Woman C.P.A.

Volume 41 | Issue 1 Article 2

1-1979

User Perception Differences Concerning Corporate Disclosure

Larry B. Godwin

Follow this and additional works at: https://egrove.olemiss.edu/wcpa

Part of the Accounting Commons, and the Women's Studies Commons

Recommended Citation

Godwin, Larry B. (1979) "User Perception Differences Concerning Corporate Disclosure," *Woman C.P.A.*: Vol. 41 : Iss. 1 , Article 2.
Available at: https://egrove.olemiss.edu/wcpa/vol41/iss1/2

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Woman C.P.A. by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

User Perception Differences Concerning Corporate Disclosure

by Larry B. Godwin

The concept of *differential disclosure* has been actively debated during the past several years. Differential disclosure is the reporting of different financial information to different users, on the theory that information has different degrees of utility for different user groups.[1] The more detailed and technical disclosures are deemed appropriate for the professional investor, while the less technical, more "understandable" disclosures are viewed as appropriate for nonprofessionals.

The concept of differential disclosure is currently operational with respect to periodic filings. The 10-K and 10-Q reports, required of companies registered with the Securities and Exchange Commission, are geared to the professional; annual and quarterly reports to stockholders are intended to serve the nonprofessional.

The Financial Analysts Federation recently released a report urging corporate managements to exert more effort in the area of differential disclosure. The aim of such a disclosure policy was seen as the determination of the optimum body of information for a company to reveal, without overburdening the analysts or shareholders with too much data.[2]

In January, 1976, when he was Chief Accountant of the SEC, John Burton said that one of the "major thrusts" of the Commission in coming months would be differential disclosure. He challenged management to analytically select the "most important" disclosures and make them available to the "average investors," while at the same time making available to analysts the "kind of data they need to reach professional judgments about a company.[3]

At the same time, former SEC Chairman Roderick Hills announced the formation of a new Advisory Committee on Corporate Disclosure to reassess all SEC disclosure policies and the Commission's methods of implementing them.[4] In November, 1977, the Committee issued its final report to the SEC and surprised some by advocating the abandonment of the Commission's existing differential disclosure policy. It suggested that public companies file with the SEC their annual and quarterly reports to shareholders in lieu of the currently required 10-K and 10-Q reports.[5] In early 1978, the SEC expressed agreement with the committee's suggestion, and said it would attempt later in the year to develop a single, comprehensive disclosure regulation combining the annual report to stockholders and the 10-K report.[6]

Theoretically the concept of differential disclosure has great merit. The most compelling argument in favor of the concept is that the "average investor" has financial information needs that may well differ from those of the professional analyst. Via differential disclosure, the needs of each class of users could be met without sacrificing the needs of other groups.[7] In addition, no class of users would be subjected to information overload if accounting reports were tailored to the needs of each class.

The purpose of this paper is to present the findings of a research project aimed at determining the similarities and differences in the disclosure preferences of analysts and shareholders. In effect, the objective of the research was to evaluate the advisability of preparing separate accounting reports for each user group under the policy of differential disclosure.

Research Design and Methodology

In order to test the validity of the concept of differential disclosure, a questionnaire approach was utilized.

The names of 298 of the approximately 5,000 members of the Financial Analysts Federation were selected from the organization's *Membership Directory,* using a random numbers table. Members eligible for selection included industry specialists in 38 fields and persons designated as "director of research" or "generalist." Excluded from the population sampled were specialists in foreign securities, special situations, bonds and venture capital, as well as members who were economists, technicians, underwriters, investment counselors, portfolio managers, or who resided outside the United States.

The common stockholders of one large U.S. corporation whose stock is traded on the New York Stock Exchange were also chosen to participate in the study. The subject corporation is engaged in the mining and refinement of minerals and the sale of mineral products; over 12,000,000 shares of common stock are outstanding. Exluded from the population sampled were officers, employees, and directors of the corporation; institutional investors (whose characteristics would, it was thought, approximate those of the analyst group); brokerage houses holding stock in street name; and persons located outside the United States. In total, 753 stockholders were selected for polling on a random basis.

Similar questionnaires were designed for administration to both the analysts and the stockholders. Twenty-five specific disclosures recently proposed or adopted by the SEC for the 10-K report and/or the annual stockholder report were listed in random order in the questionnaires. Only those disclosures which are general in nature, applicable to a wide variety of industries, appeared on the list.

Analysts were requested to indicate, for each disclosure, the usefulness in deciding whether or not to buy or recommend a company's stock. Similarly, stockholders were asked how useful each disclosure would be in deciding

Analysts appear to be more concerned with quantitative disclosures: stockholders seem more interested in the company's image and the competence of management.

whether or not to buy or sell a company's stock. In both cases, research participants were to indicate their responses by circling a number on a five-point scale on which zero represented "not useful" and four represented "very useful."[8]

A "dummy" disclosure item, not actually proposed by the SEC, was included among the legitimate disclosures in order to provide a rough gauge of the reliability of the research instrument. The text of the "dummy" item was: "A listing of the names of all common stockholders who own fewer than 100 shares of the conpany's stock at the end of the year." It was thought that this disclosure would not be useful to the investment decisions of reasonable users.

