

1-1979

Investors' Opinions Regarding General Purpose Financial Statement Usefulness

Sharon G. Siegel

Kathy J. Dow

Eugene Calderaro Jr.

Diane L. Murray

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



Part of the [Accounting Commons](#), and the [Women's Studies Commons](#)

Recommended Citation

Siegel, Sharon G.; Dow, Kathy J.; Calderaro, Eugene Jr.; and Murray, Diane L. (1979) "Investors' Opinions Regarding General Purpose Financial Statement Usefulness," *Woman C.P.A.*: Vol. 41 : Iss. 1 , Article 3. Available at: <https://egrove.olemiss.edu/wcpa/vol41/iss1/3>

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.

Investors' Opinions Regarding General Purpose Financial Statement Usefulness

by Sharon G. Siegel, Kathy J. Dow,
Eugene Calderaro, Jr., and Diane L. Murray

Much of the research involving evaluation of financial statement usefulness has been conducted using some type of investor or market reaction as the inferential measure of usefulness. These studies have produced varied results, some supporting the effectiveness of accounting information as an investor tool while others refute it.¹

A more direct approach has been the survey method, which also has not produced conclusive evidence as to financial statement usefulness. The latest survey conducted by the Securities and Exchange Commission's Committee on Corporate Disclosure in the spring of 1977 produced highly useful ratings by investors. These results support those obtained by Brenner (1971); however, they do not corroborate those found by Baker and Haslem (1973) whose survey respondents rated financial statements relatively low as an investor information source.²

APB Statement No. 4 states that:

*"Financial statements are designed to provide an important part of the information that users need for many of their decisions. The information contained in the statements should not be relied on exclusively, however, and should be supplemented by other information about the specific prospects of the company, the industry in which it operates, and the economy in general."*³

In view of this statement it seems important to attempt to reconcile the evidence as to the usefulness of accounting data
6/*The Woman CPA*

as an information source to present and potential investors. While the inferential approach has produced some evidence of a relationship between financial statement information and market behavior, the method is complicated by the myriad of other variables, operating at the same time, which may affect investor decisions. The survey approach, though not without its problems is more of an attempt to isolate individual source usefulness. The present study used this approach in an effort to provide additional evidence as to the usefulness of financial statements to investors when making investment decisions.

The specific questions we attempted to answer are:

1. Do investors view financial statements as a useful information source in making their investment decisions?
2. Are there other information sources, either currently or hypothetically available which are viewed by investors as more useful than financial statements?
3. Do investors hold any general misconceptions about the information conveyed in financial statements?
4. Do differing individual background characteristics of investors bear a significant relationship to their rating of the usefulness of financial statements?

METHOD

Subjects

Surveys were mailed to the population of faculty members and ad-

ministrators at the University of Massachusetts who were asked to complete the questionnaire and return it via campus mail. Of this population, 276 returned the survey representing a 14 percent response rate. From this sample, non-stockholders who were asked simply to indicate, were eliminated, leaving only those individuals who owned stock. This subsample contained 162, for which median descriptive data can be found in Chart 1, along with similar data representing the entire SEC survey respondent, and median NYSE stockholder.

In comparison, the current survey respondents were quite similar to the SEC respondents as far as age, income level, number of shares held, recency of trading, diversification of holding and their accounting/finance educational background. Age and income level corresponded across the three (SEC, NYSE, and current survey) groups of share holders. The two markedly dissimilar categories were sex and profession. The current survey and SEC respondents were disproportionately male while the distribution of NYSE share owners is more equally male and female. While the educational level of the three groups is largely represented by college completion, the current survey was almost exclusively comprised of academicians.

The Survey

The survey consisted of three types of questions: those which required evaluative responses, open-ended questions, and background data.

