ACCOUNTING INFORMATION QUALITATIVE CHARACTERISTICS GAP: INVESTORS’ AND AUDITORS’ PERSPECTIVE

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Abstract
The principal aim of financial reporting is to serve the interested parties by providing information that is useful in making business and economic decisions. This is a formal record of the financial activities of a business, persons or other entity. The financial statement also provides information about the financial position of an enterprise that is useful to a wide range of users. This paper titled “Accounting Information Qualitative Characteristics Gap: Investors’ and Auditors’ Perspective” is to determine whether there is an existing gap concerning the importance of accounting information qualitative characteristics from investors’ and external auditor’s perspective as they represent the independent part responsible for the fairness of financial reports. The paper discussed the conceptual framework which consists of the definition of financial reporting, expectation gap, elements of financial statements, and objectives of financial reporting and qualitative characteristics of accounting information. To achieve the purpose of this paper, a questionnaire was designed and administered to a sample of 25 investors and 29 auditors. A t-test statistical technique was used. Finally it was concluded that there is an existing audit expectation gap between the external auditors and investors in terms of the qualitative characteristics of accounting information.

Keywords: Accounting Information; Qualitative Characteristics; Expectation Gap; and Financial Reporting.
Accounting information is a set of information which describes an account for a utility. It is a set of financial data indicating an organization’s resources, revenues, debts expenses. This is a system of collection and processing of financial and accounting data which is used by the company’s directors. It is a computer based method for monitoring accounting activities by using computer technology. A financial statement is a formal record of the financial activities of a business, persons, or other entities.

The principal aim of financial reporting is to serve the interested parties by providing information that is used in making business and economic decisions. Such information facilitates the efficient functioning of capital and other markets by promoting the efficient and equitable allocation of scarce resources in the economy. The conceptual framework for financial reporting is developed by the International Accounting Standard Board (IASB) and Financial Accounting Standard Board (FASB) which is a coherent system of concepts and conventions that flow from an objective. This objective identifies the purpose of financial reporting. The concepts and conventions provide guidance for identifying the boundaries of financial reporting including selecting the transactions, other events, and circumstances to be represented, identifying how they should be recognized and measured, and, identifying how they should be disclosed (Obaidat, 2007).

The primary objective of financial reporting is to provide current and potential investors and creditors with useful information that can guide them in making decisions on investments, like in the area of lending and other resource allocation matters. This information should have qualitative characteristics to be useful for decision making.

**Conceptual Framework**

**Financial Reporting and Expectation Gap**

Financial reporting is presenting financial data of a company’s operating performance, position and funds flow for an accounting period. Financial statements alongside related information / document may be contained in various forms mainly for external party such as in the annual report. It is basically financial information that companies give about their activities including how they prepare and show it. Financial reporting is a set of documents prepared usually by government agencies at the end of an accounting period. It generally contains summary of accounting data for that period with background notes, forms and other information (Dahmash, 1995).

Gap is a space between two things or in the middle of something especially because there is a part missing. Expectation gap is a term used to describe the difference between the expectations of those who rely upon the audit reports to make economic decision about what auditors (external auditors) should do and what they are perceived to do. Expectation gap occurs when there are difference between what the public expects
from the auditor and what the auditor actually provides. The research about the audit expectation gap has been extensively conducted worldwide. The term audit expectation gap emerged during the 1970s in the United States when the American Institute of Certified Public Accountants (AICPA) set up the Commission on Auditors Responsibilities (Cohen Commission) to consider “whether a gap exists between what the public expects or needs and what auditors can and should reasonably expect to accomplish in 1978, confirmed the existence of an expectation gap. Following that, more researches have been done all over the world with the same outcome which agreed with the existence of expectation gap.

