Profile: Tanya Branwhite

Quest for True Performance Information

The Australia-based analyst Tanya Branwhite thinks that the increasingly theoretical approach to financial reporting—like mark-to-market valuations, for example—has obscured the true financial performance of the business. Now, she says, it’s up to the users of financial reports to get some more reality back in the accounts.

Intro

The global financial crisis clearly and painfully exposed shortcomings in today’s financial reporting—a fact Tanya Branwhite knows all too well. “Given I am an analyst,” she says, “financial reporting is our bread and butter. Unfortunately, the way financial reporting has developed has been more from the accounting perspective as opposed to the user perspective.” Ms. Branwhite believes, however, that stakeholders can’t be critical of the process unless they get involved and participate in the discussion. “The more dialogue we have between those who use the accounts, those who prepare the financial information, and those who are setting the financial reporting standards, the better financial reporting outcomes will be.” That is why Tanya Branwhite is more than happy to provide a few solutions herself.

Weaknesses in financial reporting

What are the issues around financial reporting?

“In my view, the very basic premise of financial reporting is to provide an unbiased, complete, and well-informed view of the financial performance of a business, based on a well-defined set of standards, which are used consistently across a whole range of companies.

“I would argue, however, that the increased complexity that we have seen introduced into financial reporting is really making it increasingly difficult to understand the financial performance of a business. It means that analysts are spending increasing amounts of time trying to come to terms with what is being reported: Trying to understand what is a ‘normal’ part of the business and what is not a ‘normal’ part of the business; and, hence, how do we get some confidence around what is actually the repeatable profit number? What is the actual position of the balance sheet, and what is the cash flow of the company?

“Obviously, the last two years have highlighted deficiencies in financial reporting. Things like off-balance sheet accounting, warehousing of financial instruments, mark-to-market valuation, and all those other issues that made financial information so opaque have increased the complexity of financial accounts

Tanya Branwhite: A brief bio

Tanya Branwhite is an executive director of strategy research at Macquarie Securities and is the current chair of the Australian Corporate Reporting Users’ Forum (CRUF), an international body established to provide a voice to users of financial statement analysis. In 2008, she was awarded Equity Analyst of the Year by CFO Magazine.

Ms. Branwhite’s career has spanned over 20 years in the Australian equity market as both a buy-side and sell-side analyst, in addition to roles as a portfolio manager and head of quantitative analysis.

See also www.macquarie.com.au.
Tanya Branwhite

such that it has become difficult for many investors to trace what is going on. When information is not presented in a useful way, the market is ill informed and so may not necessarily be making the right judgment calls.”

Disturbing emergence of shadow reporting

“Another very disturbing trend that we have seen over the last five years, as a result of the increased complexity of financial reporting, is companies presenting a view of their financial performance that is not necessarily standardized, consistent, or audited that they believe is the true operating performance of the business. Those numbers may differ significantly from the statutory presentation of the profit and loss account (P&L), but they are doing that because of the complexity of their financial reports. Management may feel that they are providing a service to their investors and a service to the market, by trying to move away from that complexity and presenting a set of accounts or a set of financial performance measures that in their eyes makes more sense to the investors.

“My concern is that we effectively see the emergence of what I call a ‘shadow reporting’ culture, which encourages investors to move away from what they see as increasingly complex and not necessarily useful financial information and they may then base their investment decisions on these shadow numbers. The problem with that is that it opens up the door to subjectivity. I am not saying that companies would necessarily present information that is not true and fair but, as we know, under situations of pressure...

“Part of the corporate communication strategy these days is to put the company in a good light with the presentation of its financial accounts. If we end up with a shadow set of accounts or a shadow set of financial information that does not adhere to a financial reporting standard, is not applied consistently across the industry or across companies, and is not audited, there may be times when investors no longer can see the true position of the company.

“In my view, it is much better to have clearly predefined pieces of financial information that are critical to investors, rather than a whole range of free-form new information. This also means that we should make the financial accounts more user-friendly and more applicable to users who are trying to understand the operating performance of a business, the investment decisions being made, and the financial implications. My hope, therefore, is that we return to the situation where all companies are presenting a set of accounts that provides a clear view of financial performance based on a consistent set of standards, applied consistently across the industry and across time, and audited by an independent auditor. This would by far and away lead to the presentation of better financial information.”

