100	Cyclical Services
1998 & 1999	904335	Reliance Security Group	FTSE Other	Cyclical Services
1998 & 1999	900580	Renold	FTSE Other	General Industrials
1998 & 1999	906480	Rentokil Initial	FTSE 100	Cyclical Services
1998 & 1999	940420	Reuters Group	FTSE 100	Cyclical Services
1998 & 1999	901714	Rio Tinto	FTSE 100	Resources
1998 & 1999	940793	Rolls Royce	FTSE 100	General Industrials
1998 & 1999	926002	Sainsbury, J	FTSE 100	Non-Cyclical Services
1998 & 1999	926029	Samuel Heath & Sons	FTSE Other	Basic Industries
1998 & 1999	892921	Science Systems	AIM	Information Technology
1998 & 1999	928738	Scot. & Southern Energy	FTSE 100	Utilities
1998 & 1999	900261	Scottish & Newcastle	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	928741	Scottish Power	FTSE 100	Utilities
1998 & 1999	871674	Securicor	FTSE 100	Cyclical Services
1998 & 1999	900600	Senior	FTSE Other	General Industrials
1998 & 1999	904373	Severn Trent	FTSE 100	Utilities
1998 & 1999	900998	Shell Transport & Trad.	FTSE 100	Resources
1998 & 1999	926773	Silentnight Holdings	FTSE Other	Cyclical Consumer Goods
1998 & 1999	900601	Simon Group	FTSE Other	Cyclical Services
1998 & 1999	900242	Six Continents	FTSE 100	Cyclical Services
1998 & 1999	900487	Smith & Nephew	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	900517	SmithKline Beecham	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	900943	Smiths Group	FTSE 100	General Industrials
1998 & 1999	896434	Solitaire Group	AIM	Cyclical Services
1998 & 1999	914596	Soundtracs	AIM	General Industrials
1998 & 1999	695504	South African Brews.	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	319410	Stagecoach Group	FTSE 100	Cyclical Services
1998 & 1999	911860	Tarsus Group	FTSE Other	Cyclical Services
1998 & 1999	910707	Taylor Nelson Sofres	FTSE Other	Cyclical Services
1998 & 1999	135090	Telewest Communications	FTSE 100	Non-Cyclical Services
1998 & 1999	900803	Tesco	FTSE 100	Non-Cyclical Services
1998 & 1999	904393	Thames Water	FTSE 100	Utilities
1998 & 1999	679683	Thomson Travel Group	FTSE Other	Cyclical Services
1998 & 1999	974197	Tinsley (Eliza) Group	FTSE Other	General Industrials
1998 & 1999	943417	Titon Holdings	FTSE Other	Basic Industries
1998 & 1999	953808	Torex	FTSE Other	Information Technology
1998 & 1999	135522	Trafficmaster	FTSE Other	Cyclical Services
1998 & 1999	926704	UA Group	AIM	Cyclical Services
1998 & 1999	900789	Unilever	FTSE 100	Non-Cyclical Consumer Goods
1998 & 1999	901106	United Business Media	FTSE 100	Cyclical Services
1998 & 1999	904367	United Utilities	FTSE 100	Utilities
1998 & 1999	870890	Vernalis Group	FTSE Other	Non-Cyclical Consumer Goods
1998 & 1999	953133	Vodafone Group	FTSE 100	Non-Cyclical Services
1998 & 1999	882272	Weeks Group (The)	AIM	Cyclical Services
1998 & 1999	135506	Wellington Holdings	FTSE Other	General Industrials
1998 & 1999	900271	Whitbread	FTSE 100	Cyclical Services
1998 & 1999	926119	WPP Group	FTSE 100	Cyclical Services
1998 & 1999	953641	WSP Group	FTSE Other	Cyclical Services
1998 & 1999	870806	Xansa	FTSE Other	Information Technology

Years	Datastream Code	Company	Listing	Sector
1998 & 1999	507551	Xenova Group	FTSE Other	Non-Cyclical Consumer Goods

Note: This Appendix provides basic details relating to market type and sector for the sample companies. Details relating to the annual reports used and the associated Datastream codes are also provided.

Appendix 5.2: Decision Rules - Categories of Disclosure

Objectives, Policies and Strategies

- Discussion of the risks that arise from financial instruments and how these risks have been managed.
- Discussion of the financial risk profile of the entity as a whole, before focusing specifically on financial instruments.
- An explanation of the role that financial instruments have had during the period in creating or changing the risks the entity faces in its activities.
- An explanation of the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives.
- A discussion of the nature of, and purposes for which, the main types of financial instruments and similar contracts are held or issued, e.g. financing, risk management, hedging.
- A description of the main financial risk management and treasury policies agreed by the directors, including the policies, on:
  (a) the fixed/floating split, maturity profile and currency profile of financial assets and liabilities;
  (b) the extent to which foreign currency financial assets and financial liabilities are hedged to the functional currency of the business unit concerned;
  (c) the extent to which foreign currency borrowings and other financial instruments are used to hedge foreign currency net investments; and
  (d) any other hedging.
- Any significant changes from the explanations provided for the previous accounting period
- Any proposed changes explained (SSAP 17)
- An explanation of how representative the period-end numerical disclosures shown in the financial statements are; any explanation of the extent to which Y/E position is regarded as unrepresentative
- If financial instruments are used for hedging:
  - disclosure about the transactions and risks that have been hedged
  - disclosure about the instruments used and discussion of whether such instruments have been accounted for using hedge accounting or not

Interest Rate Risk

Financial Liabilities

- The aggregate carrying amount of financial liabilities analysed, by principal currency, to show separately those liabilities at fixed interest rates, those at floating interest rates and those on which no interest is paid.
- Interest rate swaps, currency swaps, forward contracts when included under IRR disclosure heading or where disclosure is preceded or succeeded by IRR disclosures. Notional principal amounts and option contract terms should be included.
- Interest rate swaps, currency swaps and forwards should be taken into account as well as notional principal amounts and option contract terms.
- With respect to principal currency:
  (a) the weighted average interest rate of the fixed rate financial liabilities;

(b) the weighted average period for which interest rates on the fixed rate financial liabilities are fixed;
(c) the weighted average period until maturity for financial liabilities on which no interest is paid; and
(d) the benchmark rate for determining interest payments for the floating rate financial liabilities.

Financial Assets

- As per financial liabilities

Currency Risk

- An analysis of the net amount of monetary assets and liabilities at the balance sheet date showing the amount denominated in each currency, analysed by reference to the functional currencies of the operations involved.
- Account should be taken of currency swaps, forward contracts, when included under currency risk disclosure heading or where disclosure is preceded or succeeded by currency risk disclosures.

Liquidity Risk

- A maturity profile of the carrying amount of financial liabilities, showing amounts falling due:
  (a) in one year or less, or on demand;
  (b) in more than one year but not more than two years;
  (c) in more than two years but not more than five years; and
  (d) in more than five years.
- An analysis of the maturity and carrying amount of financial liabilities including debt and finance lease obligations
- An analysis of the maturity of any material undrawn committed borrowing facilities of the entity, showing those amounts expiring:
  (a) in one year or less;
  (b) in more than one year but not more than two years; and
  (c) in more than two years.
- A maturity analysis of financial assets

Fair Value

- Grouping of financial assets and financial liabilities (whether recognised or unrecognised) into appropriate categories and for each category disclosure of either:
  (a) the aggregate fair value as at the balance sheet date together with the aggregate carrying amount; or
  (b) the aggregate fair value of items with a positive fair value and, separately, the aggregate fair value of items with a negative fair value, in both cases as at the balance sheet date and in each case accompanied by the relevant aggregate carrying amount.
- Financial assets and financial liabilities grouped into appropriate categories for the purpose of disclosing fair values. (For example, interest rate derivatives would usually be shown separately from currency derivatives and interest rate derivatives would usually be split between interest rate swaps and instruments such as caps and collars. As it will

generally be helpful to categorise like with like, financial assets would not usually be included in a category that also included financial liabilities.)

- The method(s) and any significant assumptions used in determining fair value.
- No fair value need be disclosed if it is not practicable for the reporting entity to estimate with sufficient reliability the fair value of any financial asset or financial liability, or category of them, that is not traded on an organised market in a standard form. In such circumstances, the following is provided instead:
  (a) a description of the financial asset or financial liability (or category of them) and its carrying amount.
  (b) the reasons why it is not practicable for the reporting entity to estimate the fair value with sufficient reliability.
  (c) information about the principal characteristics of the underlying financial asset or financial liability (or category of them) that is pertinent to estimating its fair value-for example the factors that determine or affect the instrument's cash flow-and the market for such instruments.

Financial Instruments for which Hedge Accounting has been Used

- The following information is provided about gains and losses on financial assets and financial liabilities for which hedge accounting has been used:
  (a) the cumulative aggregate gains and losses that are unrecognised at the balance sheet date. If the item's fair value is not disclosed under the FRS, any gain or loss on the item need not be dealt with in this disclosure.
  (b) the cumulative aggregate gains and losses carried forward in the balance sheet at the balance sheet date, pending their recognition in the profit and loss account.
  (c) the extent to which the gains and losses disclosed under (a) and (b) are expected to be recognised in the profit and loss account in the next accounting period.
  (d) the amount of gains and losses included in the reporting period's profit and loss account that arose in previous years and were either unrecognised or carried forward in the balance sheet at the start of the reporting period.
- Financial assets or financial liabilities previously accounted for as hedges reclassified during the period and no longer accounted for as hedges and, as a result, gains and losses that arose in previous years have been recognised in the reporting period's profit and loss account, the amount of those gains and losses is disclosed.

Commodity Contracts

- Cash-settled commodity contracts treated as if they were financial assets or financial liabilities with respect to:
  (a) the narrative disclosures
  (b) the fair value disclosures
  (c) the disclosures about financial assets and financial liabilities held or issued for trading
  (d) the disclosures about hedges

Market Price Risk

- Entities are encouraged, but not required, to provide numerical disclosures that show the magnitude of market price risk arising over the period for all financial instruments and cash-settled commodity contracts and, if significant, all other items carrying market price

risk. This information should be provided using a technique or other basis that is consistent with the way the entity manages its risk exposures.

- Possible approaches:
  (a) More details about positions at the reporting date and perhaps activity during the period.
  (b) Sensitivity analysis
  (c) "Gap" analysis of interest rate repricing and/or maturity dates.
  (d) "Duration" of instruments.
  (e) Value at risk.
- When provided these are supplemented by:
  (a) an explanation of the method used and of the main parameters and assumptions underlying the data provided;
  (b) an explanation of the objective of the method used and of the limitations that may result in the information not fully reflecting the market price risk of the assets and liabilities involved; and
  (c) reasons for any material changes in the amount of reported market price risk when compared with that reported for the previous period.

Disclosure of Accounting Policies

- Adopting of FRS 13 or FAS 133.
- In order to comply with SSAP 2, the description of accounting policies will usually need to include (if the choice of policy applied has had a material effect) a description of:
  (a) the methods used to account for derivative financial instruments, the types of derivative financial instruments accounted for under each method and the criteria that determine the method used.
  (b) the basis for recognising, measuring (both on initial recognition and subsequently), and ceasing to recognise financial assets and financial liabilities.
  (c) how income and expenses (and other gains and losses) are recognised and measured.
  (d) the treatment of financial assets and financial liabilities not recognised, including an explanation of how provisions for losses are recognised on financial assets and financial liabilities that have not been recognised.
  (e) policies on offsetting.
- Where financial instruments are carried on the historical cost basis, features covered by the description of accounting policies would typically include (where the choice of policy applied has had a material effect) the treatment of:
  (a) premiums and discounts on financial assets;
  (b) changes in the estimated amount of determinable future cash flows associated with a financial instrument, such as a debenture indexed to a commodity price;
  (c) a fall in the fair value of a financial asset to below the asset's carrying amount; and
  (d) restructured financial liabilities.
- Where financial instruments are used as hedges and accounted for using hedge accounting, the description of accounting policies will usually need to include (if the choice of policy has had a material effect) a description of:
  (a) the circumstances in which a financial instrument is accounted for as a hedge;
  (b) the recognition and measurement treatment applied to an instrument used as a hedge;
  (c) the method used to account for an instrument that ceases to be accounted for as a hedge;
  (d) the method used to account for the hedge when the underlying item or position matures, is sold, extinguished, or terminated; and

(e) the method used to account for the hedge of a future transaction when that transaction is no longer likely to occur.

Appendix 5.3: Typical Examples of FRS 13 Annual Report Disclosures

Narrative Disclosures

The following extracts featured in the Financial Review sections of the annual reports and are typical examples of the narrative information provided under FRS 13.

Severn Trent Plc 25

The group's operating activities generated a net cash inflow of £628.0 million (£628.2 million) including £566 million from Severn Trent Water and £61 million from Biffa. Capital expenditure (net of disposals and grants received) together with investment in associated undertakings amounted to £610 million including £561 million in Severn Trent Water (£385 million) and £40 million in Biffa (£31 million). The group incurred cash outflows of £79.1 million on net interest and other financing costs; £209.6 million on taxation including the second installment of Windfall Tax; and £81.3 million on acquisitions. Free cashflow, ie before payment of equity dividends and other returns to shareholders and proceeds from share issues, amounted to an outflow of £350.1 million (£77.5 million outflow). Dividends of £35.7 million (£91.4 million) were paid in the year. Cash raised from the issue of shares was £2.9 million (£3.9 million; purchase of own shares cost £128.1 million). As a consequence, the group's net cash outflow was £382.9 million (£293.1 million). Inception of finance leases amounted to £15.5 million (£94.5 million) and net debt acquired with subsidiary undertakings was £1.5 million (£0.5 million). After currency exchange translation differences of £3.4 million (£0.5 million), the increase in net debt over the course of the year was £396.5 million (£387.6 million).

Treasury management
The group had committed borrowing facilities at 31 March 1999 of £1,861 million, of which £1,482 million was utilised. In addition the group had borrowed £24 million from uncommitted facilities. The group had cash and short-term deposits at 31 March 1999 amounting to £32.2 million. Of the group's committed facilities £1,566 million are available to Severn Trent Water, of which £1,207 million was utilised.

On 27 January 1999 Severn Trent Water, through its wholly owned subsidiary Severn Trent Water Utilities Finance Plc, issued £300 million bonds repayable 2024 with interest payable at 6.125% per annum. On 12 May 1999 Severn Trent Water, through the same subsidiary, issued a further £300 million bonds repayable 2029 with interest payable at 6.25% per annum. The proceeds of these bonds, together with the group's undrawn committed borrowing facilities, are adequate to finance the anticipated cash outflow in 1999/2000. On 12 July 1999 Severn Trent Plc will repay £150 million bonds on which interest is payable at the rate of 11.5% per annum.