**Fig 1: Audit Expectation – Performance Gap**
Source: Gray and Manson (2009)

**Element of Financial Statement**

The Statement of Fiscal Accounting Concepts (SFAC) is a document issued by Financial Accounting Standard Board (FASB) covering broad financial reporting concepts. SFAC 6 defines ten (10) elements of financial statements as the building blocks with which financial statements are constructed i.e. the classes of items that financial statements comprise. They focus directly on items related to measuring performance and reporting financial position. The definitions of these elements operationalise the resources, claims and changes identified in the third objective of financial report in SFAC 1. The accrual accounting model actually is embodied in the element definitions. The FASB recognized that accrual accounting procedures information is more successful in predicting future cashflows than is cashflow accounting. The 10 elements are:

(i) Assets
(ii) Liabilities
(iii) Equity
(iv) Investment by owners
(v) Distributions to owners
(vi) Revenues
(vii) Expenses
(viii) Gains
Losses
Comprehensive income

Assets represent probable future economic benefits obtained or controlled by a particular entity as a result of past transaction or events.
Liabilities represent obligation to other entities.

Equity is a residual amount, the owners’ interest in assets after subtracting liabilities

Investments by owners and distributions to owners are transactions describing any owner contribution to and withdrawal from the company.

Revenues are gross inflows resulting from providing goods or services to customers.

Expenses are gross outflows incurred in generating revenues.

Comprehensive income often does not equal net income (Singleton-Green, 2006).

Objectives of Financial Reporting
1. Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment credit and similar decisions.
2. Financial reporting should provide information that is useful to present and potential investors and creditors and other users in assessing amounts, timing and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sales, redemption, or maturity of securities or loans.
3. Financial reporting should provide information about an enterprise’s economic resources, obligations and owners’ equity.
4. Financial reporting should provide information about liquidity, solvency, and funds flows, (information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, and its capital transactions, including cash dividends and other distributions of enterprise resources to owners and about other factors that may affect an enterprise’s liquidity solvency).
5. Financial reporting should provide information about an enterprise’s financial performance during a period.
6. Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners for the use of enterprise resources entrusted to it.
7. Financial reporting should provide information that is useful to managers and directors in making decisions in the interest of owners.
8. Financial reporting should include explanations and interpretations to help users understand and financial information provided (Robert, 1973)

**Qualitative Characteristics of Accounting Information**

Accounting information is the compilation of a company’s financial transactions. Companies present accounting information to internal and external business stakeholders for making decisions. Qualitative characteristics are the attribute that make the information provided in the financial statement useful to the user. The characteristics can be viewed as a hierarchy of qualities as shown below.

![Qualitative Characteristics Hierarchy](source: Donald (1986))

To be useful, information must make a difference in the decision process. Relevance and reliability are the two primary decision-specific qualities that make the accounting information useful for decision making. Both are critical. No matter how reliable, if information is not relevant to the decision at hand, it is useless. Conversely, relevant information is of little value if it cannot be relied on. If either is missing completely from a piece of information, the information will not be useful (Kieso, Waygnat & Warfield, 2005).
Relevance: To make difference in the decision process, information must possess predictive value and/or feedback value. Generally, useful information will possess both qualities. For example, if net income and its components confirm investor expectations about future cash generating ability, then net income has feedback value for investors. This confirmation can also be useful in predicting future. Timeliness also is an important component of relevance. Information is timely when it is available for users early enough to allow its use in the decision process. The need for timely information requires that companies provide information to external users on a periodic basis.

Reliability: This is the extent to which information is verifiable representationally faithful and neutral. Verifiability implies a consensus among different measurers. For example, the historical cost of a piece of land to be reported in the statement of financial report of a company is usually highly verifiable. The cost can be traced to an exchange transaction, the purchase of the land. However, the market value of the land is much more difficult to verify. Appraisers could differ in their assessment of market value. The term objectivity often is linked to verifiability. The historical cost of the land is subjective, influenced by the measurer’s past experience and prejudices. A measurement that is subjective is difficult to verify, which makes it more difficult for users to rely on.

Representational Faithfulness: This exists when there is agreement between a measure or description and the phenomenon it purports to represent. For example, assume that the term inventory in a statement or financial report of a retail company is understood by external users to represent items that are intended for sale in the ordinary course of business. If inventory include, say machines used to produce inventory, then it lacks representational faithfulness.

Reliability: This assumes the information being relied on is neutral with respect to parties particularly affected. In that regard, neutrality is highly related to establishment of accounting standards (Jim, 2012).