Evaluative Questions

Three sections of the survey required evaluation of information types and sources as to their usefulness in making investment decisions. Responses were required along a continuum from (1) not useful to (5) very useful with (3) as neutral. The different sections related to:

- 1) General information sources - this section asked respondents to evaluate the usefulness to them of eleven general information sources such as annual reports, stockbrokers, newspapers, etc.
- 2) Financial statements - this section asked respondents to evaluate the usefulness to them of the balance sheet, income statement, statement of changes in financial position, footnotes, and auditor's report.
- 3) Alternative information - this section asked respondents to rate the

usefulness of five types of information not now widely accessible and/or available.

Open-ended Questions

The five parts of the financial statements: (balance sheet, income statement, statement of changes in financial position, footnotes, and auditor's report) were presented so that respondents could state in their own words what they found useful in regard to each.

Background Data

Fourteen background questions relating to investment activity and personal data concluded the survey.

Data Analysis

Since the thrust of the survey was to examine the degree to which different types and sources of information are viewed as useful by investors, the evaluative responses were collapsed into two sets: those rated as useful (4) and (5) and those rated neutral (3) or not useful (2) and (1). Frequencies were calculated for the evaluative responses and to determine whether a relationship existed between any of the various factors. Thus, the χ^2 test would determine whether a statistically significant difference existed between the number of useful and the number of not useful ratings obtained for a particular variable.

RESULTS

Frequency data in terms of percentages of positive useful responses to each of the evaluative questions are presented in Table 1. For general information sources, newspapers received the most favorable responses (65.6 percent) whereas SEC filings and stock exchange publications received the least useful rating (9.3 percent). The statement of changes in financial position was rated as the most useful part (47.0 percent) of the financial statements while the auditor's report was rated as useful by only 15.2 percent of the respondents. Were an independent management evaluation available, 52.3 percent of respondents would find it useful while cash flow information was rated as useful by 32.5 percent.

The χ^2 test using individual evaluative responses presupposed an expected equal distribution between useful and non-useful or neutral responses. The results of the χ^2 test determined whether significantly more respondents rated the sources and types of information in either a useful or non-useful direction. As shown in Table 2, newspapers and an independent management evaluation

Typical Shareholder

| | SEC | NYSE | Current Survey |
|-------------------------------|------------------|---------------|-------------------|
| Age | 55+ | 53 | 51-60 |
| Income | 25-49,999 | 19,000 | 20-29,000 |
| Educational level | college graduate | 42.3% college | college graduates |
| Sex | 78% male | 50-50 | 11.9% women |
| Shares | 400-499 | N/A | 500-999 |
| Most recent stock transaction | 12 mos. | N/A | 7-12 mos. |
| Diversification | 6-12 | N/A | 6-10 |
| Accounting/Finance experience | 41%-yes | N/A | 38.5%-yes |

were the only variables rated as useful by significantly more subjects than not useful. Twelve of the variables were rated by significantly more people as something more than useful while the eight remaining variables were not rated by significantly more subjects in either direction.

Three of the background variables resulted in significant relationships when cross-tabulated with the evaluative questions. Number of shares of stock owned was significant ($\chi^2(7)=15.12$, $p .05$) related to magazine and subscription advisory service usefulness ratings. Upon further inspection, the greatest contribution to the overall χ^2 in both cases was found in the large proportion of useful rating given by those respondents owning 1,000 or more shares of stock.

Income cross-tabulated with stockbroker ratings also yielded a significant relationship ($\chi^2(3)=8.67$, $p .05$). Over half of the χ^2 was due to greater than expected ratings of not useful given by respondents in the \$10-19,999 income range.

Generally, significantly more respondents who have had no finance/accounting courses viewed the information sources as other than useful while those having 1-3 finance/accounting courses generally did not differentiate their responses between useful and non-useful. Notable exceptions were the footnotes to financial statements and subscription advisory services which received highly useful ratings from that group.

Of the 157 respondents, 70 answered the open-ended question which involved specifically stating what they found useful or not useful in the income statement, balance sheet, statement of changes in financial position, footnotes,

and the auditor's report when making investment decisions. A majority of the respondents indicated that they found the statements useful for ratio analysis and the analysis of trends between years. Of those contending that the financial statements are not useful, many noted that they either do not understand or do not trust the financial statements.

