

# Usefulness of annual reports: Perceptions from Sri Lankan Investors and Lenders

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## **Extended Abstract**

Both the 2010 and 2018 version of International Accounting Standards Board's (IASB) Conceptual Framework for Financial Reporting recognise investors and lenders as the main user groups of financial reports since they are the capital providers of reporting entities. The main objective of the IASB is to set a reporting environment that ensures reporting entities provide useful information to both user groups. In general, investors decide to invest or disinvest in business, while lenders are concerned about the capacity of the business to meet debt obligations. Further, the information needs of these two groups can be significantly different when analysed jointly (e.g., Benjamin and Stanga, 1977) and individually (e.g., Naser et al., 2003; Alattar and Al-Khater, 2008; Chatterjee et al. 2010; De Zoysa and Rudkin, 2010).

Whereas previous studies do not treat investors and lenders separately, this study considers both the aspect 'usefulness to whom?' and 'usefulness for what decision?' Different users who make different decisions should not be aggregated together to assess the usefulness of annual reports. For example, an accountants or financial analyst may engage in investment-type decisions or in lending-type decisions, or both. If their opinion is not quizzed explicitly in association with investment decisions or lending decisions, biased inferential conclusions may be drawn. *How then can studies that include accountants, academics, investors and lenders into the same survey target populations demonstrates the usefulness of the information in annual reports for major capital providers?*

There is a relationship among the IASB, reporting entities, and financial statement users. The IASB reporting standards are based on Qualitative Characteristics (QCs) of information; reporting entities implement the standards and so signal compulsory and voluntary information to users, investors, and lenders in particular; this information will resonate with the individual users with different degrees of usefulness; the 2018 IASB conceptual framework specifically recognises that the QCs of useful financial information are the types of information that are likely to be most useful in financial reports, hence closing the loop. To our knowledge, however, no study has jointly examined the importance of QCs from investment and lending perspectives. *In this loop, which QCs then are being perceived important in investment and lending decisions?*

A further consideration is the transferability of information usefulness analyses from different political, social, cultural and economic environments (Jeanjean & Stolowy, 2008; Joshi, Bremser, & Al-Ajmi, 2008; Schipper, 2005). Adoption of IFRS requires major transformations in accounting systems (Lourenço, Branco, & Castelo, 2015). *While the benefits from IFRS adoption, such as comparability and access to a pan-global information standard (De George, Li, & Shivakumar, 2016), may seem obvious, did the adoption of the new reporting regimes increase the usefulness of annual reports? Has the usefulness after adopting IFRS changed for better or for worse?*

To answer for the above three questions, this paper examines the use, perceived usefulness, and adequacy of annual reports, the importance of QCs, as well as the impact of IFRS on Financial Reporting Quality (FRQ) from the perspective of Sri Lankan investment and lending decision-makers.

This study employs a questionnaire survey of Sri Lankan investors (n=214) and lenders (n=235) within explicitly stated decision scenarios i.e. buying, selling or holding equity and debt instruments for investors and providing or settling loans and other forms of credit for lenders, as per IASB's Conceptual Framework (IASB, 2018, p. A17).

The results based on frequency of use are: the annual reports are used frequently for investment and lending decisions; stock market publications are recognised as the prime source of information for investment decisions and communication with company management for lending decisions; and, there is a significant difference in the responses between investment and lending decision-makers in terms of various sources of information for their decision making. Annual reports are identified as the second source of information by both the investors and lenders.

The results based on usefulness are: both types decision-makers identified financial statements as the most useful sections in annual reports; most respondents from both groups recognised that annual reports are "very useful" while more than 80% accepted that annual reports are "useful"; there was no significant difference in the responses for the usefulness of annual reports for lending decisions, and investment decisions which means both commonly agreed that annual reports are useful for their decisions.

With respect to the adequacy of annual report information, 65% of respondents from both groups responded that annual report information is "adequate", "very much adequate", or "extremely adequate", and annual reports are regarded as more useful than adequate to make investment and lending decisions.

The results based on the importance of QCs are: both groups considered all QCs to be important for their respective decisions; understandability is the most important QC for both groups followed by timeliness; the fundamental QCs, relevance and faithful representation rank low. These results correspond to no matter what the degree of relevance, faithful representation or quality of any of the other enhancing QCs is, information needs to be communicated in an understandable way, and time for it to be useful, which in second-line may elevate to important and adequate data.

Finally, both groups of respondents agree that i) QCs have been improved as a result of adopting IFRS in Sri Lanka, and ii) the overall reporting quality has improved in Sri Lanka post-IFRS adoption when compared with the Sri Lanka Accounting Standards (SLASs) reporting regime.

This is the first perception study tailored to distil between the points of view of investors and lenders, the two primary user groups of general purpose financial reporting. Our results also challenge the IASB classification of QCs through 'fundamental' and 'enhancing'.

*Keywords:* usefulness of annual reports; investment and lending decisions; qualitative characteristics; IFRS; Sri Lanka