A Survey of the Valuation Practices of Professional Accounting Firms
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studying for professional examinations, and businessmen, the guide, so the Preface declares, deals with techniques, theories and institutional infrastructure, is clear, succinct and comprehensive, using worked examples, with little assumed mathematical and statistical knowledge, thus enabling students to gain a full understanding of the subject.

Brayshaw's book, like this review, may be concise, but neither is comprehensive. The guide offers little on the institutional framework: there is nothing on the role of financial intermediaries nor on the problems faced by small companies when raising finance, which would be of interest to businessmen. For the undergraduate there is a lack of underlying economic principles on which much of finance theory is based, such as the Hirshleifer model and, surprisingly, indifference curve analysis receives no attention. For the professional student decision trees are not included. More generally, the whole of international finance is omitted.

Numerous worked examples demonstrate techniques, but they tend to be on superficial and straightforward subjects. For instance, many pages are taken up with illustrations of a funds flow projection, which, curiously, deals with an actual, rather than a forecast, statement (pp. 106–110), and a cash budget (pp. 122–125), while more testing theoretical topics, examined in recent years by the ICAEW, are neglected. In the latter category two examples will illustrate the point. First, the treatment within the APV method of subsidised loans, although mentioned (p. 94), is ignored in the worked example. Second, the section on Miller's analysis of the introduction of personal taxation into the capital structure decision (p. 89) states that 'care must be exercised in translating this model to the UK', yet the text fails to provide the formula. Similarly, the Black-Scholes option valuation formula, which itself requires substantial statistical skill, is given (p. 82), but with no numerical illustration showing how to use the model.

All this highlights an imbalance between the various sections of the book; the level of detail is much greater for working capital management than for the more difficult topics, where readers may struggle to understand some of the explanations. In addition, there are a number of errors and the text is not as up-to-date as it should be. For example, the formula for the riskiness of a project where returns are perfectly positively correlated is stated incorrectly (p. 54) and the disclosure requirements and notification times for persons acquiring shares in a company have been reduced from 5% to 3%, and from 5 to 2 days (Companies Act 1989, s. 134) (p. 144).

Brayshaw's book is better when summarising theories and providing lists of key features. Students adore such succinctness, since it saves them the effort of searching out the relevant points from more voluminous works. Herein lies the danger of the guide. Indolent students will, unfortunately, treat it as a textbook, misguidedly relying on it totally and thereby gaining little in-depth understanding, rather than using it as a revision aid, for which, despite its faults, it would seem more suited.

I shall not be recommending this book to my students.

University of Kent at Canterbury Peter Boys

A Survey of the Valuation Practices of Professional Accounting Firms. *Simon M. Keane.* Institute of Chartered Accountants of Scotland, 1992. 27 pp.

Professor Keane's monograph briefly reviews the theory of valuation and reports on the result of a survey of the company valuation practices of sixteen Scottish accounting firms. As the sample included all of the 'big six' firms, his findings may well provide insights on valuation methods used elsewhere in the UK. Chapter 1 explains the basic DCF approach to valuation, and examines the way in which other valuation models (in particular, the earnings multiple approach) can be seen to be compatible with a DCF analysis. Chapter 2 presents the results of a guided interview survey, the principal finding of which is that the P/E model is very clearly the dominant approach employed in practice, which is broadly similar to the findings of Arnold and Moizer (1984) and Day (1986) with respect to investment analysts. However, even more depressingly for finance academics, the results appear to suggest an alarming lack of awareness amongst practitioners of such basic concepts as the error of applying a 'proxy' or 'analogue' *historic* P/E multiple to estimated future 'maintainable earnings'. Chapter 3 then goes on briefly to discuss the results, whilst Chapter 4 presents a conclusion which is (justifiably) rather critical of the practices concerned.

Whilst this monograph is undeniably useful, and is to be welcomed as a contribution to our rather limited understanding of valuation practices, it does have serious weaknesses, mostly attributable to its very short length. Professor Keane's objective appears to be to report the findings of his survey, yet only three and a half (small) pages are devoted to this. This compares with the nine pages spent on a very basic explanation of alternative valuation methods. Usefully, he gives a summary of the questionnaire used to guide the interviews in an appendix, but the effect of this is to leave the reader wondering why he has not discussed the answers to some very interesting issues which he has raised in the interviews. For example, what do valuers mean by 'maintainable earnings'? This is an intriguing question in the context of growth and inflation. And what (if any) account is taken of differing

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capital structures when valuing companies? It is disappointing that the opportunity has not been taken to exploit fully the richness of material that presumably arose from this research.

