Commonality between the preparer and the user of financial information as a prerequisite for conveying meaning

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A B S T R A C T

Preparers of financial information encode their message in an accounting language that needs to be decoded by users to enable them to understand and use the information properly. In order to convey meaning successfully, the sender and the receiver of a message need to use the same method to encode and decode the message, that is, there needs to be some commonality of language between the two parties. The research problem focuses on the issue of whether there is room to increase the commonality between the preparer and the user as a prerequisite for conveying meaning in corporate annual reports (CARS). The research problem was investigated mainly through questionnaires aimed at preparers and users of accounting information. It was found that the statutory and contextual sections of CARS are interdependent and could be utilised more in order to enhance the commonality of the accounting language for conveying meaning.

Key words: corporate annual reports, encoding and decoding messages, meaning

Introduction and background

Corporate annual reports (CARS) produce two main types of disclosures, namely statutory and contextual disclosures (Gouws & Cronjé 2008; Stanton & Stanton 2002: 479). The statutory disclosures comprise, inter alia, the statement of financial position and notes, the statement of comprehensive income and notes, the statement of

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changes in equity and notes, the statement of cash flows and notes and the directors' report. The statutory disclosures of CARS (the traditional financial reports) play a vital role in providing information to various stakeholders and are necessary because they make information comparable from year to year, across business sectors and globally.

The contextual disclosures consist of, inter alia, disclosures of economic, environmental and social elements, disclosures of key risk areas, disclosure of strategies, management commentary and disclosures of forward-looking information (Gouws & Cronjé 2008), all of which are valuable in understanding the business of an entity. Roughly 80% of the market value of an entity today (intangibles and future growth opportunities) is based on the contextual disclosures (Topazio 2007). This emphasises the importance of contextual disclosures, since statutory disclosures only limit the possible options for users when they engage in decision-making.

Preparers that compile the information in CARS encode and disclose their accounting language information in the statutory section of CARS. Because users have to decode such information, they need all the help they can get in understanding it. The contextual section of CARS may contribute to this important objective if it is used to help decode the information in the statutory section.

Statement of the problem

The research problem focused on the issue of whether there is room to increase the commonality between the preparer and the user as a prerequisite for conveying meaning in CARS.

Research question and hypothesis

The research question is the following: Is there still room to increase the commonality between the preparer and the user as a prerequisite for conveying meaning in CARS?

The hypothesis of this study is as follows: As the commonality of language between the preparer and the user of CARS is a prerequisite for conveying meaning through disclosures in CARS, there is still room for improving the statutory and contextual disclosures in CARS.

Literature review and perspectives surrounding disclosures in CARS

Perspective calls for the breadth of outlook necessary to grasp the true and full significance of things in order to make well-grounded judgements about them (Mautz & Sharaf 1961: 11). This holistic perspective is used to understand whether disclosures in CARS could contribute towards commonality of language between preparers and users of CARS for the purpose of conveying meaning. In order to understand the roles that statutory and contextual disclosures play in conveying meaning through CARS, the researchers decided to investigate certain perspectives surrounding the disclosures in CARS.

