A SUMMARY OF THE INVESTIGATION INTO THE USE MADE OF PUBLISHED ACCOUNTING REPORTS IN AUSTRALIA

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(Mr. Clift of the Department of Accounting at the University of Melbourne will introduce and discuss this paper at a meeting of the Victorian Branch on 15 February 1971. The questionnaire to which reference is made is not included in the paper but its general nature will be apparent)

Although professional bodies, academic and business writers, and company law revision committees have produced a vast amount of literature on the general topic of disclosure in the annual reports of companies, there has been relatively little effort to discover just what use is made of such reports. This situation prompted me to carry out such research and in the past two years I have been involved in two projects.

In late 1967 an Australian company sent questionnaires to all its shareholders seeking their reactions to the form and content of its annual report. My chief, Professor Goldberg, and I processed these questionnaires and wrote them up in the June 1968, Australian Accountant. The questionnaire was more an exercise in P.R. than in accounting research but some "findings" of interest to the accounting profession did come out of it.

For example, shareholders ranked the various components of the annual report in the following order of interest:

- Directors' report
- Product details
- Profit statement
- Balance Sheet
- Features of the year
- Statistical record

The questionnaire (which was prepared by officers of the company) did not seek information on "value in decision-making" but presumably the above ranking gives a valid indication of what these shareholders regard as useful data.

During 1968 I prepared a questionnaire which was administered to the investment officers of 111 long-term investment institutions in Australia. The responses were analyzed by type of institution, by type of restriction on investment policy, by type of objective, by type of personnel and by type of security. These analyses produced a great amount of information and possibly there are questions in relation to them but this paper deals with only a few aspects of the total exercise, viz:

a) commonly used financial ratios;
b) price level adjustments; and
c) a comparison of various professional groups.

A. COMMONLY USED FINANCIAL RATIOS

One question was designed to discover which indicators investment officers use to rank companies in order of risk or in terms of rate of return required.

Trends in Working Capital Ratio

Seventy answers were received representing 63 per cent of the sample. This response included 75.7 per cent of life offices, 64.5 per cent of general insurance companies
and 82.1 per cent of superannuation funds. No institution restricted to trustee investments bothered to consider this trend but institutions stating each of the policy objectives appear in the analysis. All employee groups showed strong interest in this trend, e.g., graduates, 37 or 74%; actuaries, 39 or 92.9%.

**Trends in Quick Asset Ratio**

Only 53 institutions (47.7%) consider this trend but since the ratio is traditionally related to day-to-day financing this could be regarded as quite a high response. In fact, several respondents stated that companies showing poor short-term ratios were excluded.

**Trends in Proprietary Ratio**

This question also received a high response, 56 answers (59.5%). According to the Analysis by Personnel all employee groups showed strong interest in this trend, e.g., 61.2 per cent of the accountants and 76 per cent of the graduates involved in the survey. Only institutions investing heavily in equities answered this question but the Analysis by Objective contains adherents to each policy. Not surprising is the fact that 16 (69.6%) of those pursuing safety of capital study the trend of this ratio.

**Trends in Gearing**

This question called forth the highest response in this section, 71 or 64%. As only one answer came from a foundation the three major types of institution show quite high percentage responses; Life 76%, General 71%, Superannuation 82.1%. Again, all employee groups showed strong interest in this trend, e.g., graduates, 82% and actuaries 92.9%, while all replies came from institutions concerned with equity investment. This last is interesting since one would think that the gearing ratio, or at least the proprietary ratio, is an obvious indicator of the real safety of fixed interest securities. Institutions pursuing each of the policy objectives answered this question including 15 (65.2%) of those concerned with safety of capital.

**Trends in Other Ratios**

The thirty-three responses to the question show that 29.7 per cent of the sample take the assessment of risk a little deeper but as 16 separate ratios or tests were mentioned, none of them has much significance. However the other analyses do show three significant things. Firstly, responses came only from life offices, general insurance companies and superannuation funds. Secondly, since institutions restricted to trustee investments and specified securities did not answer this question, or those relating to proprietary and gearing ratios, one is left wondering how they assess their investments. Thirdly, four of the policy objectives appear; institutions seeking growth in the value of the investment did not give any affirmative answers.