The research was conducted in three stages. Questionnaires were pretested by administration to several relevant persons, followed by discussion with them of the adequacy of the instruments. A pilot test was conducted through which the reliability and face validity of the questionnaires were determined to be sufficiently high, and the disclosure items were found to be worded sufficiently clearly that the same instruments could be used for the primary study. A test for nonresponse bias was conducted and it was determined by application of the t-test that second-request responses did not differ significantly from those received in the initial survey. Usable responses were received from 127 analysts and 275 stockholders, representing 42.6 and 36.5 percent, respectively, of the questionnaires mailed.

Research Results

The data which emerged from the questionnaire study indicate that significant differences (at the .05 percent level) in the perceived usefulness favoring one group or the other occurred for thirteen of the twenty-five legitimate disclosures. The results of the chi-square test applied to the results show that in nine instances, significantly more analysts and fewer stockholders found the disclosure items useful than expected, and in four cases, more stockholders and fewer analysts found the items useful than expected. For the remaining twelve disclosures, the results were mixed, i.e., they did not clearly favor one group over the other.

The disclosure items preceived as significantly more useful to the analyst respondents were·

Item[9]	Description
1	Book value of obsolete equipment
2	Investment in loss division
3	Capital expenditure analysis
4	Available lines of credit
5	Short-term borrowing cost
6	CPA-auditor change
7	Assets carried at less than market
8	Accounting alternatives effect on income
9	Tax rate difference explanation

Disclosure items more useful to the stockholder respondents were:

Item	Description
10	Political fund contributions
11	Attorney and CPA lawsuits
12	New issuers: Offering price of shares
13	Management effectiveness audit

These results suggest that, where significant differences exist between the two groups, analysts may find disclosures that are quantitative in nature more useful than do stockholders. With the exception of disclosure of CPA-auditor change information (Item 6), the disclosures more useful to the analysts sampled dealt with dollars and percents. Indeed a majority of them (Items 1, 2, 7, 8 and 9) are aimed at adjusting the traditional financial statements in order to estimate a company's value or recent progress, or to make the statements comparable to those of other companies. Items, 3, 4, and 5 may be useful in estimating a company's future earnings.

On the other hand, three of the four disclosures viewed more useful by the stockholders polled (Items 10, 11, and 13) are qualitative rather than quantitative in nature, i.e., they emphasize the integrity, quality and reputation of management and its activities rather than adjustments to the financial statements. Items 10 and 11 do include dollar figures, but the thrust of the disclosures seems to lie with the activities themselves rather than the amounts of money involved.

In summary, the results suggest that analysts as a group are more concerned than stockholders with analyzing current reported earnings and with estimating future earnings. In contrast, stockholders appear more interested than analysts in the basic competence of management and in the company's image. The implication may be that either (1) stockholders are more prone than analysts to make their investment decisions based on the quality of management and its activities, perhaps because, as a class, they possess a lower degree of financial sophistication to make adequate quantitative analyses from a company's financial statements; or (2) stockholders rely primarily on analysts and brokers for their investment decisions, and their interest in the qualitiative aspects of corporations merely acts as a constraint on the advice offered by others.

Another observation evident from the data is that analysts rated the disclosure items on a wider range of the scale than did stockholders. The median usefulness ratings of the analysts respondents ranged from .44 to 3.69; four medians fell below 2.00, the midpoint in the scale. The stockholder medians varied from 1.79 to 3.56, and only one received a median below 2.00.

The results suggest that analysts, as a class, are more discriminating than stockholders in their ability to pick out from the list those disclosures which they view as irrelevant. Stockholders appear to advocate "disclosure for the sake of disclosure," perhaps because of their belief that they have a right to know a great deal about the companies in which they own an interest. All the disclosures are viewed as at least moderately useful by the shareholders. This conclusion appears to be further substantiated by the fact that the stockholder sample found disclosure of the names of all shareholders who own fewer than one hundred shares of a company's stock (the trivial "dummy" item, not actually proposed by the SEC) somewhat more useful than the analysts polled.

In order to gauge the degree of con-

sensus within each of the two groups, the mean absolute deviations relative to the usefulness medians were calculated. The deviations for analysts ranged from .60 to 1.18, whereas deviations for the stockholders were much greater and ranged from .94 to 1.42. These results suggest that, while the degree of consensus for analysts is not great, the group is considerably more unified than the stockholder class. Analysts have a more common background than stockholders: they are all members of a professional organization; most of them engage in financial analysis as an occupation; and they are rather sophisticated in their knowledge of accounting terms and principles. Stockholders, on the other hand, probably vary considerably in their educational backgrounds, in the extent to which they do their own financial analysis, in their knowledge of business and accounting, and in their professional stature.