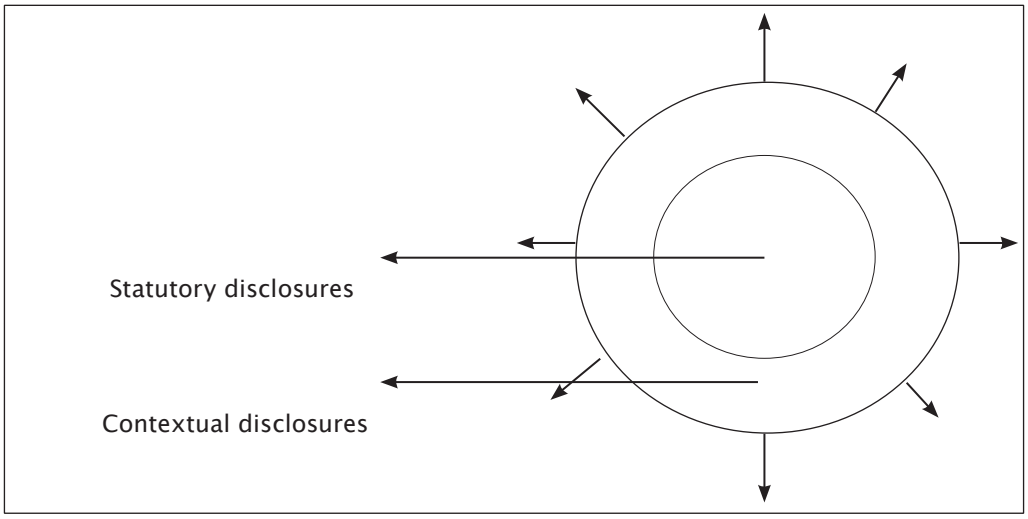


Figure 1: Statutory and contextual disclosures in CARS

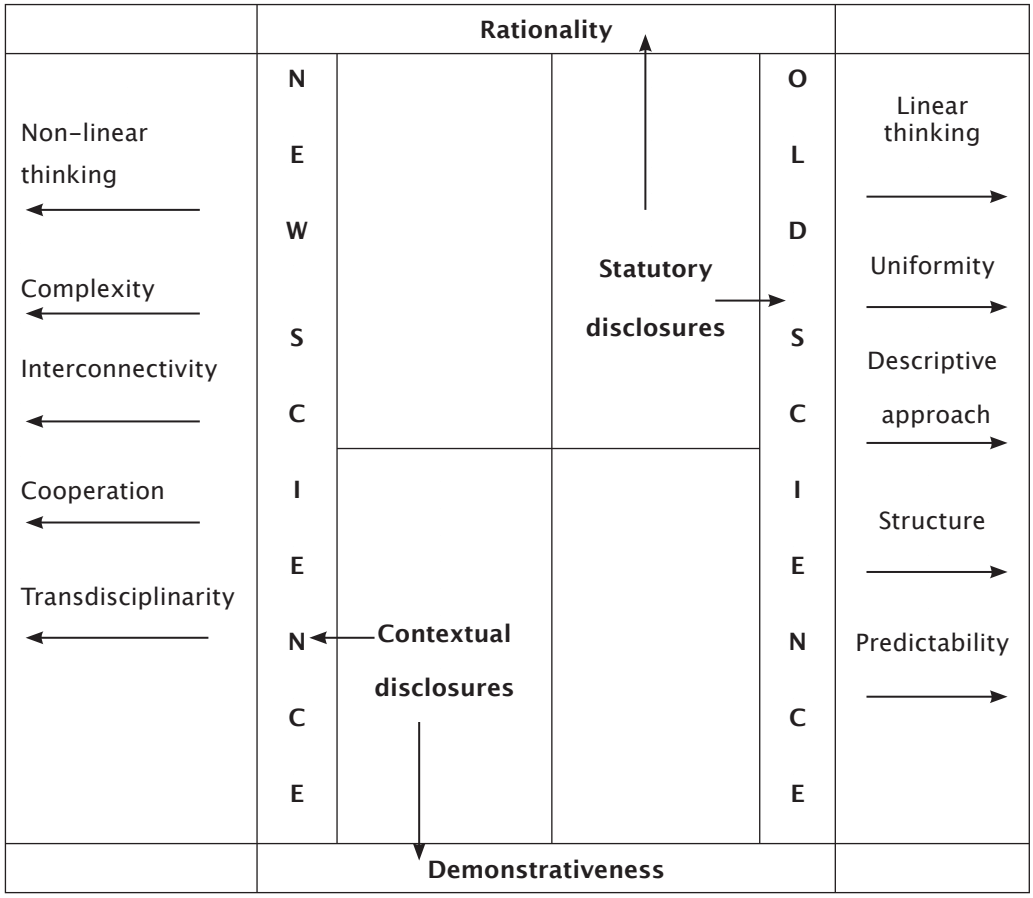
The disclosures in CARS consist of statutory and contextual disclosures, which are depicted in Figure 1. The inner circle represents the statutory disclosures in CARS and is surrounded by the outer circle, which represents the contextual disclosures. The statutory disclosures lean towards rational communication, making use of the features of the old science. This science represents the belief that in every complex system, the behaviour of the whole can be understood entirely from the properties of its parts (Wheatley 1999: 29). In terms of this model, CARS can therefore only be understood by studying the disclosures in CARS separately. The old science involves the paradigm of linear thinking, classification and boundaries that developed in the 17th century. It could be argued that the disclosures here are more rules-based and therefore in a structured format.