While none of the answers was sufficiently frequent to make it important, the following list helps to reveal the type of information required for the selection of investments:

- Net tangible assets
- Price earnings ratio - this occurred quite frequently
- Dividend yield
- Industry trend
Since it is possible to measure the degree of 'gearing' in ten or more different ways, sixty responses (54%) represent quite a high proportion. However, some respondents stated that they also calculate the ratio of Fixed Interest Borrowing to Total Funds.

Approximately two-thirds of the three major types of institution answered this question. No institution restricted to trustee investments admitted making this calculation but affirmative answers came from institutions pursuing each of the policy objectives.

Interest Cover

This question received a very high response, 70 or 63%. The response by type of institution, life 72.7%, general 67.7%, and superannuation 75%, was unusually high.

The Analysis by Personnel reveals that a high proportion of all employee types was interested in this calculation, viz: accountants 64.3%; graduates 88%; actuaries 92.9%; other 71%. No institution restricted to trustee investments answered this question but each policy type was well represented, particularly 'safety of capital' (56.5%).

Other

Since gearing can be assessed in many ways this question was asked in an attempt to discover some of the methods used. Twenty responses were received. All of these came from the three major sub-samples. No answer came from institutions restricted to trustee securities while 'regular income' and 'growth in values' do not appear in the Analysis by Objective. All employee types were concerned with other assessments of gearing.

While twenty answers represent 18 per cent of the sample, none of the ratios or tests recorded was sufficiently numerous to be important. However, since the answers suggest some interesting ideas they are listed below.

External Liabilities/Shareholders Fund
Trust deed limitations
Shareholders Funds/Total Funds
Projection of effects of new borrowings
Asset gearing
Net tangible assets
Shareholders Funds/Total Liabilities

Composition of Assets

This question received 73 affirmative answers. This represents 65.8 per cent of the sample and is the highest response to any question relating to the published reports. The major group percentages are: life 72.7%; general 80.6%; superannuation 78.6%. Institutions pursuing each of the investment policies are represented ('safety of
capital', 15 or 65.2%) while only 'trustee investments' did not appear in the Analysis by Restriction.

The Analysis by Personnel shows that all employee types were interested in this item. Of particular interest here is that 39 actuaries (92.9%) appear in this analysis. The comparable figures for accountants and graduates are 68 (69.4%) and 40 (80%) respectively.

Another question sought information about financial ratios which usually appear in accounting and financial text books. The responses to this question indicate several interesting points.

Analysis revealed that a substantial minority of respondents did not calculate any ratios at all and that none of the ratios appearing in the questionnaire was calculated by every institution claiming to calculate ratios.

Ten ratios - working capital, quick assets, proprietary, both types of gearing, net profit/shareholders' funds, net profit/total funds, tangible assets per share, earnings per share and payout - get strong support but the remainder, including those suggested by respondents, are used by only a very small proportion of the sample.

Some ratios are available from other sources. Dividend yield, earnings yield and tangible assets per share appear in the financial press while statistics from brokers and merchant banks give several of the above ratios and a number of 'non-accounting' ratios such as capital-per-employee. Many respondents claimed that they refer to this published information so the use made of these ratios is possibly greater than is indicated by this survey.

B. PRICE LEVEL ADJUSTMENTS

Until 1969 no Australian company presented its annual report in terms of price level adjusted figures. In that year, BHP, our largest company, did present its report in this way. However, many Australian companies have done something about the price level problem through asset revaluation or through reserve policy. In addition, other companies have used price-level-adjusted depreciation in their costing records without making any adjustment to their published reports. Many companies have been giving some recognition to this problem since 1949.

Even though there is this widespread awareness of the problem few of the respondents to this survey exhibited much knowledge of it. Data collected indicate that little formal adjustment is made to the published reports and general comments suggested that price level adjustments are too theoretical to be of much general value.

These questions had been included in the expectation that at least the larger life offices and superannuation funds would recognize the price level problem in their analyses of company reports. After all, these institutions do meet this problem in their own activities. According to the responses this expectation was groundless.