Respondents who indicated that financial statements are not useful directed their strongest criticisms against the balance sheet, footnotes, and auditor's report. Criticisms of the balance sheet included:

- "Always balances! Therefore not informative."
- "It always balances so why bother, the issues are avoided except for accounting."
- "The bottom lines of assets and liabilities always match-regardless of the company's conditions."

Footnotes were viewed by one respondent as "either unintelligible or just irritating," a view typical of that held by other respondents. Criticisms of the auditor's report were especially harsh:

- "Most auditors' reports tend to say, more or less, what management wants said, otherwise next year management will have a different auditor."
- "By the time they get into the audit stage the damage has been done."
- "Even a bankrupt company can receive a standard auditor's report."

Discussion

The study was conducted during the same year as the SEC study. However, the results are highly disparate as indicated in Table 3. The main difference between the present sample and the SEC's was the profession of the

| Variable | Relative % of useful ratings | | | |
|--|------------------------------|--------|--------|--------|
| | 0% | 25% | 50% | 100% |
| General information sources: | | | | |
| Annual report | | | (35.8) | |
| Friends, relatives and business assoc. | | | (38.4) | |
| Industry publications | (11.9) | | | |
| Investment advisors | | | (33.1) | |
| Magazines | | | (40.4) | |
| NYSE, AMEX publications | (9.3) | | | |
| Newspapers | | | | (65.6) |
| Quarterly filings | | | (35.1) | |
| SEC filings | (9.3) | | | |
| Stockbrokers | | | | (55.6) |
| Subscription advisory services | | (19.2) | | |
| Financial statement sections: | | | | |
| Auditor's report | | (15.2) | | |
| Balance sheet | | | (37.7) | |
| Footnotes | | (23.2) | | |
| Income statement | | | (43.7) | |
| Statement of changes in financial position | | | (47.0) | |
| Hypothetical information sources: | | | | |
| Cash flow information | | | (32.5) | |
| Financial ratios | | | (33.1) | |
| Independent management evaluation | | | | (52.3) |
| Inflation adjusted financial statements | | | | (47.7) |
| Projected financial statement data | | | (42.4) | |
| Segment financial information | | | (43.7) | |

Table 1: Relative percentages of "useful" responses to the evaluative variables

respondents, which was comprised solely of academicians. The results of this survey, therefore, reflect the opinions of a unique subgroup of investors rather than the population of investors as a whole. Without further investigation into the characteristics of the decision models of academic versus representative populations, findings cannot be generalized. It is also difficult to definitively explain the discrepancy between these findings and the SEC's. However, results point up the existence of a specific subsample of investors who do not view financial statements as useful to themselves in making their investment decisions. If these results can be generalized to other academic populations then a significant subsample of investors would exist who hold this view. The APB specifically states that "general-purpose financial statements are prepared by an enterprise under the presumption that users have common needs for information."⁶ Yet results in-

dicating that the current survey respondents' needs are not being served by the general purpose financial statements.

The number of finance/accounting related courses/seminars provides some measure of the sophistication of the respondents. The results demonstrated differing attitudes toward usefulness as the sophistication level varies. Respondents at the lowest level disproportionately viewed most of the sources as not useful while respondents at the next level were skewed in the opposite direction. Those subjects at the highest level were not significantly divided on most responses. Notable responses were to the footnotes to financial statements and subscription advisory services which may imply that the sophistication level is high for both these sources. These results are interesting in that they indicate that as the level of sophistication increases the attitude toward the usefulness of informa-

tion sources shifts from not useful to useful to an ambitious attitude. This could reflect a situation where some familiarity with the information sources could result in ready acceptance of their usefulness, and if unwarranted, perhaps a dangerous acceptance.