The group's policy for the management of interest rate risk requires that not less than 50% of the group's borrowings should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 1999 interest rates on 58.5% of the group's borrowings were so fixed, for periods ranging from 1 to 25 years.

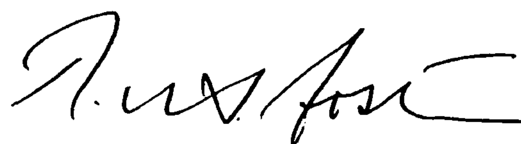
The group's business does not involve material exposure to foreign exchange transactions.

The group has investments in various assets denominated in foreign currencies, principally the US dollar and the Belgian franc. The group's current policy is to hedge an element of the currency translation risk associated with certain US dollar denominated assets through the use of currency swaps. The sterling value of foreign currency denominated assets excluding capitalised goodwill exceeded the value of liabilities, including borrowings, in foreign currencies by £22.1 million at 31 March 1999 (£10.0 million). An unrealised net translation gain of £3.9 million arose in the year (£4.3 million loss).

The group uses financial derivatives solely for the purposes of managing risk associated with financing its normal business activities.

Details of the group's borrowings, investments and financial instruments are contained in note 16 to the accounts, which has been prepared in accordance with FRS 13.

Dividends
The cost of the proposed equity dividends to the company's shareholders for the year ended 31 March 1999 was £146.5 million (£139.8 million). Dividends received or receivable by the company from its subsidiaries comprised £138.0 million from Severn Trent Water (£130.0 million, plus a special dividend of £309.6 million to cover the cost of the Windfall Tax) and £5.1 million from non-regulated businesses (£3.7 million). The group also received dividends of £1.6 million from associated undertakings (£1.7 million).



Alan Costin
Group Finance Director

Over one third of turnover now comes from non-regulated activities.

Extract from the Severn Trent plc 1999 Annual Report (p. 25)

Joint ventures

Our total share of profits from joint ventures was £11m compared to £6m last year.

Within this, Tesco Personal Finance has made good progress. We have increased the offer and value for our customers and incurred a small loss of £4m (1999 – £12m loss). Other joint ventures contributed an operating profit of £15m this year.

Treasury management and financial instruments

Group Treasury is formally authorised by the Board to manage the Group's treasury operations. The authority establishes the objectives of Group Treasury and the strategies and policies to be applied. It also defines limits to those operations, which are reviewed at least annually by the Board and formally monitored. Group Treasury activity is routinely reported to members of the Board and is subject to review by the internal and external auditors. In accordance with Group policy, Group Treasury does not engage in speculative activity.

The main financial risks faced by the Group relate to credit, liquidity, interest rates and foreign exchange. Objectives, strategies and policies for managing these risks are summarised below. These objectives, strategies and policies are consistent with those in the previous year. The balance sheet positions at 26 February 2000 are representative of the positions throughout the year.

Credit risk

The objective is to reduce the risk of loss arising from default by dealing counterparties. The strategy is to avoid high exposure to any single counterparty by spreading such risk across a number of banks or similar institutions of high credit quality. For each dealing counterparty, exposure limits, established normally by reference to the major credit rating agencies and by deal type, are reviewed at least annually by the Board. Mandates defining the Group's dealing practices are agreed with these institutions prior to deals being arranged.

Liquidity and interest rate risk

The objective is to ensure continuity of funding at low cost and to avoid significant exposure to changes in interest rates. The strategy is to maintain a portfolio of debt that is commensurate with future cash generation and complements the Group's trading operations by reducing overall business risk.

Operating subsidiaries are financed by a combination of retained profits, bank borrowings, commercial paper, medium term notes, long-term debt market issues and leases.

Exposure to debt refinancing risk is managed through modest gearing and adequate interest cover; by arranging for short-term borrowings and commercial paper issuance to be fully backed by committed bank facilities; by limiting the amount of debt repayable in any one year; and by smoothing the debt maturity profile and extending it in line with increased gearing levels.

At the year end, undrawn committed bank facilities amounted to £765m (1999 – £510m) of which £110m (1999 – £25m) expire within one year, £55m (1999 – £210m) between one and two years and £600m (1999 – £275m) in more than two years.

Derivatives, predominantly forward rate agreements and interest rate swaps and caps, are used to establish our desired mix of fixed and floating rate debt. The policy is to fix or cap between 30% and 70% of the interest cost on outstanding debt although a higher percentage may be fixed within a 12 month horizon.

The average rate of interest paid during the year was 6.8% (1999 – 7.1%). A 1% rise in interest rates would reduce profit before tax by less than 2%.

Foreign currency risk

The objective is to reduce the risk to short-term profits of exchange rate volatility. Relevant short-term transactional currency exposures are therefore hedged.

The Group also seeks to mitigate the effect of structural currency exposures by borrowing, where cost effective, in the functional currencies of its main overseas operating units. In managing its structural currency exposures, the Group's objectives are to maintain a low cost of borrowing and retain some potential for currency related appreciation while partially hedging against currency depreciation.

Financial instruments used for these purposes are predominantly foreign currency borrowings, forward exchange rate transactions and swaps.

Extract from the Tesco plc 2000 Annual Report (p. 5)

The following disclosure featured in the discussion of accounting policies section of the annual report. It provides some idea of the accounting treatment afforded to derivative financial instruments under the provisions of FRS 13.

r) **Derivatives and other financial instruments**
The financial costs of debt instruments are charged to the profit and loss account over the term of the debt at a constant rate on the carrying amount. Such costs include the cost of issue and any discount to face value arising on issue, or any premium arising on maturity.

Differences arising from the movement in exchange rates during the year on the translation into sterling of foreign currency borrowings and similar instruments used to finance long-term equity investments, are taken directly to distributable reserves and reported in the statement of total recognised gains and losses.

Extract from Severn Trent plc 1999 Annual Report (p. 45)

Financial instruments

Derivative instruments utilised by the Group are interest rate swaps and caps, cross currency swaps, forward rate agreements and forward exchange contracts and options. Termination payments made or received in respect of derivatives are spread over the life of the underlying exposure in cases where the underlying exposure continues to exist. Where the underlying exposure ceases to exist, any termination payments are taken to the profit and loss account.

Interest differentials on derivative instruments are recognised by adjusting net interest payable. Premia or discounts on derivative instruments are amortised over the shorter of the life of the instrument or the underlying exposure.

Currency swap agreements and forward exchange contracts are valued at closing rates of exchange. Resulting gains or losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs or is extinguished.

Extract from Tesco plc 2000 Annual Report (p. 23)

Financial instruments

FRS 13 "Derivatives and other financial instruments: disclosures" came into effect for these financial statements. The Group's financial instruments, as defined in FRS 13 comprise cash and liquid resources, together with debtors and creditors arising directly from operations.

The Group does not enter into derivative transactions, and it is the Group's policy not to undertake any trading in financial instruments. The Group does not have any committed borrowing facilities, as its cash balances are sufficient to finance its current operations. Cash balances are mainly held on short-term deposit with quality financial institutions, in line with the Group's policy to minimise the risk of loss. The main risks associated with the Group's financial instruments relate to interest rate risk and foreign currency risk. Numerical disclosures relating to these are given in note 15 to the financial statements. The Group's policy in relation to interest rate risk is to monitor short and medium term interest rates and to place cash on deposit for periods that optimise the amount of interest earned while maintaining access to sufficient funds to meet day to day cash requirements. In relation to foreign currency risk, the Group's policy is to hold the majority of its funds in sterling. These policies have been applied consistently throughout the year.

Extract from Oxford Biomedica Annual Report 1999 (p. 25)

Numerical Disclosures

The detailed numerical information provided under FRS 13 is displayed in the Notes to the Accounts section of the annual report. The following extracts are typical examples of the numerical tables provided under FRS 13.

15 Financial instruments

Details of the Group's objectives and policies with respect to financial instruments are given in note 1 to the financial statements. The numerical disclosures i this note deal with the financial assets and liabilities defined in FRS 13 as financial instruments. Except with respect to disclosures regarding currency risk, short term debtors and creditors have been excluded from the financial instruments disclosure.

Interest rate risk profile of financial assets

	1999 Floating rate £'000	1999 Non interest bearing £'000	1999 Total £'000	1998 Floating rate £'000	1998 Non interest bearing £'000	1998 Total £'000
Sterling	3,027	44	3,071	3,560	43	3,603
US dollars	-	5	5	-	-	-
	3,027	49	3,076	3,560	43	3,603
of which:						
Cash at bank and in hand	3,027	12	3,039	3,560	6	3,566
Other debtors (rent deposit)	-	37	37	-	37	37
	3,027	49	3,076	3,560	43	3,603

Throughout the year the Group placed funds on short term fixed rate bank deposits for periods up to 3 months. On 31 December 1999 and 31 December 1998 all fixed rate deposits had matured and the majority of funds were held in a floating rate instant access account. Fixed rate deposits earned interest at an average rate of 5.1% per annum over the year. Floating rate deposits earned interest at prevailing bank rates.

Currency exposures

The Group's functional currency is sterling. Other than a US dollar bank account which had a balance of £5,000 on 31 December 1999 (31 December 1998: £nil) there were no financial assets or liabilities in currencies other than sterling.

Fair value

The directors consider that the fair values of the Company's financial instruments do not significantly differ from their book values.

Extract from Oxford Biomedica 1999 Annual Report (p. 31)

16 Financial instruments

The group's policies in respect of foreign currency and interest rate risk management and the related use of financial instruments are set out in the Treasury management section of the Financial review on page 25.

a) Borrowings analysed by currency and interest rate after taking account of various currency and interest rate swaps entered into by the group

			Fixed borrowings		
	1999 Total £m	Floating interest £m	Fixed interest rate £m	Weighted average interest rate %	Weighted average period for which interest is fixed Years
Currency					
Sterling	1,503.7	620.9	882.8	8.20	10.91
Belgian Franc	1.0	–	1.0	6.27	2.24
US Dollars	3.1	3.1	–		
Italian Lira	2.9	2.9	–		
Total borrowings at 31 March 1999	1,510.7	626.9	883.8		
Total borrowings at 31 March 1998	1,129.4	524.3	605.1	9.25	4.47

Floating rate borrowings bear interest based on LIBOR.

Notes to the financial statements continued

16 Financial instruments continued

b) Investments in interest bearing assets

	1999 £m	1998 £m
Currency		
Sterling deposits	14.4	16.1
US Dollar deposits	–	13.2
Belgian Franc deposits	8.5	3.4
Total	22.9	32.7

Investments in interest bearing assets comprise short-term deposits placed on money markets with a maturity date not exceeding one year, and certificates of deposit. All interest rates are floating.

c) Monetary assets and liabilities by currency, excluding the functional currency

	Net foreign currency monetary assets/(liabilities)			
	US Dollar £m	Deutschmark £m	Other £m	Total £m
Functional currency of operation				
Sterling	1.7	(0.6)	0.4	1.5
Belgian Franc	–	–	(0.1)	(0.1)
Total	1.7	(0.6)	0.3	1.4

Net currency gains arising from monetary assets/(liabilities) not in the functional currency of an operation are recognised in its profit and loss account. Those arising from the translation of US Dollar and Belgian Franc functional currency financial statements into sterling are recognised in the statement of total recognised gains and losses.

d) Borrowings analysed by maturity date

		Loans			1999	1998
	Overdrafts £m	Repayable by instalments any of which are payable after five years £m	Other repayment terms £m	Finance leases £m	Total £m	Total £m
Group						
Borrowings due within one year (note 14)	4.7	4.4	276.7	0.2	286.0	128.4
Borrowings due after one year:						
Between one and two years	–	4.5	158.1	0.1	162.7	181.4
Between two and five years	–	13.5	203.2	0.5	217.2	269.3
After more than five years	–	21.6	557.7	265.5	844.8	550.3
Total borrowings due after one year (note 15)	–	39.6	919.0	266.1	1,224.7	1,001.0
	4.7	44.0	1,195.7	266.3	1,510.7	1,129.4

	Rate of interest %	1999 £m	1998 £m
Loans repayable partly or wholly after five years comprise:			
European Investment Bank loans – 2004-2008	5.1 – 7.9	289.7	277.8
Sterling bond (STWUF) – 2024	6.1	297.9	–
Local authority loans – 2010-2035	6.0 – 14.4	13.0	14.8
Other loans	3.5 – 6.3	1.1	0.1
		601.7	292.7

Company

The company has other loans totalling £332.3 million (1998: £286.2 million) which are repayable within five years.

16 Financial instruments continued

e) Borrowings facilities

The group has the following undrawn committed borrowing facilities available at 31 March 1999:

	1999 £m	1998 £m
Expiring within one year	**179.0**	175.0
Expiring in more than one but not more than two years	**50.0**	235.0
Expiring after two years	**150.0**	75.0
	379.0	485.0

f) Fair values of financial instruments

	1999		1998	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Primary financial instruments held or issued to finance the group's operations				
Short-term deposits	**22.9**	**22.9**	32.7	32.7
Cash at bank and in hand	**9.3**	**9.3**	14.7	14.7
Borrowings falling due within one year	**(286.0)**	**(288.4)**	(128.4)	(128.4)
Borrowings falling due after more than one year	**(1.224.7)**	**(1.284.4)**	(1,001.0)	(1,037.1)
Derivative financial instruments held to manage the currency and interest rate profile				
Interest rate swaps and similar instruments	**–**	**(1.8)**	–	(2.7)
Currency swaps	**–**	**0.7**	–	–
Other long-term assets/(liabilities)				
Interest in own shares	**1.9**	**1.6**	0.9	1.1
Other fixed asset investments	**1.2**	**1.2**	0.4	0.4
B Shares	**(9.1)**	**(7.9)**	(9.1)	(8.1)

Where available, market rates have been used to determine fair values. When market prices are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

Short-term debtors and creditors have been excluded from the above analysis.

g) Unrecognised gains and losses on hedges at 31 March 1999

	Gains £m	Losses £m	Total net gains/(losses) £m
Unrecognised gains and losses on hedges at 1 April 1998	10.0	(11.0)	**(1.0)**
Arising in previous years that were recognised in the year	–	–	–
Arising before 1 April 1998 that were not recognised in the financial year	10.0	(11.0)	**(1.0)**
Unrecognised gains and losses arising during the financial year	1.0	(1.9)	**(0.9)**
Unrecognised gains and losses on hedges at 31 March 1999	11.0	(12.9)	**(1.9)**
Expected to be recognised			
In one year or less	–	–	–
In later years	11.0	(12.9)	**(1.9)**

The instruments used for hedging group exposure to movements in interest rates and exchanges rates are detailed in the Financial Review on page 25. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures.