The burden is now on us, the users of financial reports, to make our voice heard

So far, however, users have not yet indicated that financial reporting has become more useful to them.

“That is true. I think to some extent the way financial reporting has developed has been more from the accounting perspective as opposed to the user perspective. We have to be conscious, though, that the overarching purpose of financial accounts is to inform a whole range of stakeholders. Therefore, it is critical that accounting standard setters think of financial reporting not only from an academic or theoretic point of view, but also from a practical point of view—how financial reporting can be best
utilized. If financial accounts are not prepared with the users in mind, and they are no longer of any use to the user, then we risk a whole area of unaudited shadow reporting being provided directly to investors that doesn’t go through the rigorous financial accounting process. That is an enormous risk and would become a major problem if that were to emerge. Therefore, there is an urgent need for users (as well as for preparers) to get more involved in the discussions and decisions about the presentation of financial accounts.

“Fortunately, there is increasing recognition of a greater need for interaction and discussion between users, preparers, and standard setters. It is a step in the right direction that in fact the standard setters are asking for input from the users for some of the projects that they are working on right now.

“It is now upon us, the users of financial reports, to make our voice heard. That is why I am more than happy to do this interview. We can’t be critical of the accounting standard-setting process unless we get involved and try to put forward solutions to some of the issues (see also ‘The Corporate Reporting Users’ Forum’).”

The Corporate Reporting Users' Forum

Tanya Branwhite worked to establish the Australian chapter of the Corporate Reporting Users’ Forum (CRUF). The CRUF was formed in 2005 as a discussion forum on current and future corporate reporting requirements. Participants are particularly keen to be allowed more comprehensive input into the deliberations of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB). CRUF participants include individuals from both buy- and sell-side institutions, and from both equity and fixed income markets. The forum includes individuals with global or regional responsibilities from around the world.

Accounting changes without discussion

The Australian CRUF chapter sees the timetable of many proposed accounting standard changes, especially from the IASB, being truncated. “This is a very disappointing development,” says Ms. Branwhite. “Under the global financial crisis banner, a number of issues have been brought forward and, in many cases, no discussion paper is being issued or time is being allowed for review. We have expressed our concern about that.”

More user input

Currently, the FASB and the IASB are increasingly opening up their ranks to users of financial reports, an important step forward for Ms. Branwhite, as she explains in this interview. According to her, further opening up to user input is a good thing as long as the FASB and the IASB are really willing to listen to users: “It really comes down to being genuinely interested in making sure that the usability of financial information is still the top priority.”

See also www.cruf.com.
Theoretical approach often obscures true financial performance

So, what are, in your view, the main issues in the accounting standard-setting process?

“Some of the issues with financial reporting have to do with the changes in accounting standards, and one thing that I am very engaged with is that we are increasingly seeing a far more theoretical approach by the International Accounting Standards Board (IASB) to financial reporting. Many of those on the outside of the fence believe that the direction in which accounting standards are moving is toward an increasingly more theoretical, and, therefore, more difficult to understand, portrayal of the business and its performance.

“Many of the changes in accounting standards are theoretical in nature, for example, the whole approach to mark-to-market valuation. While perhaps mark-to-market is important to understand, by putting those theoretical value changes through the P&L, the operating performance of the business is being increasingly muddied. This makes it increasingly more difficult for those who are trying to identify the business decisions being made by executives, and to assess the results of these decisions (see also ‘Back-up accounting changes with underlying information’).”

Back up accounting changes with underlying information

“If financial reporting is going to be more theoretical, then the usefulness of financial reports could diminish, unless the information backing up those changes is available. Hence, from an analyst perspective, we can accept the changes under accounting standards being presented as long as the financial reports make it absolutely crystal clear what value changes have been made, and how they have impacted the P&L. So, if we don’t perceive these adjustments as repeatable, as sustainable, or as part of the operating performance, we have the opportunity to strip them back out.”