This topic of price level adjustments permits an interesting international comparison. In September 1968, I attended a seminar conducted by the Australian Society of Security Analysts. Even though many of the members had been trained as accountants they did not really seem to grasp what is involved in price level adjustments. In November 1969, I attended a CPA seminar in Chicago; the reactions of this group were very similar to those at the Australian seminar.

It seems that the advocates of price level adjustments still have a major educational task ahead of them.
C. A COMPARISON OF VARIOUS PROFESSIONAL GROUPS

The appendix to this paper is a tabulation of the analysis by personnel. This does not deal with all the questions in the survey; it deals with the highest response within groups of similar questions. For example, Q.6(a) and Q.6(b) both relate to the detailed examination of balance sheets - the higher response was entered in this table. This selection of responses was intended to indicate the maximum use likely to be made of accounting reports.

The Analysis by Personnel

While the following discussion of this table proceeds on the basis that each employee is individually responsible for the selection of investments, the majority of institutions in the survey utilize investment selection committees. However, it seems reasonable to assume that each member of such a committee would apply all his skill in assessing the securities to be considered.

The first group of employees to be discussed is that whose members are qualified accountants or have had considerable experience in accounting. It was thought that experience in accounting could predispose respondents to the use of accounting information. Thus, Q.3 sought details of experience rather than of qualification. Since ‘accountant’ is an occupational title as well as a professional qualification it was not always possible to determine whether respondents claiming to be accountants were formally qualified. However, only in five cases did it appear that the respondents were not qualified but in many cases it seemed that, though qualified as an accountant and carrying the occupational title, the respondent was in fact an administrator.

In general, the responses to the questionnaire indicate that accountants do not make full use of the skills in which they have been trained. This table supports those comments. Fifteen of the questions in the profile received responses of less than 60% while the highest response was only 79%. There are several questions for which a 100% response could reasonably be expected from accountants, e.g. those relating to tests for consistency of valuation and of depreciation policy and the use of accounting information to assess management. However, these all scored less than a 60% response. Question 9 is of particular interest, 58% of the accountants involved in the survey use accounting to assess management but 78% use other information.

The second group of employees consisted of graduates in economics or commerce. Many of these either held accounting qualifications as well or had studied some accounting. Twenty-six of the thirty-three questions in the profile (Appendix I) received responses exceeding 59%; eight of these responses exceeded 85%. The three questions relating to non-accounting information - Q.9(b), Q.15 and Q.16(c) - received very high responses. However, most of the questions directed towards the use made of accounting information received higher responses from graduates than from accountants.

Thus, it seems that a much greater proportion of graduates than of accountants makes use of accounting reports in the selection of investments. Before this conclusion can be accepted it is necessary to consider two points which may modify it in some way. Most of the questionnaires were completed by one person, not by the institution's investment committee, and it is not known what answers other members of such committee would have given. Therefore, there is a danger of wrongly attributing responses to the various types of employee. The other point
relates specifically to graduates. It is not known how many of these were thoroughly trained in accounting and worked predominantly in the accounting field.

Even after allowing for these modifications it seems reasonable to conclude that the graduates involved in the survey were willing to make extensive use of all sources of information including published financial reports.

Actuaries made up the third group of employees. Evidence indicated that actuaries did not play a really active role in investment selection. Nevertheless, the figures in Appendix I show the highest responses of any group. Only seven questions received responses of less than 67%; on the other hand, five questions received responses of 100% and another eight responses fell between 90% and 98%. Even the questions relating specifically to accounting matters scored high responses.

As only five of the people interviewed were actuaries the danger of attributing responses to this group is very high. However, since the five actuaries interviewed showed strong interest in accounting information and since most of the institutions employing actuaries in investment selection had formalized analysis procedures it is not unreasonable to conclude that a high proportion of this group makes extensive use of published financial reports. Unfortunately, on the information available it is not possible to determine which type of employee initiates this kind of assessment of investment proposals.

The fourth profile in Appendix I is that of 'other' employees. This group contains representatives of many professions and occupations including some with little relationship to finance. Even so, responses to the questions in the profile are fairly high. Fifteen of these responses exceed 60% but eight are less than 40%. Two of the questions relating to non-accounting information received very high responses (84% and 79%) but Q.16(c), 'seek additional non-accounting information' shows a response of 55%. On the other hand, the questions concerned specifically with accounting matters gained low responses.