The contextual disclosures are more demonstrative, because they utilise the features of the new science. The new science of the 21st century is associated with the paradigm of non-linear thinking, where relationships, connections and context play a major role and where events and transactions are generally unpredictable (Capra 1996: 122). The essential properties of the system are those properties of the whole that none of the parts possess (Wheatley 1999: 10).

These properties originate in the interactions and relationships between the parts (Capra 1996: 29). The system that generates the information reported in CARS can only be understood in the context of the larger whole. The contextual disclosures consist of disclosures such as intellectual capital management, executive remuneration, human rights, occupational health and safety and human capital practices, innovation, research and development, customer satisfaction, climate change, corporate governance, consumer and public health, reputational risk, and the environmental and social impacts of corporate activity, operating and financial reviews, external threats, exposure risk, corporate responsiveness and impact on value (OECD 2006: 21). The arrows of the circle pointing outwards represent visual displays, graphs, explanations, decoding techniques, information and so forth, which serve to enhance a commonality of language between the preparers and users. Although the two types of disclosures are diverse, they are nevertheless interlinked (Cronjé 2008: 251), resulting in powerful disclosures in CARS in order to convey meaning.

Figure 2 illustrates the characteristics of statutorily required disclosures and contextual disclosures in CARS.

Statutory disclosures gravitate towards rationality and utilise the features of the old science. The old science favours predictability, fixed structures and linear thinking (Cronjé 2008: 15). Boundaries are fixed and difficult to cross. These disclosures are the products of generally accepted accounting standards and practices. The question to be answered is whether these disclosures enhance understanding by contributing towards a commonality of language between the preparers and users of CARS for the purpose of conveying meaning and whether the contextual section could assist in this regard. Campbell, Shrives and Bohmbach-Saager (2001: 68) argue that disclosures are only communicated once they have been read and understood. Therefore, unless information is understood, no communication can take place. Morgan (1988: 484) argues that preparers should be able to probe situations to create intelligent, actionable insight, rather than producing rigid technical statements as ends in themselves. Belkaoui (1995: 41) voices concern that the general level of readability of accounting messages is difficult, and the level of understandability of the meaning of accounting messages needs improvement. Courtis (1998: 460) is of the opinion that



Source: Adapted from Cronjé (2008: 103)

Figure 2: Statutory and contextual disclosures in CARS

CARS are prepared at a reading-ease level that ranges from difficult to very difficult. Goldberg (2001: 78) refers to a common language terminology that preparers could use to enable users to obtain an approximate understanding of their messages.

Based on the these facts as well as the complexity of statutory disclosures (Morgan 1988: 481; Evans 2004: 210), it could be argued that commonality of language, as a prerequisite for conveying meaning through statutory disclosures in CARS alone, does not exist. Wolk, Tearney and Dodd (2000: 302 & 303) add to the argument by asserting that financial reporting is so complex that the financial statements themselves must be supplemented by other forms of disclosure to ensure an adequate picture of financial conditions and operations for user analysis. This could be done by providing meaningful contextual disclosures in CARS.

The contextual disclosures favour demonstrative communication making use of the features of the new science. The new science of the 21st century is oriented towards relationships, non-linear thinking, interconnectivity and context (Capra 1996: 122). In this world, future events, transactions and conditions are generally unpredictable. These disclosures make use of narratives, pictures, visuals and graphs (Beattie & Jones 2002: 546), and so on. There needs to be some commonality of language; that is, the disclosures in CARS should mean the same to the preparer and user (Goldberg 2001: 83; Belkaoui 1995: 61). Commonality of language between preparers and users is thus a prerequisite for conveying meaning. The contextual disclosures of CARS have this attribute of commonality of language, while the statutory disclosures possibly lack commonality of language and vocabulary (Cronjé 2008: 111). Feedback from users would improve the disclosures in CARS (Clatworthy & Jones 1999: 43; Freeman & Liedtka 1997: 287) and contribute towards commonality of language between preparers and users for the purpose of conveying meaning.