Extract from Severn Trent plc 1999 Annual report (pp. 55-57)

27 FINANCIAL INSTRUMENTS AND RELATED DISCLOSURES (CONTINUED)

Classification and fair values of financial assets and liabilities

The following table sets out the classification of financial assets and liabilities and provides a reconciliation to Group net debt in Note 16. Short-term debtors and creditors have been excluded from financial assets and liabilities: provisions have been included where there is a contractual obligation to settle in cash.

	At 31.12.99		At 31.12.98	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Net debt				
Cash at bank	217	217	240	240
Liquid investments	1,697	1,700	1,617	1,627
Current asset financial instruments	1,914	1,917	1,857	1,867
8.75 per cent sterling Euro Bond 2005	(497)	(546)	(497)	(596)
6.75 per cent US$ Euro Note 2000	(311)	(311)	(301)	(307)
6.125 per cent US$ Euro Note 2006	(308)	(295)	(298)	(314)
7.0 per cent US$ Euro Note 2002		(217)		(221)
Currency swap (US$/yen)		(40)		3
	(268)	(257)	(235)	(218)
2.0 per cent CHF Bond 2004		(92)		–
Currency swap (CHF/yen)		(24)		–
	(123)	(116)	–	–
Yen 64.1 billion loan 2000		(394)		(344)
Currency swap (yen/sterling)		(9)		(54)
	(400)	(403)	(400)	(398)
Other medium-term borrowings	(64)	(64)	(73)	(73)
Short-term loans and overdrafts	(1,539)	(1,539)	(1,317)	(1,317)
Total borrowings	(3,510)	(3,531)	(3,121)	(3,223)
Interest rate swaps	–	(3)	–	(19)
Forward exchange contracts to purchase	–	2	–	(1)
Forward exchange contracts to sell	–	40	–	(9)
Total derivative instruments	–	39	–	(29)
Total net debt	(1,596)	(1,575)	(1,264)	(1,385)
Equity investments – fixed assets	–	–	75	84
Equity investments – current assets	52	167	28	296
Other debtors due after 1 year	337	337	270	270
Other creditors due after 1 year	(50)	(50)	(99)	(99)
Provisions	(55)	(55)	(58)	(58)
Total financial assets and liabilities	(1,312)	(1,176)	(1,048)	(892)
Total financial assets	2,303	2,463	2,230	2,520
Total financial liabilities	(3,615)	(3,639)	(3,278)	(3,412)

Currency swaps have been presented alongside the underlying principal instrument.

The difference between the carrying amount and the fair value of equity and liquid investments represents gross unrealised gains of £115 million and £3 million respectively.

27 FINANCIAL INSTRUMENTS AND RELATED DISCLOSURES (CONTINUED)

The following analyses are provided primarily in accordance with the requirements of FRS 13, implemented in 1999: accordingly comparative figures are not provided.

Currency and interest rate risk profile of financial liabilities

Functional currency	Total	Fixed rate	Floating rate	Non interest bearing
US dollars	1,267	619	565	83
Japanese yen	644	563	74	7
Euro	660	350	310	–
Other foreign currency	424	–	417	7
Sterling	620	497	115	8
	3,615	2,029	1,481	105

Financial liabilities comprise total borrowings of £3,510 million and other creditors due after 1 year of £50 million and provisions of £55 million. Creditors due within 1 year have been excluded.

The benchmark rate for determining interest payments for all floating rate financial liabilities is LIBOR.

Interest profile of financial liabilities

(A) Total financial liabilities – weighted average interest rate
(B) Fixed rate financial liabilities – weighted average period for which rate is fixed
(C) Financial liabilities on which no interest paid – weighted average period until maturity

Functional currency	(A) %	(B) Years	(C) Years
US dollars	6.4	3.2	1.1
Japanese yen	0.6	3.1	1.1
Euro	2.9	0.2	–
Other foreign currency	10.9	–	1.1
Sterling	8.0	5.9	1.1
Total Group	5.6	3.3	1.1

Maturity of financial liabilities	Debt £m	Finance leases £m	Other £m	Total £m
Within 1 year or on demand	2,249	1	–	2,250
Between 1 and 2 years	4	2	105	111
Between 2 and 5 years	448	–	–	448
After 5 years	806		–	806
	3,507	3	105	3,615

Currency and interest rate exposure of financial assets

	Liquid investments	Cash at bank	Other	Total	Fixed rate	Floating rate	Non-interest bearing
US dollars	1,313	14	186	1,513	–	1,327	186
Japanese yen	–	4	13	17	–	4	13
Euro	93	36	11	140	–	129	11
Other foreign currency	91	136	80	307	–	227	80
Sterling	200	27	99	326	200	27	99
	1,697	217	389	2,303	200	1,714	389

Financial assets comprise liquid investments of £1,697 million, cash at bank of £217 million, equity investments of £52 million and debtors due after 1 year of £337 million. Debtors due within 1 year have been excluded.

27 FINANCIAL INSTRUMENTS AND RELATED DISCLOSURES (CONTINUED)

Currency exposure of net monetary assets/liabilities

Functional currency	Total £m	US$ £m	Yen £m	Euro £m	Other £m
Sterling	304	191	23	39	51

The Group's currency exposures that give rise to net currency gains and losses that are recognised in the profit and loss account arise principally in sterling. Monetary assets and liabilities denominated in overseas functional currency, and borrowings designated as a hedge against overseas net assets, are excluded.

Hedges

At 31st December 1998 there were unrecognised losses of £10 million on hedges that were recognised in 1999. At 31st December 1999 there were unrecognised gains of £42 million which will be recognised in 2000 and unrecognised losses of £76 million which will be recognised as to £13 million in 2000 and £63 million between 2001 and 2004.

Committed facilities

The Group has committed facilities, to back up the commercial paper programme, of £447 million of 364 days duration renewable annually.

Extract from Glaxo Wellcome 1999 Annual Report (pp. 79-81)

Appendix 5.4: Content Analysis Grid

Note: This grid is provided for illustration purposes only. The grid used in the content analysis was slightly larger than this to reflect a standard A4 sheet.

Appendix 5.5: Content Analysis Record Sheet

Company Name						
Code (Year)						
Total Pages/ Accountancy Pages						
Category	**Propn of Page**	**Evidence**	**Auditable**	**News**	**Location**	**Memo**
Objectives, Policies & Strategies						
Interest Rate Risk						
Currency Risk						
Liquidity Risk						
Fair Values						
Financial Instruments for which hedge accounting is used						
Certain Commodity Contracts						
Market Price Risk						
Accounting Policies						
General Other						

Appendix 5.6: Companies with a Reduction in Disclosure Post FRS 13

Company	Pre FRS 13 No. of Pages	Post FRS 13 No. of Pages	Difference No. of Pages
Allied Domecq	2.80	2.62	(0.18)
Avesco	0.52	0.38	(0.14)
BAE Systems	5.74	4.88	(0.86)
BG Group	5.92	5.82	(0.10)
Blue Circle Industries	4.50	3.82	(0.68)
Brancote Holdings	0.56	0.20	(0.36)
Cadbury Schweppes	11.08	8.80	(2.28)
De La Rue	2.12	1.92	(0.20)
Diageo	5.62	5.10	(0.52)
Dixons Group	3.00	2.92	(0.08)
Epic Group	0.20	0.16	(0.04)
European Colour	1.06	0.80	(0.26)
George Wimpey	4.24	4.04	(0.20)
John David Sports	0.48	0.44	(0.04)
Magnum Power	0.48	0.40	(0.08)
Pennant International	0.40	0.36	(0.04)
Reuters Group	5.80	4.78	(1.02)
Shell Transport & Trad.	2.94	2.54	(0.40)
Vernalis Group	1.64	1.60	(0.04)
Whitbread	2.98	2.56	(0.42)
AVERAGE			**(0.40)**

Note: This appendix provides details of the 20 companies included in the sample whose disclosure of FRS 13 related information reduced following the introduction of the Standard. Details about the average reduction in terms of the number of pages of the annual report devoted to this information are also provided.

Appendix 5.7: Differences Pre and Post FRS 13 Disclosure by Companies Across all Categories (Number of Pages)

Company	OBJS	IRR	CUR	LIQ	F V	H A	COMM	MKTP	ACPOL	OTH	TOTAL
10 Group	0.20	0.56	0.06	0.00	0.06	0.00	0.00	0.00	0.12	0.00	1.00
Alexandra	1.10	0.40	0.00	0.24	0.64	0.00	0.00	0.00	0.28	0.00	2.66
Allders	0.64	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.64
Allied Domecq	-0.10	-0.16	-0.64	0.60	0.20	0.00	0.00	0.00	-0.08	0.00	-0.18
Amco Corporation	0.08	-0.04	0.00	0.04	0.00	0.00	0.00	0.00	0.00	0.00	0.08
Amey	0.94	0.60	0.00	0.00	0.52	0.00	0.00	0.00	0.04	0.00	2.10
Amstrad	0.68	0.00	0.36	0.04	0.00	0.00	0.00	0.00	-0.04	0.00	1.04
Anglo Siberian Oil	0.00	0.08	0.32	0.00	0.04	0.04	0.00	0.00	-0.04	0.00	0.44
Anite Group	0.00	0.12	0.52	0.00	0.00	0.00	0.00	0.00	0.20	0.00	0.84
Armitage Bros	0.36	-0.04	0.00	-0.04	0.00	-0.04	0.00	0.00	0.16	0.00	0.40
Assoc. Brit. Engineering	0.40	0.64	0.16	0.16	0.10	0.00	0.00	0.10	0.00	0.00	1.56
Associated British Foods	-0.08	0.92	0.36	0.16	0.40	0.64	0.00	0.00	0.20	0.00	2.60
AstraZeneca	-0.92	0.64	0.40	0.36	-0.60	0.48	0.00	0.16	0.12	0.00	0.64
Avesco	0.02	-0.08	0.00	-0.08	0.00	0.00	0.00	0.00	0.00	0.00	-0.14
Avingtrans	-0.08	0.12	0.68	0.04	0.00	0.00	0.00	0.00	0.02	0.00	0.78
B A A	-0.08	0.60	0.12	0.28	0.32	0.16	0.00	0.00	0.10	0.00	1.50
BAE Systems	-1.24	0.22	0.26	-0.10	-0.02	0.00	0.00	0.00	0.02	0.00	-0.86
Berkeley Group	0.22	0.46	0.00	0.10	0.22	0.00	0.00	0.00	0.08	0.00	1.08
BG Group	-0.14	-0.06	0.18	0.32	-0.16	0.00	-0.20	0.00	-0.04	0.00	-0.10
BHP Billiton	1.64	1.28	0.24	0.32	1.00	1.44	0.00	0.00	0.74	0.00	6.66
Biotrace International	0.20	0.08	0.44	0.02	0.06	0.04	0.00	0.00	0.00	0.00	0.84
Bloomsbury Publishing	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Blue Circle Industries	-0.32	-0.44	-0.24	0.16	-0.20	0.32	0.00	-0.02	0.06	0.00	-0.68
BOC Group	-0.56	1.38	0.20	0.18	0.20	0.92	0.00	0.00	0.48	0.00	2.80
Bond Internat. Software	0.00	0.04	0.00	0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.06
Boots Company (The)	0.24	0.56	0.32	0.48	0.40	0.20	0.00	0.00	0.16	0.00	2.36
BP	0.81	1.28	0.24	0.12	0.48	0.36	0.00	-0.36	0.30	0.88	4.11
Brammer	-0.06	0.16	0.12	0.24	0.00	0.00	0.00	0.00	0.08	0.00	0.54
Brancote Holdings	0.00	-0.08	0.00	-0.28	0.00	0.00	0.00	0.00	0.00	0.00	-0.36
Brandon Hire	0.84	0.08	0.00	-0.04	0.04	0.00	0.00	0.00	0.04	0.00	0.96
Bristol Water	0.44	0.92	0.00	0.16	0.88	0.52	0.00	0.00	0.12	0.08	3.12
Brit. Bloodstock Agency	0.00	0.04	0.20	0.00	0.20	0.00	0.00	0.00	0.04	0.00	0.48
British Airways	0.36	0.20	-0.16	0.08	0.24	0.12	0.00	0.00	0.04	0.00	0.88
British American Tobacco	0.02	0.72	0.40	0.20	0.40	0.86	0.00	0.00	0.22	0.00	2.82
British Energy	0.08	0.04	-0.04	-0.24	0.12	0.00	0.08	0.00	0.00	0.00	0.04
British Sky Broadcasting	0.36	0.40	0.08	0.36	0.24	0.52	0.00	0.00	0.28	0.00	2.24
BT Group	0.42	0.80	0.40	-0.04	-0.20	0.28	0.00	0.00	0.22	0.12	2.00
Burn Stewart Distillers	-0.04	0.56	0.28	0.32	0.08	0.00	0.00	0.00	0.16	0.00	1.36
Cable & Wireless	0.34	0.72	0.28	0.32	0.28	0.64	0.00	0.00	-0.02	0.00	2.56
Cadbury Schweppes	0.16	-1.30	-0.50	-0.16	-0.36	-0.08	0.00	0.00	-0.20	0.16	-2.28
Cakebread Robey	0.08	0.04	0.00	0.08	0.00	0.00	0.00	0.00	0.00	0.00	0.20
Carlton Communications	-0.12	0.56	0.12	0.38	0.16	0.12	0.00	0.00	0.14	0.00	1.36
Celsis International	-0.04	-0.08	0.00	0.20	0.00	0.00	0.00	0.00	0.16	0.00	0.24
Centrica	0.84	0.48	-0.04	0.40	0.56	0.72	-0.50	0.00	0.28	0.36	3.10
Charlton Athletic	0.00	0.00	0.00	0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.16
Charter	-0.56	0.12	-0.04	0.24	0.00	-0.04	0.00	0.00	0.28	0.00	0.00
Charterhouse Comms.	0.60	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.00	0.64
Clydeport	0.06	0.20	0.00	0.20	0.24	0.00	0.00	0.00	0.14	0.00	0.84
Compass Group	0.24	1.04	0.12	0.28	0.40	0.12	0.00	0.00	0.20	0.00	2.40
Compel Group	-0.02	0.00	0.00	0.12	0.00	0.00	0.00	0.00	0.00	0.00	0.10
ComputerLand UK	0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.08	0.00	0.24