This type of employee was rarely the only person involved in the selection of investments thus creating the possibility of having answers attributed to this group. However, the profile does indicate that this type of employee makes extensive use of published financial reports. There is a hint, which is supported by other comment, that this group often seeks other, more familiar, information.

Appendix I shows a strikingly similar pattern of response for the four types of employee. No doubt some of this similarity arises out of attributing the answers given by one respondent to all the employees involved in the selection of investments for that particular institution. Even so, since some members of each group were interviewed it is submitted that the Analysis by Personnel, and hence these profiles, are strongly indicative of the behaviour of each type of employee.

GENERAL CONCLUSIONS

The conclusions drawn from the survey as a whole could be summarized as follows.

a) Fairly extensive use is made of accounting reports but this use is neither as widespread nor as intensive as could be expected.

b) Disclosure of accounting information is not as detailed in Australia as it is in the U.S.A. but there was relatively little demand for more data. Requests for
more technical information and for modifications to the reports which shifted the burden of analysis back on to the company were more numerous than requests for more financial information. It appears that only the academic accountants get excited about disclosure problems.

c) The institutions surveyed are traditionally conservative in their investment policies and the analysis techniques employed accorded with this bias. That is, the ratios used and the tests carried out were aimed at measuring safety of capital rather than efficiency.

d) The members of the accounting profession involved in the survey did not use their interpretative skills to the fullest possible extent.

Appendix I

Profile of Analysis by Employee
Based on Maximum response to selected questions

<table>
<thead>
<tr>
<th>Q.</th>
<th>Type of Personnel*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
</tr>
<tr>
<td>1 Life offices</td>
<td>30</td>
</tr>
<tr>
<td>2 No restriction on investment policy</td>
<td>83</td>
</tr>
<tr>
<td>4 Policy objective - other</td>
<td>56</td>
</tr>
<tr>
<td>5 Make some modification to published reports</td>
<td>76</td>
</tr>
<tr>
<td>6 Modify balance sheet</td>
<td>45</td>
</tr>
<tr>
<td>6c Use non-accounting value concept</td>
<td>26</td>
</tr>
<tr>
<td>6d Reconcile tax provision</td>
<td>34</td>
</tr>
<tr>
<td>6f Test consistency of depreciation policy</td>
<td>43</td>
</tr>
<tr>
<td>6j Accept published funds statements</td>
<td>46</td>
</tr>
<tr>
<td>7 Use reported earnings to estimate future profits</td>
<td>43</td>
</tr>
<tr>
<td>7h Forecast both dividends and earnings</td>
<td>64</td>
</tr>
<tr>
<td>8a Trends in ratios</td>
<td>65</td>
</tr>
<tr>
<td>8b(ii) Interest cover</td>
<td>64</td>
</tr>
<tr>
<td>8c Examine composition of assets</td>
<td>70</td>
</tr>
<tr>
<td>9a Assess management by using accounting information</td>
<td>58</td>
</tr>
<tr>
<td>10 Rely on consolidated reports</td>
<td>66</td>
</tr>
<tr>
<td>11 Seek accounting reports for subsidiaries</td>
<td>41</td>
</tr>
<tr>
<td>12 Ratios calculated</td>
<td>56</td>
</tr>
<tr>
<td>13 Calculate ratios for three or more years</td>
<td>65</td>
</tr>
<tr>
<td>14 Give weight to qualified audit report</td>
<td>79</td>
</tr>
<tr>
<td>15 Use non-financial information</td>
<td>71</td>
</tr>
<tr>
<td>16 Seek additional information</td>
<td>50</td>
</tr>
<tr>
<td>17 Use accounting information to assess</td>
<td>52</td>
</tr>
<tr>
<td>18 Seek advice as an adjunct to your own investigation</td>
<td>79</td>
</tr>
<tr>
<td>19 Regularly reappraise presently owned securities</td>
<td>84</td>
</tr>
</tbody>
</table>

* The code of types of Personnel:
A Accounting, B Graduates, C Actuarial science, D other