Financial reporting standards are increasingly more theoretical

Do you foresee a reversal of this theoretical approach?

“From our discussions with the IASB, I know that financial reporting standards are going to be increasingly more theoretical. Current IASB projects like revenue recognition, I would argue, are again increasingly theoretical in their nature. They are even talking about effectively making the interest expense a mark-to-market, in other words, marking current debt levels or debt facilities to market. You may have a five-year-old facility in which you are paying 5 percent interest, but if you were to renegotiate that facility today, what interest rate would you be paying? The proposal may be that the interest expense line that goes through the P&L would be a theoretical base payment instead of what the company is currently paying. Therefore, the differential between what would be presented in the accounts and what would be the true underlying performance of the business is increasingly widening. At some point, this theoretical approach is going to end up with some very negative consequences, if we haven’t already seen that to some extent right now.

“We have made the point to the IASB that the amount of theoretical balance sheet adjustments that are booked through the P&L is at the heart of the problem. The other problem, however, is that the cat is already out of the bag in terms of the direction in which the IASB is going.”
Increase emphasis on cash earnings

So what would be your suggestions to better present performance?

“We need to change the format in which accounts are presented. Now that the P&L and the balance sheet have become far more theoretical, they are no longer a clear reflection of the ‘operational’ performance of the business. Hence, investors here in Australia are increasingly focusing on the ‘cash earnings’ of a business, i.e., the earnings that are not impacted by accounting standards such as mark-to-market, because it is seen as a more reliable measure of financial performance. In response, companies on our side of the fence are increasingly presenting cash earnings as a key metric, because they have noticed that investors are focusing on their cash flow performance.

“I think Australia is one of the few jurisdictions in the world, where we approach the cash flow analysis through a ‘direct’ cash flow method, as opposed to the ‘indirect’ method (see also: ‘Direct versus indirect cash flow method’).

Direct versus indirect cash flow method

In 2009, the Australian Accounting Standards Board (AASB) issued Standard AASB 107 that deals with the statement of cash flows. Article 18 of the standard states that an entity shall report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

In addition, article 19 of the standard states that entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information that may be useful in estimating future cash flows and is not available under the indirect method.

Appendix A of AASB 107 provides a good example of statement of cash flows, both via the direct and the indirect method.

See also www.aasb.com.au.

“As a result, you have effectively a full presentation of your P&L, but now broken down in operating, investing, and financial parts. Because of this breakdown in the direct cash flow statement, investors feel that they have a better understanding of:

• The operational performance of the business;
• The decisions that have been made from an investing perspective; and
• The overall financial position as a result, i.e., how much cash is left at the end of the period.

“This method allows companies to present a clear view on their operational performance and how that is generated. Financial decisions such as mark-to-market valuations or adjustments in the value of assets
and liabilities, on the other hand, may go through the financial component of the cash flow statement. In other words, ‘Here are all the mark-to-market valuations and this is how they are made up.’

“This trend seems to be picked up elsewhere: the IASB has recently proposed quite a radical change in the presentations of financial statements in its discussion paper Financial Statement Presentation (2009) and part of it, interestingly enough, was the introduction of the direct cash flow presentation. Although the proposal is not perfect—and we have provided them with our feedback on it—their idea of a triple breakdown in operating, investing, and financing cash flows, lines up in many investors’ minds with understanding the components of how the business operates.

“This is, of course, very familiar to us here in Australia and New Zealand, but not that familiar in the rest of the world. I think, however, there is merit to this approach for the wider investor community because they will be able to see more clearly the operating performance of the business, the investing decisions being made by the business, as well as how the business is being financed and any changes in the value of the assets and liabilities. In that way, investors can at least focus on those elements of the accounts that are most useful to them.”

**As accounting gets more complicated, investors need more information**

The information overload in many annual reports almost paradoxically seems to obscure rather than to disclose the true performance of the business. Yet preparers of financial reports cite increasingly more difficult reporting standards and professional investors and analysts always seem to ask for more information. Do these standards, investors, and analysts really contribute to the problem?