Research method

Different users see different things in the information streams (for example, the statutory information and the contextual information) disclosed in CARS, because they use different perspectives and conceptualise these things differently. In order to establish how preparers and users perceive the disclosures in CARS, it was decided to make use of questionnaires.

Questionnaires

Two questionnaires were used in this study – one aimed at the preparers and the other at the users of CARS. The questionnaire for the preparers was sent to preparers of listed companies using a database of the JSE-listed groups of companies dated 23 November 2006. A total of 45 responses were received, which equates to a response rate of 16.5%.

Convenience sampling (via returned e-mail responses) was used for the user population. Because accountants are also users of CARS in their decision-making capacity, it was decided to send the questionnaires to them. The researchers deemed that this would not only represent fully literate users of CARS (which would be the ideal), but also provide evidence of their objectivity. The e-mailing lists of the South African Institute of Chartered Accountants (SAICA) and the South African Institute of Professional Accountants (SAIPA), and the 2006 Southern African Accounting Association's (SAAA's) conference list of attendees were used to represent the user

population. A total of 118 questionnaires were returned to the researchers and then processed.

Research findings from the questionnaires

The research findings from the questionnaires are summarised in Tables 1 and 2.

Responses of preparers

Statements 1 to 7 (in Table 1) reflect the responses of the preparers of CARS.

Statement 1: *Accounting practices that capture and screen information generate the statutory and discretionary (contextual) disclosures in CARS* (Stanton & Stanton 2002: 479; Stanton, Stanton & Pires 2004: 57; Gouws & Cronjé 2008: 122). A total of 26.7% (6.7 + 20.0%) of the respondents disagreed with the statement, while 55.5% (48.8 + 6.7%) agreed. This confirms that the source of information in the two sections of CARS involves accounting practices, indicating that the neglected discretionary (contextual) section is as important as the statutory section. Since the origin of both sections is accounting practices (not necessarily performed by accountants), one can assume that commonality must exist between them: they are linked and interrelated.

Statement 2: *CARS that are driven by user needs* (Foster 1986: 3) *represent, inter alia, a system responsible for generating statutory disclosures governed by generally accepted accounting practice (GAAP) and a system responsible for generating discretionary (contextual) disclosure* (Cronjé 2008). Of the respondents, 80% (71.1 + 8.9%) agreed with the view that the two systems are responsible for the disclosures in CARS and that user needs drive the disclosures. It would thus appear that user needs do impact strongly on the whole corporate annual report when both complementary sections are seen as one. This too would contribute to commonality.

Statement 3: *There is an interrelationship between these systems (see Statement 2)* (Cronjé 2008). The aim of this statement was to confirm the view that the two systems should not be seen in isolation. The vast majority of respondents, that is, 73.3% (71.1 + 2.2%), confirmed the interrelationship between the system responsible for statutory disclosures and the system responsible for discretionary (contextual) disclosures. This confirms that the two systems work together to achieve a single goal, namely decision usefulness, thus contributing to and enhancing the commonality factor.

Statement 4: Business information created by accounting practices has the potential to become discretionary (contextual) or statutory information in CARS (Gouws & Cronjé 2008: 124). Of the respondents, 68.9% (62.2 + 6.7%) concurred with the statement. Evidence through the years has shown that a great deal of statutorily