Company	OBJS	IRR	CUR	LIQ	F V	H A	COMM	MKTP	ACPOL	OTH	TOTAL
Cookson Group	0.12	0.48	0.32	0.40	0.28	0.24	0.00	0.00	0.22	0.00	2.06
Corus Group	0.96	-0.02	0.08	-0.08	-0.16	0.16	0.00	0.10	-0.38	0.00	0.66
Coutts (C.A.) Holdings	0.00	0.00	0.00	0.08	0.00	0.00	0.00	0.00	0.00	0.00	0.08
Cradley Group Holdings	0.36	0.60	0.28	0.24	0.48	0.16	0.00	0.00	0.22	0.00	2.34
CRC Group	0.12	0.24	0.04	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.40
Daily Mail & General Tst	0.72	0.38	0.20	0.70	0.20	0.08	0.00	0.00	0.36	0.00	2.64
Dana Petroleum	0.40	0.60	0.36	0.24	0.24	0.00	0.00	0.00	0.68	0.00	2.52
Davis Service Group	1.16	0.28	0.44	-0.36	0.44	0.32	0.00	0.00	0.36	0.00	2.64
De La Rue	-0.28	-0.08	0.00	0.08	0.00	0.00	0.00	0.00	0.08	0.00	-0.20
Diageo	0.32	-0.76	-0.20	-0.16	0.28	0.24	0.00	-0.30	0.14	-0.08	-0.52
Digital Animations Group	1.00	0.48	0.48	0.40	0.12	0.00	0.00	0.00	0.12	0.00	2.60
Dinkie Heel	0.36	0.04	0.00	-0.16	0.00	0.00	0.00	0.00	0.08	0.00	0.32
Dixons Group	-0.30	-0.40	-0.22	0.00	0.00	0.72	0.00	0.00	0.12	0.00	-0.08
Elementis	0.10	0.28	0.12	-0.28	0.20	-0.28	0.00	0.00	0.04	0.00	0.18
EMAP	2.68	1.80	0.36	1.28	1.04	0.60	0.00	0.00	0.48	0.00	8.24
Emess	1.16	1.88	0.36	1.12	0.64	0.00	0.00	0.00	0.20	0.00	5.36
EMI Group	0.42	-0.10	0.06	0.68	0.48	0.12	0.00	0.00	0.08	0.00	1.74
Energis	0.56	-0.32	0.00	0.28	0.40	0.20	0.00	0.00	-0.08	0.00	1.04
Ennstone	0.60	0.52	-0.04	-0.44	0.04	0.00	0.00	0.00	0.04	0.00	0.72
Epic Group	0.00	0.00	0.00	-0.04	0.00	0.00	0.00	0.00	0.00	0.00	-0.04
Eurodis Electron	0.32	0.68	0.40	0.08	0.20	0.40	0.00	0.00	0.08	0.00	2.16
European Colour	-0.14	0.00	-0.04	-0.08	0.00	0.00	0.00	0.00	0.00	0.00	-0.26
Fayrewood	0.24	1.36	0.72	0.72	0.28	0.00	0.00	0.00	0.00	0.00	3.32
Filtronic	0.56	1.10	0.80	0.30	0.12	0.04	0.00	0.00	0.04	0.00	2.96
First Choice Holidays	0.32	0.44	0.00	-0.04	0.32	0.32	0.00	0.00	0.24	0.00	1.60
Flomerics Group	0.28	0.12	0.00	-0.04	0.00	0.00	0.00	0.00	0.04	0.00	0.40
Fountains	0.60	0.64	0.08	0.32	0.00	0.00	0.00	0.00	0.20	0.00	1.84
French	0.48	0.40	0.28	0.08	0.00	0.00	0.00	0.00	0.20	0.00	1.44
Gallaher Group	0.24	0.32	0.24	0.44	0.28	0.32	0.00	0.00	-0.04	0.00	1.80
GB Railways Group	0.08	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.08
George Wimpey	-0.24	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.00	-0.20
GKN	1.32	-0.04	0.80	0.04	0.00	1.60	0.00	0.00	0.72	0.00	4.44
Glaxo Wellcome	0.16	1.08	0.40	0.76	0.00	0.12	0.00	0.00	-0.02	0.00	2.50
Goldshield Group	1.00	0.04	0.00	-0.32	0.00	0.00	0.00	0.00	0.12	0.00	0.84
Granada	0.38	0.30	0.16	0.74	1.02	0.32	0.00	0.00	0.08	0.08	3.08
Groupe Chez Gerard	0.08	0.08	0.00	0.34	0.00	0.00	0.00	0.00	0.00	0.00	0.50
GUS	0.20	1.00	0.16	0.36	0.24	0.32	0.00	0.00	0.24	0.00	2.52
Hanson	-0.06	-0.08	0.12	0.16	0.12	0.00	0.00	0.00	0.52	0.00	0.78
Hartstone Group	0.14	-0.24	0.56	0.00	0.04	0.00	0.00	0.00	0.00	0.00	0.50
Hat Pin	0.40	0.48	0.00	0.52	0.04	0.00	0.00	0.00	0.04	0.00	1.48
Hays	1.12	1.20	0.00	0.40	0.08	0.08	0.00	0.00	-0.04	0.00	2.84
Hewden Stuart	0.16	0.08	0.20	0.20	0.08	0.00	0.00	0.00	0.06	0.00	0.78
Hilton Group	0.86	0.74	0.08	0.18	0.18	0.32	0.00	0.00	0.44	0.00	2.80
Hogg Robinson	-0.06	1.52	0.44	-0.24	0.32	0.12	0.00	0.00	0.28	0.04	2.42
Imperial Chemical Inds.	0.06	0.08	0.00	0.48	-0.20	0.20	0.00	0.10	-0.16	0.00	0.56
Imperial Tobacco Group	0.76	0.92	0.32	0.76	0.40	1.00	0.00	0.00	0.36	0.00	4.52
Infast Group	0.00	0.24	0.04	0.38	0.04	0.02	0.00	0.00	0.24	0.00	0.96
International Greetings	0.62	0.56	0.00	0.16	0.08	0.00	0.00	0.00	0.00	0.00	1.42
International Power	1.08	1.22	0.40	0.70	0.16	0.44	0.32	0.00	0.20	0.00	4.52
Invensys	0.54	0.58	0.10	0.12	0.56	0.52	0.00	0.00	0.50	0.00	2.92
Jacques Vert	0.36	0.32	0.00	0.36	1.00	0.00	0.00	0.00	0.00	0.00	2.04
Jarvis Porter	0.84	0.32	0.42	0.38	0.08	0.00	0.00	0.00	0.08	0.00	2.12
Jasmin	0.12	0.08	0.32	-0.08	0.00	0.00	0.00	0.00	0.20	0.00	0.64
Jenning Brothers	0.12	0.00	0.00	0.00	0.08	0.00	0.00	0.00	0.00	0.00	0.20

Company	OBJS	IRR	CUR	LIQ	F V	H A	COMM	MKTP	ACPOL	OTH	TOTAL
John David Sports	0.00	0.00	0.00	-0.04	0.00	0.00	0.00	0.00	0.00	0.00	-0.04
Kelda Group	0.10	0.04	0.00	0.16	0.28	0.32	0.00	0.00	0.19	0.00	1.09
Kingfisher	0.26	0.84	0.04	-0.04	0.28	-0.08	0.00	0.00	-0.04	0.00	1.10
Kleeneze	0.26	0.12	0.12	0.00	0.00	0.04	0.00	0.00	0.00	0.00	0.54
Laura Ashley Holdings	0.74	-0.02	0.36	-0.16	0.00	0.20	0.00	0.00	0.04	0.00	1.16
Logica	0.88	0.64	0.16	0.00	0.32	0.52	0.00	0.00	0.00	0.00	2.52
London Clubs Internat.	0.76	0.44	0.28	0.20	0.16	0.16	0.00	0.00	0.00	0.00	2.00
Longbridge International	0.16	0.60	0.00	0.16	0.04	0.00	0.00	0.00	0.08	0.00	1.04
Lonmin	0.52	1.60	0.36	0.08	0.28	0.16	0.00	0.00	0.04	0.00	3.04
Low & Bonar	0.26	0.48	0.20	0.44	0.36	0.24	0.00	0.00	0.12	0.00	2.10
LPA Group	0.00	0.00	1.40	0.24	0.00	0.00	0.00	0.00	0.04	0.00	1.68
M S B International	0.12	0.52	0.08	0.52	0.16	0.00	0.00	0.00	0.08	0.00	1.48
Macro 4	-0.24	0.64	0.16	0.08	0.32	0.32	0.00	0.00	0.00	0.00	1.28
Magnum Power	0.00	0.00	0.00	-0.08	0.00	0.00	0.00	0.00	0.00	0.00	-0.08
Manganese Bronze Hldgs.	0.16	0.48	0.28	-0.04	0.32	0.20	0.00	0.00	0.16	0.00	1.56
Marconi	1.08	0.92	0.60	0.32	0.40	0.28	0.00	-0.08	0.46	0.00	3.98
Marks & Spencer	-0.20	0.96	-0.44	0.08	0.04	-0.04	0.00	0.00	0.08	0.00	0.48
Mayborn Group	0.14	0.02	0.08	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.24
McAlpine (Alfred)	0.12	0.60	0.08	0.44	0.36	0.08	0.00	0.00	0.04	0.00	1.72
McKechnie Group	0.56	0.18	0.00	0.10	0.28	0.24	0.00	0.00	0.44	0.00	1.80
Mears Group	0.00	0.00	0.00	0.32	0.00	0.00	0.00	0.00	0.00	0.00	0.32
Melrose Resources	0.64	0.00	0.24	0.14	0.00	0.00	0.00	0.00	0.16	0.00	1.18
Metrodome Group	0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.16
Microgen	0.42	0.72	0.08	0.12	0.08	0.08	0.00	0.00	0.14	0.00	1.64
Misys	0.32	0.06	0.08	-0.14	0.36	0.08	0.00	0.00	0.48	0.00	1.24
Morrison(WM) Supermarket	0.80	-0.04	0.06	0.20	0.04	0.00	0.00	0.00	0.06	0.00	1.12
Mulberry Group	0.40	0.44	0.88	0.12	0.48	0.24	0.00	0.00	0.28	0.00	2.84
National Grid Group	-0.28	0.68	0.00	1.04	0.44	0.48	0.00	0.00	0.24	0.00	2.60
Netcall	0.00	0.00	0.00	0.08	0.00	0.00	0.00	0.00	0.00	0.00	0.08
Nightfreight	0.80	0.60	0.28	0.40	0.00	0.12	0.00	0.00	0.56	0.00	2.76
Novar	0.36	0.24	0.48	0.44	0.16	0.32	0.00	0.00	0.32	0.00	2.32
NWF Group	0.60	0.24	0.00	-0.04	0.20	0.00	0.00	0.00	0.00	0.00	1.00
Osborne & Little	1.10	0.00	0.28	0.14	0.20	0.48	0.00	0.00	0.28	0.00	2.48
Oxford BioMedica	0.16	0.48	0.08	0.00	0.04	0.00	0.00	0.00	0.16	0.00	0.92
Pan Andean Resources	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Parity Group	0.98	0.16	0.32	0.04	0.00	0.00	0.00	0.00	0.00	0.00	1.50
Pearson	1.44	0.92	0.76	-0.16	-0.16	0.24	0.00	0.00	-0.08	0.00	2.96
Pendragon	0.48	0.32	0.06	0.14	0.36	0.00	0.00	0.00	0.12	0.00	1.48
Peninsular & Oriental	0.08	0.98	0.16	0.26	0.64	1.00	0.00	0.00	0.36	0.00	3.48
Pennant International	0.00	0.00	0.00	-0.04	0.00	0.00	0.00	0.00	0.00	0.00	-0.04
Pennon Group	0.18	1.20	0.36	0.16	0.64	0.84	0.00	0.00	0.00	0.00	3.38
Photo-Me Intl	0.60	1.24	0.72	0.40	0.36	0.20	0.00	0.00	0.20	0.04	3.76
Pilkingtons Tiles Group	0.86	0.44	0.48	0.48	0.12	0.00	0.00	0.00	0.08	0.00	2.46
PizzaExpress	0.60	0.00	0.08	0.12	0.08	0.00	0.00	0.00	0.04	0.00	0.92
Powderject Pharmaceutic.	0.22	0.56	-0.04	0.28	0.24	0.00	0.00	0.00	0.02	0.00	1.28
Powell Duffryn	0.16	0.64	0.08	0.28	0.40	0.60	0.00	0.00	0.00	0.00	2.16
Powergen	0.42	0.12	0.10	0.28	0.26	0.26	0.16	0.00	0.30	0.00	1.90
Premier Farnell	0.04	0.92	0.72	-0.08	0.88	0.04	0.00	0.00	0.48	0.12	3.12
Prowting	0.28	0.00	0.00	0.24	0.06	0.00	0.00	0.00	0.16	0.00	0.74
QS Group	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Queens Moat Houses	0.52	-0.24	-0.08	0.00	0.16	0.08	0.00	0.00	0.12	0.00	0.56
Rage	1.68	0.00	0.32	-0.16	0.00	0.00	0.00	0.00	0.00	0.00	1.84
Railtrack Group	0.74	0.52	0.00	-0.90	-0.24	0.06	0.00	0.02	0.02	0.00	0.22
Ramco Energy	1.20	0.20	0.24	0.00	0.32	0.00	0.00	0.00	0.28	0.00	2.24