Conclusions

In terms of the stated objectives of this study, the conclusions which follow form the results are:

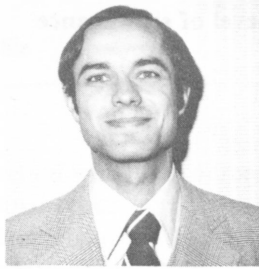
- 1) significantly more investors view the financial statements as not useful in making investment decisions,
- 2) other information sources are viewed as more useful in investment decisions than financial statements,
- 3) the investors surveyed do hold some but not many misconceptions about the information conveyed in financial statements, and
- 4) individual investors' background

| Evaluative variable | Direction and level of significance |
|--|-------------------------------------|
| General information sources: | |
| Annual reports | - *** |
| Friends, relatives and business associates | - * |
| Industry publications | - *** |
| Investment advisors | - * |
| Magazines | n.s. |
| NYSE, AMEX publications | - *** |
| Newspapers | + *** |
| Quarterly reports | - *** |
| SEC filings | - *** |
| Stockbrokers | n.s. |
| Subscription advisory services | - *** |
| Financial statement sections: | |
| Auditor's report | - *** |
| Balance sheet | - * |
| Footnotes | - *** |
| Income statement | n.s. |
| Statement of changes in financial position | n.s. |
| Alternative information sources: | |
| Cash flow information | - * |
| Financial ratios | n.s. |
| Independent management evaluation | + ** |
| Inflation adjusted financial statements | n.s. |
| Projected financial information | n.s. |
| Segment financial information | n.s. |

Table 2: Direction and level of significance of the responses given to the evaluative questions

| Financial statement section | SEC Survey | Current Survey |
|--|------------|----------------|
| Auditor's report | 61% | 15.2% |
| Balance sheet | 86% | 37.7% |
| Footnotes | 72% | 23.2% |
| Income statement | 91% | 43.7% |
| Statement of changes in financial position | 72% | 47.0% |

Table 3: Comparison of relative frequencies of useful ratings given to the financial statement sections by subjects in the SEC survey and the current survey.



Gene Calderaro is employed in the Comptroller's Office of Western Electric in New York City. He received a B.B.A. and M.S.B.A. degree in Accounting from the University of Massachusetts/Amherst.



Kathy J. Dow is a Teaching Assistant in the Accounting Department at Boston University where she is working toward the DBA degree. Ms. Dow received an A.B. degree from Rutgers University, the M.S.B.A. in Accounting from the University of Massachusetts/Amherst, and is a member of American Accounting Association, Beta Gamma Sigma and Beta Alpha Psi.



Diane L. Murray is a staff accountant with Arthur Young & Co. in Stamford, CT. Ms. Murray received a B.S. degree from the University of San Francisco, an M.S.B.A. in Accounting from the University of Massachusetts/Amherst, and is a member of Beta Alpha Psi and Beta Gamma Sigma.



Sharon G. Siegel is Teaching Associate in the Accounting Department at the University of Massachusetts/Amherst. She holds a B.A. degree from Gonzaga University, a M.S.B.A. in Accounting from the University of Massachusetts/Amherst.

as to the number of finance/accounting related courses/seminars does have a significant relationship to their view of information sources usefulness.

These results do not support the SEC survey. Due to the educational level of the current survey sample, these results could be hypothesized to more accurately represent information source usefulness to sophisticated investors rather than to investors with a somewhat naive view of statement usefulness. Whether or not this is a valid inference, the occurrence of the low rating given financial statements by well educated investors relative to other sources does indicate that the dynamic nature of financial accounting to provide a useful primary investor information source has not been maintained.

Even more seriously, the objective of the accounting profession to provide general purpose financial statements could be questioned. If the SEC and the current survey respondents did possess common needs, as the APB postulates, then the survey results should not have been so divergent.