“Well I think it is a little bit of a ‘chicken-and-egg’ situation. What has happened from an analyst perspective is that the increased complexity of financial reporting standards has meant that the P&L and balance sheet are increasingly more difficult to interpret. So unfortunately, analysts are now asking for increasing amounts of information, simply because that is the only way they can actually then pull apart those numbers that are presented to them:

- ‘How do I understand the changes from one period to the next?’
- ‘How do I understand those changes in value?’
- ‘How do I understand that revenue was X and now it is X + whatever?’

“Because particularly theoretical, non-operational changes—caused by changes in the underlying accounting standards—have impacted many key components of the P&L, and so analysts need more information to peel back those numbers to what they would see as the operating performance or operating revenue of the business.

“Therefore, I think one has gone with the other. As the accounting standards themselves have gotten more complex, analysts have needed more information to understand the numbers that they are looking at. Hence, you then end up with about 400 pages in financial reporting, so that analysts are able to peel back that information.

“Another problem is the increased complexity of companies and the environment in which they operate. That also makes it much more difficult to understand what is going on. Therefore, analysts also need more information and more time to look at the accounts. Sure, it is not fantastic having to wade
through 200 or 300 pages, but as an analyst, that is what we are paid to do. That is our full-time profession. So having a lot of detailed information should not be something to complain about.”

**It would be a great mistake to just simplify the accounts for retail investors**

*Where would that leave the non-professional retail investors?*

“I think the actual trend is working against retail investors. The reality is that the environment, the business world, the financial world, and, of course, the accounting standards themselves are increasingly complex and all impact on the reported performance of the business. We can’t get away from that, and that is the reality.

“Now, we can go back and say that the non-professional retail investor should get a set of less complex accounts, and certainly they can. The problem I have with that is, they might then look at the simplified accounts and take that at face value, while in fact there is a greater complexity behind those numbers than that face value presents. As a result, if they take that information at face value, they may draw a very different conclusion, than they would have if they had analyzed all the information. Much of the critical performance information is actually in the accounts. It is just that it may be buried on page 425.”

*So there is no easy fix there?*

“I don’t think so. It would be a great mistake to just dumb down the financial accounts and present that to the retail investors without much further explanation. With mark-to-market valuations for example—particularly given the fact that they are booked through the P&L—retail investors might see huge volatility in profitability that is mark-to-market related only, and doesn’t relate at all to the operations of the business. They may draw a very different conclusion on a 50 percent improvement in profitability, which may be simply a revaluation of a number of financial instruments or assets that are being held by the business.”

**Provide a standardized summary of key information**

*What should be done instead?*

“What should be done is to better summarize the key information from those accounts. In some ways, the best case would be almost a summary presentation of all information contained in those accounts, but presented in a few pages: ‘here is your revenue, here is your EPS, here is your profit growth.’ That would probably help the retail investor who may not necessarily want to look at all those 500 pages. We should analyze the full financial accounts and summarize them in a way in which those retail investors or even the institutional investors can say, ‘OK, I can read all these pages, but ultimately I can pull it back to this core of key information.’

“It would be very useful if there were a general agreement about how the summarized key information should be presented consistently—in other words, a standardized set of information across the market (see also ‘Disturbing emergence of shadow reporting’) that would provide a good snapshot to understand how the business is performing.”
Would retail investors better rely on the journalist or analyst type of review of information? Should we, let the professionals do the number crunching and provide their view on the business to the retail investors?

“Yes, that would be an option. Part of our job is to help the wider investor base to better understand what is happening. Professional analysts and investors have time and expertise to effectively break down all that information, but, ultimately, we are all interested in the same things: What is the true operating performance of the business? What is the value of the assets and liabilities on a longer-term basis, and therefore, what is the company’s actual financial position?”

Companies should set out their internal key performance indicators

As an analyst, do you attach great importance to forward-looking information?

“Yes, absolutely, and nowadays with the publication of a new set of financial accounts, there is usually a management presentation on the performance of the business and on the key issues looking forward. In many ways, investors are interested in the management perspective on these issues.