Company	OBJS	IRR	CUR	LIQ	F V	H A	COMM	MKTP	ACPOL	OTH	TOTAL
Reckitt Benckiser	0.48	0.12	-0.36	0.12	0.16	-0.40	0.00	0.00	0.04	0.04	0.20
Reed Elsevier	-0.04	0.32	-0.30	0.46	0.42	0.50	0.00	0.00	0.40	0.00	1.76
Reliance Security Group	0.12	0.28	0.00	0.08	0.00	0.00	0.00	0.00	0.08	0.00	0.56
Renold	0.16	0.40	0.48	0.56	0.40	0.04	0.00	0.00	0.12	0.00	2.16
Rentokil Initial	0.48	1.32	0.24	0.88	0.80	0.08	0.00	0.00	0.24	0.00	4.04
Reuters Group	-0.90	-0.16	-0.16	-0.08	0.12	0.04	0.00	0.40	0.00	-0.28	-1.02
Rio Tinto	0.02	1.08	0.52	0.12	1.08	-0.04	0.00	0.00	0.16	0.00	2.94
Rolls Royce	0.70	0.64	0.24	0.12	0.56	1.00	0.00	0.00	0.20	0.00	3.46
Sainsbury, J	1.36	0.76	-0.08	0.12	0.00	0.00	0.00	0.60	0.60	0.00	3.36
Samuel Heath & Sons	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Science Systems	0.28	0.24	0.68	0.28	0.08	0.00	0.00	0.00	0.00	0.00	1.56
Scot. & Southern Energy	0.76	0.18	0.00	0.34	0.36	0.00	0.36	0.00	0.40	0.00	2.40
Scottish & Newcastle	0.40	0.92	0.08	0.84	0.60	0.40	0.00	0.00	0.36	0.00	3.60
Scottish Power	-0.04	0.00	0.00	0.00	-0.12	0.36	0.00	0.00	0.02	0.00	0.22
Securicor	0.42	0.40	0.00	0.28	0.24	0.00	0.00	0.00	0.08	0.00	1.42
Senior	0.24	0.72	0.00	0.52	0.36	0.32	0.00	0.00	0.28	0.00	2.44
Severn Trent	0.12	0.04	-0.04	0.16	0.08	0.40	0.00	-0.08	0.32	0.00	1.00
Shell Transport & Trad.	-0.32	-0.06	0.02	-0.06	0.08	0.00	-0.08	0.00	0.02	0.00	-0.40
Silentnight Holdings	0.52	1.16	0.10	0.16	0.10	0.08	0.00	0.00	0.20	0.00	2.32
Simon Group	0.08	0.68	0.20	0.20	0.24	0.08	0.00	0.00	0.20	0.00	1.68
Six Continents	0.42	0.04	0.00	0.12	0.48	0.20	0.00	0.00	0.14	-0.08	1.32
Smith & Nephew	0.12	0.24	-0.04	0.12	0.00	0.00	0.00	0.00	0.08	0.00	0.52
SmithKline Beecham	0.60	0.04	0.08	0.20	0.04	0.40	0.00	0.00	0.30	0.00	1.66
Smiths Group	-0.08	0.04	0.28	0.00	0.04	0.60	0.00	0.00	0.10	0.00	0.98
Solitaire Group	0.24	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.08	0.00	0.32
Soundtracs	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
South African Brews.	0.22	0.92	0.56	0.24	0.28	1.04	0.00	0.00	0.76	0.00	4.02
Stagecoach Group	1.48	0.32	0.80	-0.16	0.48	0.52	0.00	0.00	0.18	0.00	3.62
Tarsus Group	0.20	0.58	0.52	0.26	0.40	0.04	0.00	0.00	0.32	0.00	2.32
Taylor Nelson Sofres	1.08	0.60	0.60	0.84	0.28	0.16	0.00	0.00	0.04	0.00	3.60
Telewest Communications	0.80	0.56	0.90	0.50	0.64	0.20	0.00	0.00	1.92	0.00	5.52
Tesco	0.10	-0.08	-0.16	-0.44	0.40	0.16	0.00	0.00	0.04	0.00	0.02
Thames Water	0.50	0.68	0.00	0.80	0.52	0.00	0.00	0.00	0.16	0.00	2.66
Thomson Travel Group	1.72	0.48	0.24	0.40	0.28	0.24	0.00	0.00	0.32	0.00	3.68
Tinsley (Eliza) Group	0.40	0.12	0.24	0.76	0.00	0.04	0.00	0.00	0.04	0.00	1.60
Titon Holdings	0.80	0.36	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.00	1.20
Torex	0.96	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.96
Trafficmaster	0.16	0.00	0.00	0.00	0.00	0.04	0.00	0.00	0.00	0.00	0.20
UA Group	0.00	0.00	0.00	0.04	0.00	0.00	0.00	0.00	0.00	0.00	0.04
Unilever	0.40	1.08	0.20	0.12	0.44	0.00	0.00	0.00	0.14	0.00	2.38
United Business Media	0.24	1.04	0.08	0.56	0.40	0.40	0.00	0.00	0.18	0.00	2.90
United Utilities	-0.20	0.80	0.00	0.40	0.16	0.00	0.58	0.00	0.40	0.00	2.14
Vernalis Group	0.00	0.10	-0.26	0.24	-0.08	0.00	0.00	0.00	-0.04	0.00	-0.04
Vodafone Group	0.10	0.44	0.08	0.04	0.24	0.44	0.00	0.00	0.14	0.00	1.48
Weeks Group (The)	0.00	0.64	0.08	0.64	0.12	0.00	0.00	0.00	0.20	0.00	1.68
Wellington Holdings	0.60	0.04	0.08	0.12	0.00	0.00	0.00	0.00	0.00	0.00	0.84
Whitbread	-0.16	-0.08	0.00	0.00	0.00	-0.16	0.00	0.00	-0.02	0.00	-0.42
WPP Group	0.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.00	0.44
WSP Group	0.16	0.20	0.12	0.32	0.00	0.00	0.00	0.00	0.28	0.00	1.08
Xansa	0.11	0.52	0.40	0.00	0.00	0.00	0.00	0.00	0.08	0.00	1.11
Xenova Group	0.72	0.16	-0.04	0.04	0.08	0.00	0.00	0.00	-0.04	0.00	0.92

Note: This appendix shows the difference in the number of pages for each of the disclosure categories about derivative information pre, and post, the issue of FRS 13. The differences are shown for every company in the sample.

Appendix 5.8: Narrative and Numerical Disclosure for all Sample Companies Post FRS 13 Implementation

Company	Narrative Post FRS 13 No. of pages	Numerical Post FRS 13 No. of pages
10 Group	0.44	0.64
Alexandra	1.60	1.36
Allders	0.76	0.00
Allied Domecq	0.62	2.00
Amco Corporation	0.12	0.96
Amey	1.06	1.52
Amstrad	0.92	0.20
Anglo Siberian Oil	0.64	0.20
Anite Group	0.52	0.56
Armitage Bros	0.52	0.12
Assoc. Brit. Engineering	1.04	0.92
Associated British Foods	0.64	2.68
AstraZeneca	1.88	5.04
Avesco	0.14	0.24
Avingtrans	0.98	0.28
B A A	0.88	2.36
BAE Systems	2.44	2.44
Berkeley Group	1.12	0.00
BG Group	2.50	3.32
BHP Billiton	3.82	5.48
Biotrace International	0.40	0.48
Bloomsbury Publishing	0.12	0.28
Blue Circle Industries	1.16	2.66
BOC Group	2.52	5.72
Bond Internat. Software	0.12	0.70
Boots Company (The)	2.20	2.00
BP	3.16	5.36
Brammer	0.78	0.52
Brancote Holdings	0.04	0.16
Brandon Hire	1.00	0.56
Bristol Water	1.04	2.28
Brit. Bloodstock Agency	0.36	0.24
British Airways	2.10	2.64
British American Tobacco	1.94	4.06
British Energy	1.36	1.00
British Sky Broadcasting	1.28	2.24
BT Group	3.44	2.88
Burn Stewart Distillers	0.68	1.52
Cable & Wireless	2.10	3.24
Cadbury Schweppes	4.28	4.52
Cakebread Robey	0.12	0.08
Carlton Communications	1.82	2.72
Celsis International	0.36	0.72

Company	Narrative Post FRS 13 No. of pages	Numerical Post FRS 13 No. of pages
Centrica	1.88	2.88
Charlton Athletic	0.00	0.40
Charter	1.02	3.56
Charterhouse Comms.	0.68	0.24
Clydeport	0.40	0.44
Compass Group	1.60	2.44
Compel Group	0.10	0.40
ComputerLand UK	0.28	0.00
Cookson Group	1.00	2.16
Corus Group	2.00	2.04
Coutts (C.A.) Holdings	0.04	1.08
Cradley Group Holdings	0.58	2.00
CRC Group	0.20	0.40
Daily Mail & General Tst	1.60	2.64
Dana Petroleum	1.24	1.52
Davis Service Group	1.60	1.96
De La Rue	1.56	0.36
Diageo	1.46	3.64
Digital Animations Group	1.28	1.36
Dinkie Heel	0.52	0.24
Dixons Group	1.16	1.76
Elementis	1.08	1.96
EMAP	3.80	5.88
Emess	1.48	5.04
EMI Group	1.66	2.64
Energis	1.32	1.28
Ennstone	0.72	0.88
Epic Group	0.04	0.12
Eurodis Electron	0.72	2.60
European Colour	0.32	0.48
Fayrewood	1.40	2.12
Filtronic	0.92	2.80
First Choice Holidays	0.90	1.28
Flomerics Group	0.52	0.20
Fountains	1.00	1.80
French	0.72	1.40
Gallaher Group	1.76	2.72
GB Railways Group	0.16	0.00
George Wimpey	0.76	3.28
GKN	2.88	3.44
Glaxo Wellcome	2.94	4.72
Goldshield Group	1.20	0.00
Granada	1.58	2.92
Groupe Chez Gerard	0.30	0.44
GUS	0.90	2.28
Hanson	1.70	1.64
Hartstone Group	0.76	1.12

Company	Narrative Post FRS 13 No. of pages	Numerical Post FRS 13 No. of pages
Hat Pin	0.56	1.00
Hays	1.28	2.08
Hewden Stuart	0.78	0.00
Hilton Group	1.88	2.96
Hogg Robinson	0.84	2.80
Imperial Chemical Inds.	2.24	5.94
Imperial Tobacco Group	2.04	5.48
Infast Group	1.34	0.50
International Greetings	0.72	1.40
International Power	2.00	5.14
Invensys	1.40	4.40
Jacques Vert	0.56	1.76
Jarvis Porter	1.20	1.28
Jasmin	1.00	0.56
Jenning Brothers	0.20	0.12
John David Sports	0.08	0.36
Kelda Group	0.69	1.52
Kingfisher	2.32	3.24
Kleeneze	0.26	0.28
Laura Ashley Holdings	0.90	0.72
Logica	1.28	2.04
London Clubs Internat.	1.08	1.16
Longbridge International	0.32	0.76
Lonmin	0.84	3.04
Low & Bonar	0.74	1.80
LPA Group	0.08	1.64
M S B International	0.42	1.38
Macro 4	0.32	1.56
Magnum Power	0.08	0.32
Manganese Bronze Hldgs.	0.72	1.28
Marconi	2.26	2.56
Marks & Spencer	0.58	2.28
Mayborn Group	0.22	0.36
McAlpine (Alfred)	0.48	1.56
McKechnie Group	1.14	1.04
Mears Group	0.04	0.48
Melrose Resources	1.00	0.68
Metrodome Group	0.18	0.00
Microgen	0.88	1.20
Misys	1.48	0.92
Morrison(WM) Supermarket	0.98	0.38
Mulberry Group	1.32	1.84
National Grid Group	2.32	2.04
Netcall	0.08	0.20
Nightfreight	1.52	1.44
Novar	1.48	1.96
NWF Group	0.72	0.88

Company	Narrative Post FRS 13 No. of pages	Numerical Post FRS 13 No. of pages
Osborne & Little	1.76	0.80
Oxford BioMedica	0.32	0.60
Pan Andean Resources	0.04	0.04
Parity Group	1.26	1.06
Pearson	3.96	4.96
Pendragon	0.70	1.06
Peninsular & Oriental	1.40	4.04
Pennant International	0.12	0.24
Pennon Group	0.98	3.98
Photo-Me Intl.	1.24	3.08
Pilkingtons Tiles Group	1.10	2.40
PizzaExpress	0.96	0.00
Powderject Pharmaceutic.	0.80	1.08
Powell Duffryn	0.70	2.88
Powergen	2.34	1.92
Premier Farnell	0.96	2.80
Prowting	0.70	0.28
QS Group	0.08	0.08
Queens Moat Houses	2.26	4.32
Rage	2.04	0.36
Railtrack Group	1.70	2.74
Ramco Energy	1.72	0.80
Reckitt Benckiser	1.70	2.84
Reed Elsevier	1.58	3.48
Reliance Security Group	0.20	0.48
Renold	0.86	2.00
Rentokil Initial	1.48	3.68
Reuters Group	2.30	2.48
Rio Tinto	1.88	5.60
Rolls Royce	2.02	3.08
Sainsbury, J	2.98	2.16
Samuel Heath & Sons	0.02	0.00
Science Systems	0.80	1.04
Scot. & Southern Energy	1.88	1.08
Scottish & Newcastle	1.52	3.64
Scottish Power	2.18	1.84
Securicor	0.62	1.16
Senior	1.32	2.56
Severn Trent	0.86	2.40
Shell Transport & Trad.	1.36	1.18
Silentnight Holdings	1.36	1.72
Simon Group	0.66	1.32
Six Continents	2.20	1.88
Smith & Nephew	0.74	1.04
SmithKline Beecham	2.68	2.32
Smiths Group	1.44	1.48
Solitaire Group	0.32	0.00

Company	Narrative Post FRS 13 No. of pages	Numerical Post FRS 13 No. of pages
Soundtracs	0.04	0.16
South African Brews.	2.66	5.16
Stagecoach Group	2.86	3.76
Tarsus Group	0.84	1.76
Taylor Nelson Sofres	1.80	2.48
Telewest Communications	7.22	1.96
Tesco	1.58	1.92
Thames Water	1.38	2.92
Thomson Travel Group	2.32	1.84
Tinsley (Eliza) Group	0.48	1.60
Titon Holdings	0.88	0.36
Torex	1.00	0.48
Trafficmaster	0.16	0.04
UA Group	0.08	0.20
Unilever	2.42	2.56
United Business Media	1.64	4.96
United Utilities	4.08	1.32
Vernalis Group	1.00	0.60
Vodafone Group	2.08	2.52
Weeks Group (The)	0.40	1.44
Wellington Holdings	0.72	0.36
Whitbread	1.24	1.32
WPP Group	1.02	0.54
WSP Group	0.96	0.56
Xansa	0.24	1.44
Xenova Group	0.98	0.72
TOTAL	**253.79**	**370.76**
MEAN	**1.21**	**1.76**
STANDARD DEVIATION	**0.96**	**1.45**

Note: This appendix shows the total narrative and numerical disclosure about derivative information following the issue of FRS 13 for every company in the sample.