Summary of Research Findings

The results suggest that the two user groups may be differentiated along several lines. Analysts appear to be more concerned than stockholders with using quantitative disclosures aimed at analyzing current reported earnings and estimating future earnings. Stockholders, on the other hand, seem to be more interested in qualitative disclosures dealing with the company's image and the competence of management.

Analysts seem to be better able than stockholders to distinguish the irrelevant information from a rather extensive list of disclosures. Stockholders apparently desire convenient access to large quantities of information, suggesting "disclosure for the sake of disclosure" as a matter of principle.

Analysts as a group appear to be more homogeneous than stockholders. The degree of consensus among financial analysts concerning the usefulness of corporate disclosures seems to be significantly greater than for stockholders.

Conclusion

The limited scope of the research project does not warrant sweeping generalizations. However, the survey results suggest that the SEC's *existing* differential disclosure policy of requiring extensive corporate disclosure in the 10-K report, but a more limited degree of revelation in the annual stockholder report, is sound. Although stockholders indicate that they are moderately interested in all the SEC's disclosures, the research results seem to show that the interest on the part of the analysts is significantly greater for disclosures of the quantitative variety. Analysts, then, who appear more concerned than stockholders with disclosures such as the analysis of capital expenditures and the explanation of tax rate differences, should have available to them this type of information in the 10-K. Since analysts probably already have greater access to the 10-K report than do stockholders, it follows that the disclosures analysts perceive as significantly more useful could be revealed via that source.

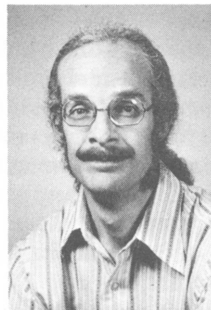
Qualitative disclosures, such as information concerning attorney and CPA lawsuits and political fund contributions, on the other hand, seem to have greater appeal to the stockholder group, and perhaps should be required for the corporate annual shareholder report. Such reports are made widely available to current and prospective investors, by brokerages houses as well as by the issuing corporations, and would seem to be a suitable medium for disclosures of the qualitative type.

However, stockholders as a class apparently are not homogeneous. Fortunately, the *individual* stockholders who desire a more complete revelation of data concerning companies in which they own an interest, including disclosures of a quantitative nature, do have access to the 10-K report. The SEC requires companies over which it has jurisdiction to furnish to stockholders, on request and without charge, a copy of its most recent 10-K report.

Therefore, by catering to the average stockholder through the annual stockholder report, yet providing the financial analyst and the sophisticated stockholder convenient access to 10-K data as well, the SEC's *current* policy of differential diclosure seems optimal.

However, as reported earlier in this paper, the SEC intends to propose regulations which would develop a single, comprehensive disclosure policy combining the annual report to stockholders and the 10-K report. By abandoning its differential disclosure policy, the SEC appears to do a disservice to its registrant corporations, to their stockholders, and to financial analysts. Stockholder reports would presumably contain considerably more financial information under the new policy. Such reports, which will not contain data that the analyst could not currently obtain via the 10-K report, will become more expensive to prepare and mail. In addition, the "average investor," when presented with the greater quantities of data, may find it increasingly difficult to isolate those areas which are most relevant to the decision processes. Both the stockholder and the analyst may be inhibited from making optimal decisions because of information overload.

In sum, the research results seem to support the validity of the concept of differential disclosure. The SEC's plan to combine the stockholder reports and statutory filings appears to be a step backward when the viewpoints of stockholders, analysts and the issuing corporations are considered.■



LARRY B. GODWIN, *CPA, DBA, is Assistant Professor of Accounting at Oregon State University. Prior to entering the teaching profession he was a staff auditor with Arthur Andersen & Co.*

NOTES

[1]Clara C. Lelievre, "General Purpose Financial Statements," *The Woman CPA* (July, 1977), p. 20.

[2]"Financial Analysts Cite Areas of Annual Report Deficiencies," *Journal of Accountancy* (July, 1977), p. 20.

[3]"Hills Announces Reassessment of Disclosure at SEC Conference," *Journal of Accountancy* (Febrary, 1976), p. 28.

[4]*Ibid.*, p. 27.

[5]"SEC Corporate Disclosure Group Issues Final Report," *Journal of Accountancy* (December, 1977), p. 22.

[6]"SEC Acts On Recommendations of Disclosure Advisory Group," *Journal of Accountancy*, (April, 1978), p. 12.

[7]Lelievre, *op. cit.*, p. 21.

[8]The three intermediate numbers were not labeled.

[9]The disclosure items did not appear in this order on the questionnaire. The order was changed to facilitate discussion of the research results.