Table 1: Responses of preparers of CARS

	Rating scale (%)					
	Strongly disagree	**Disagree**	**Unsure**	**Agree**	**Strongly agree**	**Total**
Statement 1: Accounting practices that capture and screen information generate the statutory and discretionary (contextual) disclosures in CARS.	6.7	20.0	17.8	48.8	6.7	100.0
Statement 2: CARS that are driven by user needs represent, inter alia, a system responsible for generating statutory disclosures governed by generally accepted accounting practice (GAAP) and a system responsible for generating discretionary (contextual) disclosures.	0.0	8.9	11.1	71.1	8.9	100.0
Statement 3: There is an interrelationship between these systems (see Statement 2).	2.2	6.7	17.8	71.1	2.2	100.0
Statement 4: Business information created by accounting practices has the potential to become discretionary (contextual) or statutory information in CARS.	2.2	11.1	17.8	62.2	6.7	100.0
Statement 5: A management commentary (MC) that captures the whole story of entities' performance and prospects seen through the eyes of management should be incorporated in CARS.	0.0	0.0	2.2	51.1	46.7	100.0
Statement 6: An independent analyst's report should be part of CARS.	33.4	51.1	8.9	4.4	2.2	100.0
Statement 7: The business information in CARS that is not useful or comprehensible should be discarded or replaced.	2.2	8.9	15.6	51.1	22.2	100.0

required information originated in the contextual section (for example, earnings per share, statement of cash flows and segmental disclosures). Clearly this can be seen as a process over time, which adds to the commonality of accounting language for the purpose of conveying meaning. This confirms accounting's orientation towards the new science.

Statement 5: *A management commentary (MC) that captures the whole story of entities' performance and prospects, as seen through the eyes of management, should be*

incorporated in CARS (IASB 2010). A discussion includes narrative information, which means, inter alia, a written account of events in the form of a 'story' that explains and complements the annual financial statements (Gouws & Cronjé 2001: 163). In 2005, a mandatory operating and financial review (OFR) was required from companies in the UK, effective from the March 2006 year-end onwards. This requirement was subsequently withdrawn. During 2010, an IFRS Practice Statement – Management Commentary: A Framework for Presentation (MC) (IASB 2010) – was introduced for the disclosures of management comments in CARS. The research results support the introduction of the MC. A total of (51.1 +46.7%) 97.8% of preparers were in agreement that such information would be useful to users in their decision-making. This also confirms the need to create reviews or management commentary to capture the whole story – in essence to achieve commonality. This indicates merging the contextual and statutory sections because the MC is linked to both. This would make it difficult to distinguish between the statutory and contextual sections, thus indicating greater willingness to work together to achieve commonality of language.

Statement 6: *An independent analyst's report should be part of CARS* (Cronjé 2008). Of the respondents, 84.5% (33.4 + 51.1%) were opposed to such a report. Although independent analysts' reports could be regarded as competition, they could contribute towards comprehensibility and form part of the contextual disclosures. With a high degree of commonality between the preparer and the user, one would not expect an independent analyst's report to be necessary. This makes the contextual section even more important for understanding the statutory section, rather than having an independent analyst's report.

Statement 7: *The business information in CARS that is not useful or comprehensible should be discarded or replaced* (Cronjé 2008). Capra (2002: 202) contends that the goal of optimising instead of maximising information is a fundamental requirement for the proper functioning of systems. Hence, if information is no longer useful or comprehensible, it should be discarded or replaced. A high percentage, 73.3% (51.1 + 22.2%), of the preparers were open to discarding any information that is no longer useful. Complexity should be removed and understandability increased as far as the disclosures of information in CARS are concerned. This will contribute to commonality of language between preparers and users of CARS.

Responses of users

Statements 1 to 6 covered the responses of users of CARS, which are reflected in Table 2. The users in this section were also accountants, but not the same individuals as the preparers whose responses are reflected in Table 1. As stated earlier, the

objective was to review accountants' perceptions (with their 'user hat' on) in order to fully understand the relationship between preparers and users. Relationships are influenced by how much people care.

Statement 1: *Since the statutory information and discretionary (contextual) information in CARS complement each other, I make use of both these sources of information* (Cronjé 2008). Of the users who utilised CARS, the vast majority, 78.0% (60.2 + 17.8%), used both sections of CARS. The reason for this is that the statutory information and contextual information in CARS complement each other. Both sources of information are used regardless of their origin (statutory disclosures originate from practices that are prescribed, rigorous and control-driven, while contextual disclosures originate from practices that are process-driven, spontaneous and creative) contributing to the commonality of accounting and financial language to foster understanding and usefulness.