Appendix 5.9: Total Disclosure for all Sample Companies Pre and Post FRS 13 Implementation

Company	Pre FRS 13 No. of Pages	Post FRS 13 No. of Pages	Difference No. of pages
10 Group	0.08	1.08	1.00
Alexandra	0.30	2.96	2.66
Allders	0.12	0.76	0.64
Allied Domecq	2.80	2.62	-0.18
Amco Corporation	1.00	1.08	0.08
Amey	0.48	2.58	2.10
Amstrad	0.08	1.12	1.04
Anglo Siberian Oil	0.40	0.84	0.44
Anite Group	0.24	1.08	0.84
Armitage Bros	0.24	0.64	0.40
Assoc. Brit. Engineering	0.40	1.96	1.56
Associated British Foods	0.72	3.32	2.60
AstraZeneca	6.28	6.92	0.64
Avesco	0.52	0.38	-0.14
Avingtrans	0.48	1.26	0.78
B A A	1.74	3.24	1.50
BAE Systems	5.74	4.88	-0.86
Berkeley Group	0.04	1.12	1.08
BG Group	5.92	5.82	-0.10
BHP Billiton	2.64	9.30	6.66
Biotrace International	0.04	0.88	0.84
Bloomsbury Publishing	0.40	0.40	0.00
Blue Circle Industries	4.50	3.82	-0.68
BOC Group	5.44	8.24	2.80
Bond Internat. Software	0.76	0.82	0.06
Boots Company (The)	1.84	4.20	2.36
BP	4.41	8.52	4.11
Brammer	0.76	1.30	0.54
Brancote Holdings	0.56	0.20	-0.36
Brandon Hire	0.60	1.56	0.96
Bristol Water	0.20	3.32	3.12
Brit. Bloodstock Agency	0.12	0.60	0.48
British Airways	3.86	4.74	0.88
British American Tobacco	3.18	6.00	2.82
British Energy	2.32	2.36	0.04
British Sky Broadcasting	1.28	3.52	2.24
BT Group	4.32	6.32	2.00
Burn Stewart Distillers	0.84	2.20	1.36
Cable & Wireless	2.78	5.34	2.56
Cadbury Schweppes	11.08	8.80	-2.28
Cakebread Robey	0.00	0.20	0.20
Carlton Communications	3.18	4.54	1.36
Celsis International	0.84	1.08	0.24
Centrica	1.66	4.76	3.10

Company	Pre FRS 13 No. of Pages	Post FRS 13 No. of Pages	Difference No. of pages
Charlton Athletic	0.24	0.40	0.16
Charter	4.58	4.58	0.00
Charterhouse Comms.	0.28	0.92	0.64
Clydeport	0.00	0.84	0.84
Compass Group	1.64	4.04	2.40
Compel Group	0.40	0.50	0.10
ComputerLand UK	0.04	0.28	0.24
Cookson Group	1.10	3.16	2.06
Corus Group	3.38	4.04	0.66
Coutts (C.A.) Holdings	1.04	1.12	0.08
Cradley Group Holdings	0.24	2.58	2.34
CRC Group	0.20	0.60	0.40
Daily Mail & General Tst	1.60	4.24	2.64
Dana Petroleum	0.24	2.76	2.52
Davis Service Group	0.92	3.56	2.64
De La Rue	2.12	1.92	-0.20
Diageo	5.62	5.10	-0.52
Digital Animations Group	0.04	2.64	2.60
Dinkie Heel	0.44	0.76	0.32
Dixons Group	3.00	2.92	-0.08
Elementis	2.86	3.04	0.18
EMAP	1.44	9.68	8.24
Emess	1.16	6.52	5.36
EMI Group	2.56	4.30	1.74
Energis	1.56	2.60	1.04
Ennstone	0.88	1.60	0.72
Epic Group	0.20	0.16	-0.04
Eurodis Electron	1.16	3.32	2.16
European Colour	1.06	0.80	-0.26
Fayrewood	0.20	3.52	3.32
Filtronic	0.76	3.72	2.96
First Choice Holidays	0.58	2.18	1.60
Flomerics Group	0.32	0.72	0.40
Fountains	0.96	2.80	1.84
French	0.68	2.12	1.44
Gallaher Group	2.68	4.48	1.80
GB Railways Group	0.08	0.16	0.08
George Wimpey	4.24	4.04	-0.20
GKN	1.88	6.32	4.44
Glaxo Wellcome	5.16	7.66	2.50
Goldshield Group	0.36	1.20	0.84
Granada	1.42	4.50	3.08
Groupe Chez Gerard	0.24	0.74	0.50
GUS	0.66	3.18	2.52
Hanson	2.56	3.34	0.78
Hartstone Group	1.38	1.88	0.50
Hat Pin	0.08	1.56	1.48
Hays	0.52	3.36	2.84

Company	Pre FRS 13 No. of Pages	Post FRS 13 No. of Pages	Difference No. of pages
Hewden Stuart	0.00	0.78	0.78
Hilton Group	2.04	4.84	2.80
Hogg Robinson	1.22	3.64	2.42
Imperial Chemical Inds.	7.62	8.18	0.56
Imperial Tobacco Group	2.00	6.52	4.52
Infast Group	0.88	1.84	0.96
International Greetings	1.00	2.42	1.42
International Power	2.62	7.14	4.52
Invensys	2.88	5.80	2.92
Jacques Vert	0.28	2.32	2.04
Jarvis Porter	0.36	2.48	2.12
Jasmin	0.92	1.56	0.64
Jenning Brothers	0.12	0.32	0.20
John David Sports	0.48	0.44	-0.04
Kelda Group	1.12	2.21	1.09
Kingfisher	4.30	5.40	1.10
Kleeneze	0.00	0.54	0.54
Laura Ashley Holdings	0.46	1.62	1.16
Logica	0.80	3.32	2.52
London Clubs Internat.	0.24	2.24	2.00
Longbridge International	0.04	1.08	1.04
Lonmin	0.84	3.88	3.04
Low & Bonar	0.44	2.54	2.10
LPA Group	0.04	1.72	1.68
M S B International	0.32	1.80	1.48
Macro 4	0.60	1.88	1.28
Magnum Power	0.48	0.40	-0.08
Manganese Bronze Hldgs.	0.44	2.00	1.56
Marconi	0.84	4.82	3.98
Marks & Spencer	2.38	2.86	0.48
Mayborn Group	0.44	0.68	0.24
McAlpine (Alfred)	0.32	2.04	1.72
McKechnie Group	0.38	2.18	1.80
Mears Group	0.20	0.52	0.32
Melrose Resources	0.50	1.68	1.18
Metrodome Group	0.02	0.18	0.16
Microgen	0.44	2.08	1.64
Misys	1.16	2.40	1.24
Morrison(WM) Supermarket	0.24	1.36	1.12
Mulberry Group	0.32	3.16	2.84
National Grid Group	1.76	4.36	2.60
Netcall	0.20	0.28	0.08
Nightfreight	0.20	2.96	2.76
Novar	1.12	3.44	2.32
NWF Group	0.60	1.60	1.00
Osborne & Little	0.08	2.56	2.48
Oxford BioMedica	0.00	0.92	0.92
Pan Andean Resources	0.08	0.08	0.00

Company	Pre FRS 13 No. of Pages	Post FRS 13 No. of Pages	Difference No. of pages
Parity Group	0.82	2.32	1.50
Pearson	5.96	8.92	2.96
Pendragon	0.28	1.76	1.48
Peninsular & Oriental	1.96	5.44	3.48
Pennant International	0.40	0.36	-0.04
Pennon Group	1.58	4.96	3.38
Photo-Me Intl.	0.56	4.32	3.76
Pilkingtons Tiles Group	1.04	3.50	2.46
PizzaExpress	0.04	0.96	0.92
Powderject Pharmaceutic.	0.60	1.88	1.28
Powell Duffryn	1.42	3.58	2.16
Powergen	2.36	4.26	1.90
Premier Farnell	0.64	3.76	3.12
Prowting	0.24	0.98	0.74
QS Group	0.08	0.08	0.00
Queens Moat Houses	6.02	6.58	0.56
Rage	0.56	2.40	1.84
Railtrack Group	4.22	4.44	0.22
Ramco Energy	0.28	2.52	2.24
Reckitt Benckiser	4.34	4.54	0.20
Reed Elsevier	3.30	5.06	1.76
Reliance Security Group	0.12	0.68	0.56
Renold	0.70	2.86	2.16
Rentokil Initial	1.12	5.16	4.04
Reuters Group	5.80	4.78	-1.02
Rio Tinto	4.54	7.48	2.94
Rolls Royce	1.64	5.10	3.46
Sainsbury, J	1.78	5.14	3.36
Samuel Heath & Sons	0.02	0.02	0.00
Science Systems	0.28	1.84	1.56
Scot. & Southern Energy	0.56	2.96	2.40
Scottish & Newcastle	1.56	5.16	3.60
Scottish Power	3.80	4.02	0.22
Securicor	0.36	1.78	1.42
Senior	1.44	3.88	2.44
Severn Trent	2.26	3.26	1.00
Shell Transport & Trad.	2.94	2.54	-0.40
Silentnight Holdings	0.76	3.08	2.32
Simon Group	0.30	1.98	1.68
Six Continents	2.76	4.08	1.32
Smith & Nephew	1.26	1.78	0.52
SmithKline Beecham	3.34	5.00	1.66
Smiths Group	1.94	2.92	0.98
Solitaire Group	0.00	0.32	0.32
Soundtracs	0.20	0.20	0.00
South African Brews.	3.80	7.82	4.02
Stagecoach Group	3.00	6.62	3.62
Tarsus Group	0.28	2.60	2.32

Company	Pre FRS 13 No. of Pages	Post FRS 13 No. of Pages	Difference No. of pages
Taylor Nelson Sofres	0.68	4.28	3.60
Telewest Communications	3.66	9.18	5.52
Tesco	3.48	3.50	0.02
Thames Water	1.64	4.30	2.66
Thomson Travel Group	0.48	4.16	3.68
Tinsley (Eliza) Group	0.48	2.08	1.60
Titon Holdings	0.04	1.24	1.20
Torex	0.52	1.48	0.96
Trafficmaster	0.00	0.20	0.20
UA Group	0.24	0.28	0.04
Unilever	2.60	4.98	2.38
United Business Media	3.70	6.60	2.90
United Utilities	3.26	5.40	2.14
Vernalis Group	1.64	1.60	-0.04
Vodafone Group	3.12	4.60	1.48
Weeks Group (The)	0.16	1.84	1.68
Wellington Holdings	0.24	1.08	0.84
Whitbread	2.98	2.56	-0.42
WPP Group	1.12	1.56	0.44
WSP Group	0.44	1.52	1.08
Xansa	0.57	1.68	1.11
Xenova Group	0.78	1.70	0.92
TOTAL	308.86	623.71	314.85

Note: This appendix shows the total disclosure about derivative information pre, and post, the issue of FRS 13 for every company in the sample.

Appendix 5.10: Content Analysis Percentage of Annual Report by Market Type

Table 1: FTSE 100 – Percentage of Annual Report (n=73)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	1.1746	1.5129	0.3383	0.0000
Interest Rate Risk	0.6676	1.1763	0.5087	0.0000
Currency Risk	0.2343	0.3526	0.1183	0.0010
Liquidity Risk	0.5721	0.8376	0.2655	0.0000
Fair Values	0.3097	0.6322	0.3225	0.0000
Hedge Accounting Used	0.1205	0.4717	0.3512	0.0000
Certain Commodity Contracts	0.0640	0.0808	0.0168	0.3220
Market Price Risk	0.0464	0.0467	0.0003	0.9820
Accounting Policies	0.2933	0.5240	0.2307	0.0000
General Other	0.0149	0.0340	0.0191	0.2420
TOTAL	3.4970	5.6660	2.1690	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	1.1824	1.5000	0.3176	0.0003
Interest Rate Risk	0.5882	1.1500	0.5618	0.0000
Currency Risk	0.1333	0.3117	0.1784	0.0019
Liquidity Risk	0.5057	0.7302	0.2245	0.0004
Fair Values	0.2474	0.5872	0.3398	0.0000
Hedge Accounting Used	0.0571	0.3894	0.3323	0.0000
Certain Commodity Contracts	0.0000	0.0000	0.0000	0.7692
Market Price Risk	0.0000	0.0000	0.0000	0.8060
Accounting Policies	0.2000	0.4416	0.2416	0.0000
General Other	0.0000	0.0000	0.0000	0.3792
TOTAL	3.4035	5.8082	2.4047	0.0000

Table 2: FTSE Other – Percentage of Annual Report (n=100)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.4119	1.1742	0.7624	0.0000
Interest Rate Risk	0.2327	0.8499	0.6173	0.0000
Currency Risk	0.0891	0.4703	0.3812	0.0000
Liquidity Risk	0.5880	0.8491	0.2611	0.0000
Fair Values	0.0454	0.3597	0.3143	0.0000
Hedge Accounting Used	0.0771	0.2310	0.1539	0.0000
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0040	0.0077	0.0037	0.1760
Accounting Policies	0.1066	0.3149	0.2083	0.0000
General Other	0.0000	0.0053	0.0053	0.0770
TOTAL	1.5550	4.2620	2.7070	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.1633	1.0742	0.9109	0.0000
Interest Rate Risk	0.0597	0.7274	0.6677	0.0000
Currency Risk	0.0000	0.3564	0.3564	0.0000
Liquidity Risk	0.5275	0.7243	0.1968	0.0011
Fair Values	0.0000	0.2051	0.2051	0.0000
Hedge Accounting Used	0.0656	0.0909	0.0253	0.0001
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.4154
Accounting Policies	0.0861	0.2519	0.1658	0.0000
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.0619	4.1288	3.0669	0.0000

Table 3: AIM – Percentage of Annual Report (n=37)

Panel A – Means				
Type of Disclosure	**Pre FRS 13**	**Post FRS 13**	**Difference**	**P-Value**
Objectives, Policies & Strategies	0.0370	0.6130	0.5760	0.0000
Interest Rate Risk	0.1150	0.6000	0.4850	0.0000
Currency Risk	0.0015	0.2478	0.2463	0.0070
Liquidity Risk	0.6650	0.8600	0.1950	0.0530
Fair Values	0.0000	0.1402	0.1402	0.0010
Hedge Accounting Used	0.0338	0.0481	0.0143	0.3550
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0997	0.2136	0.1139	0.0010
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.9520	2.7220	1.7700	0.0000
Panel B – Medians				
Type of Disclosure	**Pre FRS 13**	**Post FRS 13**	**Difference**	**P-Value**
Objectives, Policies & Strategies	0.0000	0.3556	0.3556	0.0000
Interest Rate Risk	0.1176	0.2857	0.1681	0.0025
Currency Risk	0.0000	0.0000	0.0000	0.0007
Liquidity Risk	0.3750	0.5000	0.1250	0.2772
Fair Values	0.0000	0.0000	0.0000	1.0000
Hedge Accounting Used	0.0000	0.0000	0.0000	0.9160
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1176	0.1429	0.0253	0.0384
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.6250	2.1540	1.5290	0.0000