Secondary Qualitative Characteristics
- Comparability: This is the ability to help users see similarities and differences between events and conditions. This is the ability of investors and creditors to compare information across companies to make their resource allocation decisions. Closely related to comparability is the notion that consistency of accounting practices over time, permits valid comparisons between periods. The predictive and feedback value of information is enhanced if users can compare the performance of a company over time (Jim, 2012).
Consistency: This means conformity, from period to period with unchanging policies and procedures. Conformity can be achieved by applying the same accounting treatment to similar events from period to period. It does not mean that an enterprise cannot switch from one accounting method to another if the new method is justified and is preferable. The enterprise should disclose the reasons and the effect of such change. Accounting, policies and procedures often help companies present their accounting information in a consistent manner. Publicly help companies often disclose their accounting policies and procedures in their quarterly or annual report. This information helps business stakeholders understand the accounting system in place and how the company maintains consistency.

Methodology
Primary and secondary data were both adopted for this paper. The questionnaire was administered which contains the qualitative characteristics of accounting information with five scales reflecting the importance of each characteristic. The questionnaire was administered by hand to 30 investors and 40 external auditors, while 25 were retrieved from investors and 29 from external auditors. Then an independent-sample t-test was used to analyze the data collected.

Hypothesis
The expectation gap is considered one of the major issues confronting the accounting profession. This paper is one of such many papers that deal with the expectation gap have the focus of this paper is the expectation gap in terms of the qualitative characteristics of accounting information. The paper is based on this null hypothesis (H0) at 5 percent level of significance.

H0: There is no gap between external auditors and investors in terms of the importance of the qualitative characteristics of accounting information.

Results and Discussion
The results of the independent-sample t-test are reported in Table 1. The Levene’s test for quality of variance shows that there are no differences between the variances of the two groups. There are agreements between the two groups about the importance of specific characteristics. Table 2 shows the summary of importance ranks assigned to characteristics by investors and auditors.

Table 1: Independent-Sample T-test

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Investors Group</th>
<th>Auditors Group</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Understandability</td>
<td>86.40%</td>
<td>91.03%</td>
<td>-1.359</td>
</tr>
<tr>
<td>Relevance</td>
<td>75.20%</td>
<td>88.25%</td>
<td>-3.29</td>
</tr>
<tr>
<td>Predictive value</td>
<td>75.20%</td>
<td>86.21%</td>
<td>-2.40</td>
</tr>
<tr>
<td>Feedback value</td>
<td>78.40%</td>
<td>79.31%</td>
<td>-0.22</td>
</tr>
</tbody>
</table>
From the table, it is seen that there is a significant difference between investors and auditors concerning the various characteristics. The investors focus on lines while the auditors do not because they know it will be at the expense of reliability and audited financial statements need time after the statement of financial report date to be published. Investors also do not give predictive value enough attention because they rely on brokers who direct them, so they do not have any previous expectations and do not need to correct the prior expectati

Table 2: Summary of Importance/Ranks Assigned to Characteristics

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Investors Rank</th>
<th>Auditors Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Understandability</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Relevance</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Predictive value</td>
<td>11</td>
<td>7</td>
</tr>
<tr>
<td>Feedback value</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>Timeliness</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>Reliability</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Verifiability</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Representational</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>faithfulness</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Neutrality</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Comparability</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>Consistency</td>
<td>9</td>
<td>6</td>
</tr>
</tbody>
</table>

The result of the test of the hypothesis shows that there is an existing gap between the external auditors and investors groups in terms of the qualitative characteristics of accounting information. Through analysing this gap, it can be seen that auditors and investors agree about the others which cause the gap. It it been also clear that auditors are more concerned about qualitative characteristics than the investors.

Conclusion

There is no doubt that a full set of qualitative characteristics is crucial for decision making process usefulness, in spite of the conflict between them. Who can ensure these characteristics in the financial reporting? It is difficult to say of its
characteristics because there is a conflict of interest between management and external users. Users of accounting information seek assurance services to help improve the reliability and relevance of the information used as the basis for their decisions while, the assurance services are performed by the external auditors who are responsible for expressing an opinion about the fairness of financial statements. This paper finally concludes that there is an existing audit expectation gap that consists of ignorance gap, deficient standard gap and deficient performance gap between the external auditors and investor

References