Table 2: Responses of the users of CARS

	Rating scale (%)					
	Strongly disagree	**Disagree**	**Unsure**	**Agree**	**Strongly agree**	**Total**
Statement 1: Since the statutory information and discretionary (contextual) information in CARS complement each other, I make use of both these sources of information.	0.8	11.9	9.3	60.2	17.8	100.0
Statement 2: A management commentary (MC), which captures the whole story of entities' performance and prospects seen through the eyes of management, should be incorporated in CARS.	2.6	5.9	13.6	52.5	25.4	100.0
Statement 3: In CARS, graphs enhance the interpretation of numbers.	1.7	5.1	9.3	57.6	26.3	100.0
Statement 4: I would like to see more disclosure on intellectual capital.	0.0	5.1	18.6	61.9	14.4	100.0
Statement 5: CARS should provide an observable feedback section for users.	5.1	17.9	34.2	36.8	6.0	100.0
Statement 6: Information in CARS that is not useful or comprehensible should be adapted or replaced.	1.0	8.5	8.5	63.2	18.8	100.0

Statement 2: *A management commentary (MC) that captures the whole story of entities' performance and prospects, as seen through the eyes of management, should be incorporated in CARS* (IASB 2010). A high percentage, 77.9% (52.5 + 25.4%), of users were in favour of including an MC in CARS, indicating their need for comprehension, context and meaning. The response of preparers to the same sentiment (see Table 1, Statement 5), namely that 97.8% confirmed this sentiment, is difficult to understand because users are more demanding when it comes to the information they desire. However, both parties agreed, which confirms a desire for commonality. The MC would act as a kind of interface between the statutory and contextual sections and provides the ideal opportunity for establishing commonality goals in order to enhance understanding and meaning.

Statement 3: *In CARS, graphs enhance the interpretation of numbers* (Cronjé 2008). A representation of information in formats other than numbers alone, such as pie charts, graphs, flow diagrams and so on, is necessary to improve the interpretation of numbers. Of the respondents, 83.9% (57.6 + 26.3%) confirmed this sentiment. Any technique or representation that can demystify complex financial data adds to the commonality of language (and understanding) between the preparer and user.

Statement 4: *I would like to see more disclosure on intellectual capital* (Cronjé 2008). The importance of disclosing abstract phenomena such as intellectual capital is reflected in the fact that 76.3% (61.9 + 14.4%) of the respondents agreed with this statement. Because it is difficult, in fact almost impossible, to report on such abstract phenomena in the statutory section, an obvious place would be in the contextual section where far more freedom and possibilities are permissible. Such designs could offer new insights and improve the commonality between the statutory and contextual sections of CARS.

Statement 5: *CARS should provide an observable feedback section for users* (Clatworthy & Jones 1999: 43; Freeman & Liedtka 1997: 287). The results of this statement indicate that respondents did not fully understand the role of feedback in systems. This is indicated by the fact that 23% (5.1 + 17.9%) of the respondents did not agree, 34.2% were unsure and 42.8% (36.8 + 6.0%) concurred with the statement. In systems theory, feedback is a precondition for the improvement, evolution and growth of systems. Feedback allows systems to constantly renew and discard useless information. The weakness in current financial systems with respect to providing a feedback section in CARS where users and stakeholders can respond in terms of quality and decision-useful issues sabotages the achievement of a higher degree of commonality between preparers and users of CARS.

Statement 6: *Information in CARS that is not useful or comprehensible should be adapted or replaced* (Cronjé 2008). Of the respondents, 82% (63.2 + 18.8%)

agreed with this statement, indicating that this is what preparers want (see Table 1, Statement 7), but both are dependent on a feedback system. The desire to adapt, replace or discard information can only be achieved when feedback is possible. One may therefore conclude that the need for and willingness to support the commonality objective are constrained by the lack of feedback.

Statistical analysis of the survey finding

In Table 3, the statements of preparers (refer to Table 1) of CARS are ranked in accordance with their means. Statements 5, 7 and 2 have the highest mean scores of 4.45, 3.82 and 3.80, respectively. Statements 1 and 6 have the lowest mean scores of 3.29 and 1.91, respectively.