In his discussion of the results and conclusion, Professor Keane does not properly tackle the issue of the sensitivity of valuations to forecast error. This seems critical, since it may be the case that valuations are more sensitive to the accurate forecasting of future costs and revenues than to the application of a 'correct' capitalisation method. It is surprising, therefore, to find that there is little mention of forecasting methods in the questionnaire. In addition, little acknowledgement is given of the real difficulties which confront a valuer wishing to use a discounted free cash flow approach. These might include the size of the market risk premium (contrast a recent report in the *Financial Times* suggesting a figure of 2% with the 9% recommended by the London Business School Risk Measurement Service), the model to be used to reflect capital structure (active or passive debt management policies, and a Miller, Modigliani and Miller, or 'intermediate' equilibrium model?), the problem of personal taxation and whether a single or multi-index model of risk pricing should be used.

This monograph has certain parallels with vegetarian 'nouvelle cuisine'; it whets the appetite but leaves one feeling hungry and wondering where the beef is. If overall length was such a constraint, many readers will no doubt wish that Chapter 1 had been sacrificed in favour of a fuller discussion of the findings. All this seems a shame, because Professor Keane has undertaken an interesting piece of research. It is to be hoped that a more detailed analysis of the survey will be published elsewhere.

University of Exeter Alan Gregory

Financial Reporting, Information and Capital Markets. *Michael Bromwich.* Pitman, 1992. viii + 376 pp. £19.99.

Michael Bromwich's new text for second and third-year undergraduates and first-year graduate students attempts to integrate information economics with decision theory in a way that will, one hopes, guide students (and others) in making judgments about the development and reporting of accounting information. The book is divided essentially into five parts (my suggested five being slightly different from the author's four). Chapters 1 and 2 provide the setting, and an overview of how these three topics—information economics, decision theory, and accounting information—are to be intertwined. Chapters 3–5 then develop investment decision-making very much along the lines of Hicks (although badly misinterpreting Hicks, I think, when it comes to incorporating uncertainty—see below). Chapters 6–9 develop, in turn, the notions of information economics along the lines of Demski, Beaver, Feltham, and others, attempting to establish what this body of knowledge can tell us about the development and reporting of accounting information. Having established at this point, Bromwich feels, a framework for the production of 'private' accounting information, Chapters 10–12 turn to possible regulation, with involvement of government. Finally, almost as an afterthought, agency theory is brought into the framework in Chapters 13–14. Decision theory, information necessary for the making of decisions involving expectations about the future, and implications for accounting are, then, the essence, if perhaps an oversimplified statement, of what I believe Bromwich is about. Bromwich is very careful, indeed cumbersome, about saying what he is about to do, and what he has done, at every stage. Yet this reader remains unclear about *exactly* what he is assuming, hence his argument. Let us try to follow Professor Bromwich through his thought processes, section by section.

Bromwich's treatment of Hicksian income under conditions of *certainty* in Chapters 3–4 is straightforward. Hicks *ex ante* and *ex post* income under conditions of *uncertainty* in Chapter 5 is something else. Bromwich at one point says that Hicks 'intended to work generally with certain, rather than uncertain, numbers in planning but would occasionally "interpret these certain expectations as being those particular figures which best represent the uncertain expectations of reality"' (Chapter 8, page 173). For Bromwich, on the other hand, 'Uncertainty will be assumed to be associated only with the state of the environment which will reign. . . . The returns to be yielded by all projects in each state of the environment are assumed to be completely known.' (page 27)[1]

What Hicks and, I think, most people mean by 'uncertainty' (the incorporation of which in our thinking was surely the essence of *Value and Capital*), is that individual expectations about the future very much play a role in matters, but that individuals can diverge, one from another, in their *expectations* (and probability estimates of these)—even given identical information inputs. Bromwich wants us to *accept* Hicksian *ex post* income under uncertainty as a guide for the production of accounting information—in order to link such

[1] I originally read, and have always read, Hicks as dealing throughout with uncertainty. What he is saying surely on page 126 (which Bromwich cites) is that his uncertainty can be expressed in terms of probabilities, that he (like Bromwich) cannot easily deal with *risk*, and risk-averseness. Hicks is certainly *not* saying that he is going to deal only with certainty!

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