“Knowing what management has set as its internal key performance indicators (KPIs) is critical information, as it provides an insight as to how aligned the company’s long-term performance objectives are with those of its shareholders. Maybe each company needs to set out its KPIs and how management is being rewarded on those KPIs. This way, you can get to some extent inside management’s thinking of the business: how they are driving the business, what they are going to judge themselves by, or how the board is going to judge management. It would make you more aware of those things specific to each company, so you could get a better insight into the future direction of that company. If investors were able to better understand the company’s objectives and how it is planning to achieve them, it would be easier for the investor to judge how the company is actually performing to those KPIs.

“Now, you may start to cross over into some information that some companies may say is confidential, very business specific, and sensitive to competition. Well, in that sense we can’t step too far, but perhaps better information about their KPIs, what their objectives are, and better communication from management about that will help investors to understand the future direction and to measure performance against those objectives.”

Standardize geographical and divisional presentation

As an analyst, would you like to be able to compare companies across a specific sector?

“There is one great inconsistency when you are looking at companies across a specific sector or industry. Some companies present on a geographical basis, whereas others present on a divisional basis. So, if we look at peer companies in the same industry, the breakdown of their financials might be incomparable. I find it extremely frustrating that we have no standard yet in the sense of presentation of either geographic or divisional or both.”

Publicize financial reports over a longer timeframe

Is it important for you as an analyst that companies speed up the publication of their financial reports?

“In Australia, we don’t have a lot of consistent quarterly reporting, so we tend to have two reporting periods in the year. Listed companies are now required to report within eight weeks of our year-end. As
a result of changes in the listing rules here, we now effectively have a three-week period in which all of
our companies report. To be honest, that has worked against analysts because we have so much
information being thrown at us in such a short period, that there is fatigue in the market by the end of
the reporting period. It then takes a lot of time for everyone to go back and review these accounts in a
great degree of detail. That has really worked against us."

**Real-time reporting would eliminate the information vacuum**

*Should companies step up their reporting frequency, perhaps even to real-time reporting?*

“My view may not necessarily be representative of other analysts, but I do feel that real-time reporting
could be a real holy grail for us. Receiving information as it becomes available would get us away from
the fact that we operate in an information vacuum, going from reporting period to reporting period.
That probably also means there is going to be an increasing uniformity between financial reporting and
management reporting. Ultimately, of course, as an analyst, getting the management reporting and the
financial reporting almost lining up would be fantastic. Then, analysts and management would be
looking at the same information, in the same way, and at the same time.

“This idea of real-time reporting is just starting to be flagged, because only recently have we had
information systems that are potentially capable of allowing us to generate real-time reports. It would
still probably mean, however, that we need some sort of set period in which all the information is
updated, so that we get a full set of accounts. But if that update is not necessarily going to provide a
huge amount of new information—because external stakeholders have been kept informed all along—
then this would significantly diminish the urge of jumping on the information as it becomes available.
That frenzy of information would go away because the periodic update would be basically a summary of
the information users had already received over the past three or four months.”

**Real-time reporting might actually help stakeholders look at longer-term picture**

*One of the arguments against increasing the frequency of financial reporting is that it might encourage
short-termism in the markets. What is your view on that?*

“To some extent, although it sounds perhaps counterintuitive, I think real-time reporting would in fact
help investors to pull back from short-termism, because they are not going to be jumping on quarterly
information.

“Instead they are going to be putting bits of information together as it comes through into the jigsaw
puzzle, and still looking at the bigger picture. So, if they were to get that periodic summary of accounts,
they would be more relaxed and it wouldn’t be so time sensitive. It also takes the inconvenience away
that, every three or six months, investors have to go through every single number to see what has
changed.”

*Could you compare that with your online credit card account, where you can actually watch your credit
card debt building up day by day?*

“That is a very good analogy actually, because when you do get your bill, nothing is a shock. You actually
check things off saying, ‘well, I am aware of that, I am aware of that, and I am aware of that,’ and I think
real-time reporting would end up the same way.
“You would still need to get a full set of accounts on a regular basis, but reviewing them would almost be a check process rather than an information process because the information process has been happening throughout the year as real-time information has been provided to you.”