Table 3: Ranked means for preparers (N=45)

Statements	Mean
Statement 5: A management commentary (MC), which captures the whole story of entities' performance and prospects seen through the eyes of management, should be incorporated in CARS.	4.45
Statement 7: The business information in CARS that is not useful or comprehensible should be discarded or replaced.	3.82
Statement 2: CARS that are driven by user needs represent, inter alia, a system responsible for generating statutory disclosures governed by generally accepted accounting practice (GAAP) and a system responsible for generating discretionary (contextual) disclosures.	3.80
Statement 3: There is an interrelationship between these systems (see Statement 2).	3.64
Statement 4: Business information created by accounting practices has the potential to become discretionary (contextual) or statutory information in CARS.	3.60
Statement 1: Accounting practices that capture and screen information generate the statutory and discretionary (contextual) disclosures in CARS.	3.29
Statement 6: An independent analyst's report should be part of CARS.	1.91

Therefore, for the users of CARS, the MC plays the most important role in contributing to the commonality of language between the preparer and the user. An independent analyst's report forming part of CARS plays the least important role.

In Table 4, the statements of users of CARS (refer to Table 2) are ranked in accordance with their means. Statements 3, 2 and 6 have the highest mean scores of

4.02, 3.92 and 3.90, respectively. Statements 1 and 5 have the lowest mean scores of 3.82 and 3.21, respectively.

Table 4: Ranked means for users (N=118)

Statements	Mean
Statement 3: In CARS, graphs enhance the interpretation of numbers.	4.02
Statement 2: A management commentary (MC), which captures the whole story of entities' performance and prospects seen through the eyes of management, should be incorporated in CARS.	3.92
Statement 6: Information in CARS that is not useful or comprehensible should be adapted or replaced.	3.90
Statement 4: I would like to see more disclosure on intellectual capital.	3.86
Statement 1: Since the statutory information and discretionary (contextual) information in CARS complement each other, I make use of both these sources of information.	3.82
Statement 5: CARS should provide an observable feedback section for users.	3.21

Therefore, for the users of CARS, graphs are the most important in contributing to the commonality of language between the preparer and the user, as they enhance the interpretation of numbers, while the MC plays the second most important role. Preparers and users therefore view the degree of importance of the MC differently. The requirement that CARS should provide an observable feedback section played the least important role for users.

Summary and conclusion

Preparers of financial information encode their message in an accounting language that needs to be decoded by users to enable them to understand and use the information properly. In order to convey meaning successfully, the sender and the receiver of a message need to use the same method to encode and decode the message, that is, there needs to be some commonality of language between the two parties.

The objective of this article was to assess whether there is room to increase the commonality between the preparer and the user as a prerequisite for conveying meaning in CARS. In this article, the statement of the problem and the hypothesis were addressed, the perspectives surrounding disclosures in CARS were discussed, an overview was given of the research methods that were used, and the research findings stemming from the questionnaires were reported.

One of the most significant findings was the objectivity of the accountants both in their capacity as preparers and users by showing a great sense of care. Both preparers and users (accountants with their 'user hats' on) showed strong belief in the value of commonality of language to enhance the conveying of meaning. Another finding was that the statutory and discretionary sections should merge in order to create a greater degree of commonality. The realisation of the commonality prerequisite can only be achieved through interaction between the statutory and contextual sections. Evidence from both preparers and users showed increased awareness of the commonality objective, as opposed to using the report of an independent analyst to assist in this regard. The main constraint in achieving the commonality of language goal (to enhance the conveying of meaning) was evident in the lack of a feedback section in CARS to reflect stakeholders' and users' sentiments regarding the usefulness of CARS. Feedback is a key feature of open systems that are regulated, try to achieve goals and are therefore useful in effectively gauging and making the necessary adjustments (Lyttlejohn 1998: 38).

Possible contributions of the study to the accounting sciences

The two sections of CARS complement each other in providing decision-useful information. More emphasis should be placed on research into and the education of students in this regard.

The fact that the decoding of statutory information can be realised through the contextual section offers new and innovative opportunities to accounting practitioners and management to enhance the commonality between preparers and users. After all, accounting is not limited to the statutory reporting function only, but includes the dimension of the recording function. One should record in order to report.

The contextual section can generate profound new accounting practices which, over time, could prove themselves worthy contenders in statutory statements such as the information on earnings per share and cash flows.

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