Appendix 5.11: Content Analysis Results by Sector

Table 1: Basic Industries Sector - Number of Pages of FRS 13 Disclosure (n=20)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.4190	0.6340	0.2150	0.0330
Interest Rate Risk	0.3660	0.5970	0.2310	0.0130
Currency Risk	0.1620	0.2550	0.0930	0.0360
Liquidity Risk	0.4110	0.5480	0.1370	0.0280
Fair Values	0.1800	0.2480	0.0680	0.0670
Hedge Accounting Used	0.0980	0.1960	0.0980	0.0800
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0530	0.0620	0.0090	0.2160
Accounting Policies	0.1650	0.2430	0.0780	0.0900
General Other	0.0040	0.0040	0.0000	1.0000
TOTAL	1.8580	2.7870	0.9290	0.0010

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.2000	0.5900	0.3900	0.0858
Interest Rate Risk	0.0600	0.4500	0.3900	0.0961
Currency Risk	0.0000	0.2000	0.2000	0.2117
Liquidity Risk	0.2400	0.5400	0.3000	0.4079
Fair Values	0.0000	0.2100	0.2100	0.1181
Hedge Accounting Used	0.0400	0.0400	0.0000	0.5221
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.6891
Accounting Policies	0.0400	0.1400	0.1000	0.0745
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.0200	2.5100	1.4900	0.0961

Table 2: Cyclical Consumer Goods Sector - Number of Pages of FRS 13 Disclosure (n=11)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.1960	0.7400	0.5440	0.0020
Interest Rate Risk	0.0727	0.3164	0.2440	0.0550
Currency Risk	0.0000	0.3491	0.3491	0.0005
Liquidity Risk	0.2473	0.3382	0.0909	0.0210
Fair Values	0.0000	0.1727	0.1727	0.0280
Hedge Accounting Used	0.0290	0.2470	0.2180	0.1650
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0545	0.2582	0.2036	0.0070
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.6000	2.4220	1.8220	0.0001

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.1000	0.6000	0.5000	0.0040
Interest Rate Risk	0.0000	0.3200	0.3200	0.0187
Currency Risk	0.0000	0.0000	0.0000	1.0000
Liquidity Risk	0.2000	0.3400	0.1400	0.2623
Fair Values	0.0000	0.0000	0.0000	1.0000
Hedge Accounting Used	0.0400	0.0400	0.0000	0.2607
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0400	0.2400	0.2000	0.0016
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.4400	2.1200	1.6800	0.0006

Table 3: Cyclical Services Sector - Number of Pages of FRS 13 Disclosure (n=80)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.3668	0.7410	0.3742	0.0000
Interest Rate Risk	0.2332	0.6140	0.3807	0.0000
Currency Risk	0.0730	0.1900	0.1170	0.0000
Liquidity Risk	0.3285	0.5115	0.1830	0.0000
Fair Values	0.0713	0.2667	0.1955	0.0000
Hedge Accounting Used	0.0473	0.1585	0.1112	0.0000
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0023	0.0075	0.0052	0.2970
Accounting Policies	0.0700	0.1907	0.1207	0.0000
General Other	0.0065	0.0055	0.0010	0.8100
TOTAL	1.1990	2.6840	1.4850	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.0800	0.6200	0.5400	0.0000
Interest Rate Risk	0.0800	0.5600	0.4800	0.0000
Currency Risk	0.0000	0.0800	0.0800	0.0000
Liquidity Risk	0.2200	0.4400	0.2200	0.0010
Fair Values	0.0000	0.2000	0.2000	0.0000
Hedge Accounting Used	0.0400	0.0400	0.0000	0.0008
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.8901
Accounting Policies	0.0400	0.1300	0.0800	0.0000
General Other	0.0000	0.0000	0.0000	0.6897
TOTAL	0.5600	2.4100	1.8500	0.0000

Table 4: General Industrials Sector - Number of Pages of FRS 13 Disclosure (n=21)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.4000	0.6340	0.2340	0.0420
Interest Rate Risk	0.2200	0.6060	0.3860	0.0010
Currency Risk	0.0857	0.3238	0.2381	0.0020
Liquidity Risk	0.3780	0.5970	0.2190	0.0040
Fair Values	0.0714	0.2771	0.2057	0.0000
Hedge Accounting Used	0.0695	0.2676	0.1981	0.0040
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0057	0.0104	0.0047	0.3290
Accounting Policies	0.0600	0.1857	0.1257	0.0010
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.2900	2.9020	1.6120	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.1600	0.6400	0.4800	0.0195
Interest Rate Risk	0.0800	0.6000	0.5200	0.0092
Currency Risk	0.0000	0.2800	0.2800	0.0005
Liquidity Risk	0.2800	0.4600	0.1800	0.1243
Fair Values	0.0000	0.2800	0.2800	0.0020
Hedge Accounting Used	0.0400	0.2000	0.1600	0.0234
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.5925
Accounting Policies	0.0400	0.1600	0.1200	0.0025
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.7000	2.8600	2.1600	0.0011

Table 5: Information Technology Sector - Number of Pages of FRS 13 Disclosure (n=18)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.1039	0.3600	0.2561	0.0070
Interest Rate Risk	0.0678	0.3422	0.2744	0.0060
Currency Risk	0.0000	0.1933	0.1933	0.0040
Liquidity Risk	0.2611	0.3256	0.0644	0.1620
Fair Values	0.0000	0.0800	0.0800	0.0220
Hedge Accounting Used	0.0244	0.0800	0.0556	0.1090
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0356	0.1033	0.0678	0.0330
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.4930	1.4840	0.9920	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.0000	0.2600	0.2600	0.0125
Interest Rate Risk	0.0200	0.3000	0.2800	0.0009
Currency Risk	0.0000	0.0000	0.0000	1.0000
Liquidity Risk	0.2700	0.3100	0.0400	0.3654
Fair Values	0.0000	0.0000	0.0000	1.0000
Hedge Accounting Used	0.0400	0.0400	0.0000	0.4516
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0400	0.0400	0.0000	0.0779
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.4200	1.5200	1.1000	0.0010

Table 6: Non-Cyclical Consumer Goods Sector - Number of Pages of FRS 13 Disclosure (n=25)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.8150	1.0350	0.2200	0.0060
Interest Rate Risk	0.4890	0.7920	0.3030	0.0130
Currency Risk	0.2224	0.2960	0.0736	0.2350
Liquidity Risk	0.3432	0.5568	0.2136	0.0010
Fair Values	0.2704	0.3880	0.1176	0.0300
Hedge Accounting Used	0.0800	0.2808	0.2008	0.0100
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0760	0.0704	-0.0056	0.6890
Accounting Policies	0.1888	0.3120	0.1232	0.0030
General Other	0.0032	0.0080	0.0048	0.5240
TOTAL	2.4880	3.7390	1.2510	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.6000	0.9200	0.3200	0.2002
Interest Rate Risk	0.2000	0.6400	0.4400	0.0167
Currency Risk	0.0800	0.3200	0.2400	0.0648
Liquidity Risk	0.2400	0.4400	0.2000	0.0819
Fair Values	0.0000	0.0400	0.0400	0.0588
Hedge Accounting Used	0.0400	0.1200	0.0800	0.0219
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1200	0.2600	0.1400	0.0407
General Other	0.0000	0.0000	0.0000	0.5717
TOTAL	1.6400	3.3200	1.6800	0.0388

Table 7: Non-Cyclical Services Sector - Number of Pages of FRS 13 Disclosure (n=10)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.7460	1.3580	0.6120	0.0010
Interest Rate Risk	0.3520	0.8380	0.4860	0.0100
Currency Risk	0.0700	0.3580	0.2880	0.0380
Liquidity Risk	0.3380	0.4980	0.1600	0.0860
Fair Values	0.2080	0.4400	0.2320	0.0150
Hedge Accounting Used	0.0280	0.2520	0.2240	0.0070
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0080	0.0600	0.0520	0.4190
Accounting Policies	0.5040	0.8420	0.3380	0.1070
General Other	0.0000	0.0120	0.0120	0.3430
TOTAL	2.2540	4.6580	2.4040	0.0010

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.6800	1.4400	0.7600	0.0233
Interest Rate Risk	0.3200	0.8600	0.5400	0.0126
Currency Risk	0.0200	0.2400	0.2200	0.0413
Liquidity Risk	0.2800	0.5600	0.2800	0.1124
Fair Values	0.0000	0.4000	0.4000	0.0757
Hedge Accounting Used	0.0400	0.2000	0.1600	0.0046
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1200	0.4900	0.1300	0.2265
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	2.2800	4.7100	2.1000	0.0091

Table 8: Resources Sector - Number of Pages of FRS 13 Disclosure (n=12)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.6290	1.0270	0.3980	0.0400
Interest Rate Risk	0.2430	0.7370	0.4930	0.0220
Currency Risk	0.1680	0.3950	0.2270	0.0000
Liquidity Risk	0.3350	0.4180	0.0830	0.1170
Fair Values	0.1430	0.4230	0.2800	0.0320
Hedge Accounting Used	0.0800	0.2430	0.1630	0.2020
Certain Commodity Contracts	0.0917	0.0683	0.0233	0.0206
Market Price Risk	0.0300	0.0000	-0.0300	0.3390
Accounting Policies	0.1983	0.3900	0.1917	0.0310
General Other	0.0270	0.1000	0.0730	0.3390
TOTAL	1.9460	3.8020	1.8560	0.0120

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.2200	0.8400	0.6200	0.2964
Interest Rate Risk	0.0700	0.4000	0.3300	0.1314
Currency Risk	0.0100	0.3100	0.0300	0.0636
Liquidity Risk	0.3200	0.3500	0.0300	0.6638
Fair Values	0.0000	0.2400	0.2400	0.0835
Hedge Accounting Used	0.0400	0.0400	0.0000	0.4035
Certain Commodity Contracts	0.0000	0.0000	0.0000	0.9645
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1200	0.4600	0.3400	0.1489
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	0.7000	2.6500	1.9500	0.2364

Table 9: Utilities Sector - Number of Pages of FRS 13 Disclosure (n=13)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.7370	1.0450	0.3080	0.0190
Interest Rate Risk	0.2290	0.7220	0.4920	0.0020
Currency Risk	0.0692	0.1262	0.0570	0.2960
Liquidity Risk	0.3600	0.6950	0.3350	0.0040
Fair Values	0.1662	0.5000	0.3338	0.0010
Hedge Accounting Used	0.0246	0.3585	0.3338	0.0010
Certain Commodity Contracts	0.2000	0.2770	0.0770	0.2960
Market Price Risk	0.0061	0.0000	-0.0061	0.3370
Accounting Policies	0.1415	0.3438	0.2023	0.0000
General Other	0.0000	0.0338	0.0338	0.2480
TOTAL	1.9340	4.1010	2.1670	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.5600	1.0800	0.5200	0.1510
Interest Rate Risk	0.1800	0.6200	0.4400	0.0012
Currency Risk	0.0000	0.0000	0.0000	0.3957
Liquidity Risk	0.2800	0.4800	0.2000	0.0255
Fair Values	0.0000	0.4400	0.4400	0.0041
Hedge Accounting Used	0.0000	0.3600	0.3600	0.0022
Certain Commodity Contracts	0.0000	0.0000	0.0000	0.5492
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1200	0.3600	0.2400	0.0103
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.7600	4.2600	2.5000	0.0003

Table 10: Basic Industries Sector – Percentage of Annual Report (n=20)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.5780	1.1000	0.5220	0.0120
Interest Rate Risk	0.5160	0.9050	0.3890	0.0040
Currency Risk	0.2205	0.3809	0.1604	0.0430
Liquidity Risk	0.7020	0.9300	0.2270	0.0570
Fair Values	0.2322	0.3664	0.1342	0.0500
Hedge Accounting Used	0.1579	0.2684	0.1105	0.0850
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0513	0.0635	0.0122	0.2000
Accounting Policies	0.2260	0.3441	0.1181	0.0660
General Other	0.0025	0.0027	0.0002	0.3300
TOTAL	2.6870	4.3610	1.6740	0.0010

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.4671	1.0586	0.5915	0.0272
Interest Rate Risk	0.1366	0.9139	0.7773	0.0396
Currency Risk	0.0000	0.4325	0.4325	0.1560
Liquidity Risk	0.5149	0.9293	0.4144	0.2385
Fair Values	0.0000	0.3844	0.3844	0.0834
Hedge Accounting Used	0.0748	0.0990	0.0242	0.4807
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.6891
Accounting Policies	0.1043	0.2918	0.1875	0.0274
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	2.0400	4.5900	2.5500	0.0223

Table 11: Cyclical Consumer Goods Sector – Percentage of Annual Report (n=11)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.4520	1.6050	1.1520	0.0020
Interest Rate Risk	0.1510	0.6530	0.5020	0.0480
Currency Risk	0.0000	0.8160	0.8160	0.0070
Liquidity Risk	0.6170	0.7650	0.1479	0.1390
Fair Values	0.0000	0.4070	0.4070	0.0240
Hedge Accounting Used	0.0740	0.4070	0.3330	0.0990
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1269	0.5142	0.3873	0.0010
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.4210	5.1680	3.7460	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.2500	1.3950	1.1450	0.0021
Interest Rate Risk	0.0000	0.4167	0.4167	0.0143
Currency Risk	0.0000	0.0000	0.0000	1.0000
Liquidity Risk	0.5714	0.6250	0.0536	0.4302
Fair Values	0.0000	0.0000	0.0000	1.0000
Hedge Accounting Used	0.1000	0.1053	0.0053	0.3529
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1143	0.4286	0.3143	0.0007
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.5000	5.5000	4.0000	0.0003

Table 12: Cyclical Services Sector – Percentage of Annual Report (n=80)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.5072	1.1659	0.6587	0.0000
Interest Rate Risk	0.3386	0.9547	0.6160	0.0000
Currency Risk	0.0977	0.3063	0.2086	0.0000
Liquidity Risk	0.5842	0.8775	0.2933	0.0000
Fair Values	0.0891	0.4107	0.3216	0.0000
Hedge Accounting Used	0.0699	0.2181	0.1482	0.0000
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0028	0.0086	0.0058	0.2940
Accounting Policies	0.1098	0.3108	0.2010	0.0000
General Other	0.0073	0.0079	0.0006	0.9050
TOTAL	1.8070	4.2580	2.4520	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.1723	1.0349	0.8626	0.0000
Interest Rate Risk	0.1436	1.0115	1.1551	0.0000
Currency Risk	0.0000	0.1788	0.1788	0.0000
Liquidity Risk	0.3967	0.7715	0.3748	0.0010
Fair Values	0.0000	0.3299	0.3299	0.0000
Hedge Accounting Used	0.0449	0.1035	0.0586	0.0001
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.5564
Accounting Policies	0.0842	0.2667	0.1825	0.0000
General Other	0.0000	0.0000	0.0000	0.2579
TOTAL	1.0930	4.4430	3.3500	0.0000