Social and environmental aspects have financial implications

*Could you give us an analyst’s perspective on integrated reporting or triple bottom line reporting, not only taking into account the economic aspects, but also the sustainability and social aspects of a company?*

“I think that sort of reporting is going to be of increasing importance, because, at some point, there are going to be very clear financial implications on social and environmental aspects. We are not there yet, but in many ways, I would see that many of these issues are going to end up having financial ramifications, for example carbon pricing and trading. They actually will become part of the same, or just another aspect of, the company’s management responsibilities and—as there are also going to be costs and benefits in a financial sense to the company—also part of the management accounts, and the financial accounts.

“How the accounting standards, and how accountants should deal with those issues is obviously a huge question mark, but in many ways, rather than seeing them as separate, these issues should become integrated into the mainstream financial reporting. Real cash is being impacted; the profitability of the business is being impacted. Hence, it will be reported just as any other aspect of the business is reported.”

Convergence is admirable, but not at the expense of the quality of financial reports

*On a final note, how important is further convergence of accounting standards, especially between International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (GAAP), for investors?*

“Interestingly enough, I noticed in a survey¹ from the CFA Institute that investors were saying that usefulness and reliability of financial reporting is probably more important to them than convergence. I would agree with that. Convergence is a great outcome if we can get it, but not if it is at the cost of the quality of financial reports.

“When you are trying to bring two parties together from a different perspective, there is always a risk that you end up with what I call the ‘lowest common denominator.’ In other words, the only way that we can agree is to have the least bad outcome, and that may be at the cost of the quality or usefulness of the financial reports.

“For most investors, if it meant that they still would have to deal with two different sets of accounts, but the information in those accounts would be more relevant, reliable, transparent, and consistent, respectively then I think most investors would rather continue dealing with essentially two sets of accounting standards—US GAAP and IFRS—than go the convergence route and end up with financial accounts that aren’t particularly helpful or useful. Therefore, I do think that the priority of both the FASB

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and the IASB should be the quality of financial reporting. If convergence is one of the outcomes, that would then be fantastic. If convergence is not the outcome yet, I don’t think we have lost too much as long as those other quality criteria are met.”

### Key recommendations from Tanya Branwhite

1. The emergence of a subjective, free form “shadow reporting” culture should be discouraged. Instead, companies should present a set of accounts that provide a clear view of financial performance based on a consistent set of standards, applied consistently across the industry and across time, and audited by an independent auditor.

2. The best way to discourage a shadow reporting culture is to make the financial accounts more user-friendly, and more applicable to users who are trying to understand the operating performance of a business, the investment decisions being made, and the financial implications.

3. Users of financial reports should get more involved in the accounting standard-setting process and try to put forward solutions to some of the issues; otherwise, they can’t be critical.

4. Preparers of financial information should clearly indicate how changes in accounting have impacted their accounts, so users of financial reports have the opportunity to strip those changes back out.

5. The IASB should reduce the amount of theoretical balance sheet adjustments that are booked through the P&L in order to narrow the gap between the numbers presented in the accounts and the true underlying performance of a business.

6. The use of a direct cash flow statement should be encouraged, so the wider investor community will more clearly see the operating performance of the business, the investing decisions being made by the business, as well as how the business is being financed and any changes in the value of the assets and liabilities.

7. Companies should set out their key performance indicators (KPIs), so investors would be able to better understand the company’s objectives and how it is planning to achieve them, and would be able to better measure performance against those objectives.

8. Real-time reporting should be encouraged because it would get us away from the fact that we operate in an information vacuum, going from reporting period to reporting period. It would prevent investors from having to go through every single number to see what has changed every three or six months. It would also help investors to pull back from short-termism, because they would not be jumping on quarterly information.

9. As social and environmental aspects have a real impact on a company’s cash position and profitability and, therefore, should become integrated into the mainstream financial reporting (rather than being reported separately).

10. The priority of both the FASB and the IASB should be the quality of financial reporting: making the information in the accounts more relevant, reliable, transparent, and consistent. If convergence is not the outcome yet, we have not lost too much as long as those other quality criteria are met.

*We welcome your feedback on these recommendations. To provide us with your feedback, please complete this brief [survey](#).*