What then is the solution? The current study indicates that more useful sources than financial statements are now available to stockholders as six of the general information sources were rated higher than financial statements as a composite. In addition, four of the alternative information sources were also rated higher. Information as to the quality of management was also highly rated by respondents in the Baker & Haslem (1973) and SEC (1977) survey. Perhaps, then, the efforts of accounting for the needs of the individual investor have been misdirected. Development or adaptation of alternative information sources to financial statements may prove more useful to individual investors, especially in view of the temporal constraints and attempts at condensed presentation which render financial statements untimely and incomplete as an investor information source. For instance, constructive data could emerge with preparation of investor information from the plethora of data now required by the government and its agencies for general consumption regarding the firm, its products, general information and industry conditions. The present survey indicates much of this information is considered highly useful but inaccessible by respondents. Additionally, then the accounting profession might be better served by directing

its efforts toward a narrower user group, possibly the sophisticated analyst and the firm's creditors, resulting in more functional reports for all interest groups. ■

NOTES

¹Studies supporting financial statement usefulness include V. Niederhoffer and P.J. Regan, "Earnings Changes, Analysts' Forecasts, and Stock Prices," *The Financial Analysts Journal*, 28 (May-June 1972), 65-71; J. W. Ashley, "Stock Prices and Changes in Earnings and Dividends: Some Empirical Results," *Journal of Political Economy*, 70 (February 1962), 82-85; R. Ball and P. Brown, "An Empirical Evaluation of Accounting Income Numbers," *Journal of Accounting Research*, 6 (Autumn 1968), 159-78; W.H. Beaver, "The Information Content of Annual Earnings Announcements," *Empirical Research in Accounting: Selected Studies*, 1968, Supplement to Vol. 6 *Journal of Accounting Research*, 67-92; P. Brown and J.W. Kennelly, "The Informational Content of Quarterly Earnings: An Extension and Some Further Evidence," *Journal of Business*, 45 (July 1972), 403-15; R.G. May, "The Influence of Quarterly Earnings Announcements on Investor Decisions as Reflected in Common Stock Price Changes," *Empirical Research in Accounting: Selected Studies*, 1971, Supplement to Vol. 9, *Journal of Accounting Research*, 119-63; A. Martin, "An Empirical Test of the Relevance of Accounting Information for Investment Decisions," *Empirical Research in Accounting: Selected Studies*, 1971, Supplement to Vol. 9, *Journal of Accounting Research*, 1-31; J.E. Kiger, "An Empirical Investigation of NYSE Volume and Price Reactions to the Announcement of Quarterly Earnings," *Journal of Accounting Research*, 10 (Spring 1972), 113-28; R. S. Kaplan and R. Roll, "Investor Evaluation of Accounting Information: Some Empirical Evidence," *Journal of Business*, 45 (April 1972), 225-57. Studies not supporting financial statement usefulness as an investor tool include M. Friedman, "Comment," on C. Smith, "Survey of the Empirical Evidence on Economies of Scale," in *Business Concentration and Price Policy* (Princeton: Princeton University Press, 1955), p. 230; G.J. Stigler, *The Organization of Industry* (Homewood, Ill.: Richard D. Irwin, Inc., 1968), p. 72; J.L. Treynor, "The Trouble with Earnings," *Financial Analysts Journal*, 28 (September-October 1972), 43; G.J. Benston, "The Effectiveness and Effect of the SEC's Accounting Disclosure Requirements," in *Economic Policy and the Regulation of Corporate Securities*, H.B. Manne, ed. (Washington, D.C.: George Washington University and American Enterprise Institute for Public Policy Research, 1968), p. 73.

²Vincent C. Brenner, "Are Annual Reports Being Read?—An Empirical Study," *The National Public Accountant* (November 1971), p. 16; H. Kent Baker and John A. Haslem, "Information Needs of Individual Investors," *The Journal of Accountancy*, (November 1973), ip. 65.

³Commerce Clearing House, Inc., *Professional Standards*, Volume 3, (Chicago, July 1, 1977), p. 7221.

⁴SEC Advisory Committee on Corporate Disclosure, *Individual Investor Opinion Survey* (unpublished survey, Spring 1977).

⁵1976 *Fact Book*, ed. Thomas T. Murphy (New York: New York Stock Exchange, 1977), p. 50.

⁶Commerce Clearing House, Inc., *Professional Standards*, p. 7191.

⁷*Ibid.*, p. 7331.