Table 13: General Industrials Sector – Percentage of Annual Report (n=21)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.6420	1.1390	0.4970	0.0200
Interest Rate Risk	0.3590	1.0180	0.6590	0.0010
Currency Risk	0.1390	0.5950	0.4560	0.0030
Liquidity Risk	0.7360	1.1280	0.3920	0.0100
Fair Values	0.1141	0.4575	0.3434	0.0000
Hedge Accounting Used	0.1112	0.4165	0.3053	0.0030
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0095	0.0200	0.0105	0.3220
Accounting Policies	0.1130	0.3027	0.1897	0.0010
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	2.2240	5.0770	2.8530	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.3478	1.1563	0.8085	0.0129
Interest Rate Risk	0.1311	1.0000	0.8689	0.0096
Currency Risk	0.0000	0.5246	0.5246	0.0003
Liquidity Risk	0.5581	0.9412	0.3831	0.1823
Fair Values	0.0000	0.4375	0.4375	0.0011
Hedge Accounting Used	0.0656	0.3889	0.3233	0.0109
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.5355
Accounting Policies	0.0870	0.2623	0.1753	0.0008
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.7460	4.9370	3.1910	0.0003

Table 14: Information Technology Sector – Percentage of Annual Report (n=18)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.2210	0.6930	0.4720	0.0050
Interest Rate Risk	0.1870	0.6810	0.4930	0.0050
Currency Risk	0.0000	0.3780	0.3780	0.0040
Liquidity Risk	0.6900	0.7480	0.0580	0.4940
Fair Values	0.0000	0.1305	0.1305	0.0180
Hedge Accounting Used	0.0582	0.1349	0.0767	0.1040
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0896	0.2231	0.1335	0.0310
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.2460	2.9890	1.7430	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.0000	0.5091	0.5091	0.0144
Interest Rate Risk	0.0408	0.6342	0.5934	0.0027
Currency Risk	0.0000	0.0000	0.0000	1.0000
Liquidity Risk	0.6357	0.6762	0.0405	0.7159
Fair Values	0.0000	0.0000	0.0000	1.0000
Hedge Accounting Used	0.0685	0.0700	0.0015	0.5461
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.0985	0.1177	0.0192	0.1593
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.1190	2.8650	1.7460	0.0012

Table 15: Non-Cyclical Consumer Goods Sector – Percentage of Annual Report (n=25)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.8820	1.2550	0.3730	0.0070
Interest Rate Risk	0.5340	0.9630	0.4280	0.0040
Currency Risk	0.2717	0.3762	0.1045	0.1980
Liquidity Risk	0.4760	0.7050	0.2290	0.0340
Fair Values	0.2452	0.4107	0.1655	0.0100
Hedge Accounting Used	0.1109	0.3118	0.2009	0.0170
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0683	0.0487	0.0197	0.2210
Accounting Policies	0.2304	0.3921	0.1617	0.0020
General Other	0.0040	0.0065	0.0025	0.7030
TOTAL	2.8230	4.4690	1.6460	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.9057	1.3793	0.4736	0.0456
Interest Rate Risk	0.3265	0.8889	0.5624	0.0109
Currency Risk	0.0845	0.3273	0.2428	0.0825
Liquidity Risk	0.5085	0.5435	0.0350	0.1771
Fair Values	0.0000	0.4545	0.4545	0.0361
Hedge Accounting Used	0.0656	0.1379	0.0723	0.0137
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	0.9507
Accounting Policies	0.1778	0.3704	0.1926	0.0091
General Other	0.0000	0.0000	0.0000	0.5717
TOTAL	2.5710	4.4250	1.8540	0.0034

Table 16: Non-Cyclical Services Sector – Percentage of Annual Report (n=10)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.9570	1.6720	0.7150	0.0040
Interest Rate Risk	0.5210	1.0260	0.5050	0.0640
Currency Risk	0.0940	0.4460	0.3530	0.0620
Liquidity Risk	0.5110	0.7150	0.2040	0.0850
Fair Values	0.2360	0.5440	0.3070	0.0150
Hedge Accounting Used	0.0396	0.3147	0.2751	0.0120
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0095	0.0582	0.0487	0.4380
Accounting Policies	0.5970	0.8230	0.2260	0.1210
General Other	0.0000	0.0071	0.0071	0.3430
TOTAL	2.9660	5.6070	2.6410	0.0020

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.8890	1.6690	0.7800	0.0376
Interest Rate Risk	0.3479	1.0230	0.6751	0.0757
Currency Risk	0.0250	0.2304	0.2054	0.0539
Liquidity Risk	0.2883	0.6909	0.4026	0.3847
Fair Values	0.0000	0.5317	0.5317	0.0858
Hedge Accounting Used	0.0488	0.2349	0.1861	0.0082
Certain Commodity Contracts	0.0000	0.0000	0.0000	1.0000
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.2400	0.5940	0.3540	0.3258
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	3.1730	5.5080	2.3350	0.0046

Table 17: Resources Sector – Percentage of Annual Report (n=12)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.6900	1.1180	0.4280	0.0360
Interest Rate Risk	0.2430	0.7520	0.5090	0.0290
Currency Risk	0.1477	0.4445	0.2969	0.0030
Liquidity Risk	0.4342	0.4578	0.0236	0.7970
Fair Values	0.1360	0.3960	0.2600	0.0110
Hedge Accounting Used	0.0983	0.2413	0.1430	0.1620
Certain Commodity Contracts	0.0951	0.0673	0.0278	0.1660
Market Price Risk	0.0337	0.0000	-0.0337	0.3390
Accounting Policies	0.2340	0.4530	0.2190	0.0750
General Other	0.0300	0.1090	0.0790	0.3390
TOTAL	2.1420	4.0380	1.8960	0.0100

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.5900	0.8930	0.3030	0.2345
Interest Rate Risk	0.1892	0.6363	0.4471	0.0984
Currency Risk	0.0225	0.4576	0.4351	0.0202
Liquidity Risk	0.4238	0.6134	0.1896	0.7503
Fair Values	0.0000	0.3071	0.3071	0.0420
Hedge Accounting Used	0.0894	0.0958	0.0064	0.4350
Certain Commodity Contracts	0.0000	0.0000	0.0000	0.8939
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1861	0.4327	0.2466	0.2477
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	1.4320	4.0930	2.6610	0.0885

Table 18: Utilities Sector – Percentage of Annual Report (n=13)

Panel A – Means

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	1.0630	1.5160	0.4530	0.0250
Interest Rate Risk	0.3680	1.1090	0.7400	0.0005
Currency Risk	0.1093	0.1795	0.0702	0.2300
Liquidity Risk	0.5780	1.0170	0.4390	0.0090
Fair Values	0.2200	0.7870	0.5670	0.0060
Hedge Accounting Used	0.0360	0.5400	0.5040	0.0030
Certain Commodity Contracts	0.2710	0.3910	0.1200	0.2090
Market Price Risk	0.0103	0.0000	-0.0103	0.3370
Accounting Policies	0.1952	0.4923	0.2971	0.0000
General Other	0.0000	0.0608	0.0608	0.2180
TOTAL	2.8510	6.0910	3.2400	0.0000

Panel B – Medians

Type of Disclosure	Pre FRS 13	Post FRS 13	Difference	P-Value
Objectives, Policies & Strategies	0.7742	1.7705	0.9963	0.0812
Interest Rate Risk	0.2105	0.9118	0.7013	0.0018
Currency Risk	0.0000	0.0000	0.0000	0.4644
Liquidity Risk	0.3256	0.8000	0.4744	0.0513
Fair Values	0.0000	0.6000	0.6000	0.0041
Hedge Accounting Used	0.0000	0.4865	0.4865	0.0024
Certain Commodity Contracts	0.0000	0.0000	0.0000	0.6278
Market Price Risk	0.0000	0.0000	0.0000	1.0000
Accounting Policies	0.1618	0.4138	0.2520	0.0023
General Other	0.0000	0.0000	0.0000	1.0000
TOTAL	3.0470	6.2650	3.2180	0.0002

Appendix 6.1: Preparer Semi-Structured Interview Questionnaire

Data Collection

1. When did you adopt FRS 13 – before it was mandatory or after March 1999?

2. Which departments were responsible for collating the data?

3. Was a particular individual assigned to collect the information?

4. Was the information all collected at a point in time or gathered during the course of the year?

5. If at a point in time, was this before or after the year end?

6. How much of the data was new or required in a different format from that used previously for either financial or management reporting?

7. Do you use this additional data for other purposes now?

8. Does the extra information necessary under the standard allow a greater degree of control over treasury activities?

9. Do you think about the potential consequences of the information that is now provided?

Cost of Data Collection

10. How easy was it to obtain the data?

11. Do you need to build/buy new systems?

12. Did you incur direct additional costs to collect the data?

13. Were there other costs incurred in collecting the data and are these costs recurring?

14. Were there any problems with the implementation of the standard? Were problems that were encountered resolved by group meetings?

15. If so, who was involved?

Reporting Standard

16. Was the Standard clear on a careful reading?

17. Did you seek assistance on its interpretation?

18. If so, who did you ask, and on which Sections of the Standard?

19. What is your overall impression of the Standard? Do you find the Standard useful?

Treasury Practice

20. Have you undertaken any hedges or changed your hedging practices in any way following the adoption of, and because of, FRS 13?

21. Has the introduction of FRS 13 changed the perceptions of using derivatives?

22. Do you use options, caps, collars or floors? Would FRS 13 stop you or make you think about using them?

FAS 133/138 and IAS 39

23. Will FAS 133/138 or IAS 39 affect you in any way?

24. What about the hedge accounting and effectiveness requirements?

25. Will you adopt hedge accounting for existing products/new contracts? Do you want to adopt hedge accounting if possible? What about option style contracts?

FRS 13 and Accountability

26. Do you think the information required under FRS 13 is useful to anyone including shareholders and potential investors?

27. Have external parties asked you for further information about your disclosure?

28. Do you think that accountability is your responsibility and do you think that your accountability extends beyond shareholders?

29. How would you define accountability and whom do you see yourself as accountable to?

30. Has FRS 13 had any unanticipated consequences?

31. What do you see as the benefits, if any of the standard?

32. If at all, how would you have preferred the standard to have been changed?

33. Is there anything that we should have asked about the standard and its consequences that we haven't already asked?

Appendix 7.1: User Semi-Structured Interview Questionnaire

Risk Management

(1) Could you provide us with some background as to your fund's investments: FTSE 100, mid 250, AIM, overseas equities, bonds etc.

(2) How important are investee companies' hedging policies and their management of risk?

(3) Do you ask to see your investee companies' documented policies on the use of derivatives and other financial instruments?

(4) From your experience which derivative or other financial instruments tend to be used most frequently by your investee companies and what are they mainly used for?

(5) What emphasis do you place on (a) the amount of hedging and the products used and (b) the completeness of company disclosures.

Fund Management

(6) Do you currently assign a particular staff member to the task of gathering hedging information about investee firms?

(7) Do you consider the financial risk exposure of a potential investment? What criteria do you use, how frequently is it reviewed by whom?

(8) Given that you may be managing UK pension assets which will ultimately pay pensions in pounds or euro, do you expect UK-based companies that you are invested in to be hedging all their overseas earnings back into sterling/euro?

(9) Do you make hedging overlay decisions on your investment portfolios based on information about individual company strategies? Who makes this decision, how frequently is it reviewed and does the fund have a policy towards foreign exchange or interest rate risk management?

FRS 13

(10) Why do you believe that some companies disclosed information about their usage of derivatives and other financial instruments prior to the introduction of FRS 13, (and perhaps in particular prior to the Discussion Paper published in July 1996 and the Exposure Draft a year later)?

(11) What types of companies disclosed such information prior to FRS 13?

(12) Why do you think that some companies chose not to disclose details of their usage of derivatives and other financial instruments?

(13) How did you find out about investee companies' exposure and usage of derivatives:
Disclosures in company reports?
Through your private lines of communication with the investee company?

(14) Do you have any input into FRS 13? Did you comment on the FRED? Were you consulted about it?

(15) What has been the impact of forced disclosure, if any? Were there any differences between narrative and numerical disclosures?

(16) Has FRS 13 changed managerial behaviour towards their firms' hedging policy, for example, the operating procedures of companies or the precise methods of hedging the firm employs?

(17) Have you learnt more about investee companies' derivatives usage since the introduction of FRS 13? Do you feel that FRS13's required disclosures have provided helpful information about company risk and strategy? Have the narrative disclosures helped in this regard?

(18) How frequently do investee companies revalue their derivatives portfolio? What methods are used to evaluate the riskiness of specific derivatives transactions or portfolios in your investee companies?

(19) Could/should FRS 13 have gone further with its required disclosures?

(20) Have you noticed any difference in
(a) disclosure levels (including quality of disclosure) and (b) improvement in disclosure levels pre and post FRS13, between larger and smaller companies?

(21) Do you feel that investee company compliance with FRS13 is in accordance with the spirit as well as the form of the FRS?

(22) How would you weigh up the relative costs and benefits of forced disclosure (i.e. do the benefits of FRS13 exceed the costs for investee companies)?

Corporate Governance

(23) To whom is the risk management head accountable in your investee companies? Who reviews their activities and what actions are taken as a result of these reviews?

(24) Is the risk management department normally a cost or investment center and how are employees in that department remunerated?

(25) Is derivatives activity reported to the Board of Directors in your investee companies, and if so, how frequently?

(26) Do non-executive directors have any input to the risk management function (i.e. via board meetings?)

(27) Do you feel that FRS 13 disclosures help you to evaluate the corporate governance of investee companies?

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(28) How well do you feel that the requirements of FRS 13 fit in with (satisfy) the Turnbull recommendations?

FAS 133, IAS 39 and the JWG Proposals

(29) Do you think recent international developments will have a greater impact? What about the fair value requirements?

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(30) Is there anything that we should have asked about the standard and its consequences that we haven't already asked?