

## Accounting versus investing

As a preface, it would be most useful to revisit the basic principles of accounting, which are:

- An accounting entity – an economic unit with identifiable boundaries for which accountants accumulate and report financial information
- Accounting period – relates to specific periods, typically one year.
- Materiality
- Conservatism – should lean towards understatement rather than overstatement
- Consistency – accounting reports should be prepared on a consistent basis with preceding years, unless otherwise disclosed
- Objectivity – bias free and verifiable accounting data
- Going Concern – a business is assumed to have an indefinite life, in the absence of evidence to the contrary
- Measuring unit – basic unit of money
- Historical cost – measures are primarily based on historical cost
- Matching of expenses with revenue
- Revenue recognition at point of sale

Whereas the basic principles of investing mainly coincide with the theory of current and future value, and the notion of price discrepancy between what is offered today and what a business should theoretically be worth after applying relevant investment valuation methodologies.

Fund managers generally look for transparency, accountability and integrity in their quest to assess viability of any type of investments related to a corporate. Equity valuation metrics applied include industry specific benchmarks, such as Price to Book for the financial sector, market relative measures such as Price to Earnings Ratio, and absolute valuation methodologies such as Discounted Cashflow and Dividend Discount Models. Qualitative measures mainly involve business franchise analysis and evaluation of management. Liquidity considerations also play a role, as country risk premium.

Given the very seemingly divergent concepts of accounting and investing, how do we reconcile these two professions? Is there even a need to reconcile the two? Unless one is totally unconcerned with minority rights, then the question does not even arise at all. As asset managers entrusted with clients' money, and expectations of making well informed decisions based on fundamental judgement, i.e. relative outperformance against relevant benchmarks (fast becoming obsolete in equities investing), and absolute performance (the new buzzword) regardless of market conditions. It's not that we disagree with the sound accounting hallmarks mentioned above, we mainly have issues with the affinity with historical costing and associated standards espousing this concept. Depreciation policies should be dispensed with and replaced with current valuation of assets which gives accountants the amount to write off as depreciation to the P&L. The other one that comes to mind is the treatment of Goodwill, which should also adopt a more market based approach. There also exist rife abuses of the matching concept, where repurchase agreements are entered into before the year-end in a bid to window-dress activities.

Admittedly, these last few years have seen vast improvements in corporate reporting. Quarterly reporting, with Profit and Loss Accounts and Balance Sheets, was godsend to us fund managers, cushioning the risk of significant shocks in the market. We also laud the new reporting provisions embedded within the New KLSE Listing Requirements. We now have the display of "Cost of Goods Sold" in the accounts, as other useful information such as directors' pay and related party transactions. Further modifications to segmental reporting and interim financial reporting were added positives. More interestingly, we had the introduction of more market based reporting (using fair values), namely accounting for the impairment of assets (MASB 23) and the recognition of financial instruments (MASB 24 and ED 35). Although we generally disagree with the proposed treatment for deemed 'held-to-maturity' investments and 'penalty' in the case of a breach, in line with IAS 39, preferring market valuations for all investments irregardless. Nonetheless, we look forward to recognition and hence better disclosure of Off Balance Sheet items with the advent of

MASB 24 and ED 35. The treatment of Special Purpose Vehicles is another area of interest, hence we very much look forward to the proposed future exposure draft relating to this matter.

I hasten to add that we look forward to better narratives in Annual Reports encompassing industry outlook, competitive positioning and management strategy in creating value for shareholders. Currently these are sorely lacking. It is also perhaps not too much to ask for better and more comprehensible disclosure of Cashflow items within purported Cashflow Statements. Lastly, a reminder that timeliness is also of the essence.