

Decision Usefulness Approach to Financial Reporting: A Case for Employees

Ali Abdulridha Jabbar

Cihan University, College of Financial and Administration, Sulaiymani, Kurdistan Region, Iraq.

Abstract— *Financial reporting it centers on about the FRS 101 known as presentation of financial statements. The International Accounting Standard Board (IASB) develop this standard to revised IAS 1 for improvement the qualities when present in the financial statement. FRS 101 is usually based on IAS 1 presentation of financial statements issued by IASB. That means, compliance the FRS 101 also will cause compliance with IAS 1. There are no different between two accounting standards. This paper describes and underlying criticism raised in the decision usefulness approach of financial reporting in the case of employees. The employees of the company can be categorized into two, i.e., the present and prospective employees. This paper examines why the reward system and corporate social responsibility must be used by organizations as an instrument for employees to improve their living conditions. The underlying significant role which employees play in organizational development has drawn considerable attention all over the world because the employees as the key to ensuring tactics and strategies of company's run successfully. The argument is that employees increase the performance of the organizations through efficient and effective information that comes from financial reporting.*

Keywords— *Financial Reporting, Employees and Accounting Approach.*

I. INTRODUCTION

The employees in a company are very important because success or failure of the company depends on the capability of the company to handle or monitor their employees. Employees play a very significant role in enhancing the growth and development of the business organization. Therefore, there is need to report and disclose various activities to them as a way to motivate them to improve their performance and to attain a “win-win situation” in the reporting entity. The underlying significant role which employees play in organizational development has attracted worldwide attention. According to Glautier and Underdown (2001), employees have an interest in the outcomes of management decision at all levels of managers. The

improvement or increase in industrial through employees' involvement in management resulted in significant implications for the provision of financial information to employees. According to Belkaoui (2009), with the emergence of employees and unions who act as users of accounting information, managers have found that they have to rely more on the employees for effective operating processes and so relevant information should be provided to enable them to make continuous improvements to the output level of the company (Drury, 1997). We define financial reporting quality as the precision with which financial reporting conveys information about the firm's operations, in particular its expected cash flows, that inform equity investors. This definition is consistent with the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 1 (1978), which states that one objective of financial reporting is to inform present and potential investors in making rational investment decisions and in assessing the expected firm cash flows. To enhance comparability with prior studies, we use a measure of accruals quality derived in Dechow and Dichev (2002) as one proxy for financial reporting quality

Therefore, this paper attempts to examine why decision usefulness approach to financial reporting should be for the information needs of the employees. In this paper, I categorize employees into present and prospective employees. Besides that, the paper also examines how the reward system of the company can affect the employees and the corporate culture and corporate social responsibility and add significant value to the employees' well-being. The paper is divided into five interconnected sections. The next section presents the conceptual framework and the decision usefulness approach to financial reporting for employees. The third section presents the material and method used. The fourth is about the results from the interview and questionnaire as well as the discussion. The final section contains the conclusion and recommendations regarding the topic.

II. LITERATURE REVIEW

1. Conceptual Framework

A. Financial Reporting

According to Adebayo (2005), financial reporting is the most important way through which managers of the companies give accounts of their stewardship to the owners or other shareholders. Accordingly, financial reporting should make disclosures in clear terms and conditions, based on the resources acquired and utilized. Deegan & Unerman (2007) defined financial reporting as the process through which organizations interact or communicate about financial information to users. Financial reporting is most important source that manager need to use the information to make decision and same time produce higher quality of information to users of financial statements such as shareholders by using limited resources.

According to Lewis and Pendrill (1996), the objective served by a financial report has been described by the British Accounting Standards Board (BASB). The Board states that: *“The main objective of the financial statement is to provide information on the financial positions and performance of an enterprise to make it useful and help users in assessing the stewardship of management and for making economic decision.”*

According to Belkaoui (2009), the objective of financial reporting is not limited to the content of financial statements:

- i. Financial reporting includes not only financial statement but also communicates directly information provided by accounting systems (for example, information about company resources, obligations, earnings, etc.).
- ii. Financial reporting should provide information concerning how the manager has discharged his stewardship responsibility to the owner by ethical use of resources.
- iii. Financial reporting should provide information to help the investor and creditor predict the future and evaluate the enterprise's current performance for future decision making.
- iv. Financial reporting should provide information about performance during the period. Investors and creditors often use the past information to help in assessing the prospects of an enterprise.
- v. Financial reporting should provide information that assists managers and directors to make decisions in the interest of the owners.

Glautier and Underdown (2001) stated that the failure to establish a framework for financial reporting purposes is directly the result of the attitude of management. It is not even absence of the framework that is the major problem, but

to establish a framework may be difficult because the users of financial information vary. Glautier also said financial information should cater for external users' needs, like the potential investors, consumers, suppliers and the local communities. It should also satisfy the needs of the shareholders by way of reporting equitable sharing of corporate profit.

To contract measurement tools, Beest, Braam and Boelens (2009) said if financial statements are to be produced, higher quality financial information should have fundamental characteristics underlying decision usefulness. The qualitative characteristics need to produce higher quality in financial information such as understandability, comparability, timeliness, accuracy and verifiability. The effect higher quality of information can help the user to make best decisions.

2. Theoretical Framework

A. The Decision Usefulness Accounting Approach

According to Jonas and Young (1998), decision usefulness should be the criterion to measure the quality of accounting standard. That means production of standards is supposed to begin with standards setters seeking information from potential users of the report, for example, auditors, before preparing the report.

Scott, (2009), cited that, the decision usefulness approach to accounting theory takes the view that: *“if we can't prepare theoretically correct financial statements, at least we can try to make financial statements more useful”!* In adopting the approach, two main questions must be addressed:

- Who are the users of Financial Statements?
Refer to who the user financial statements such as employees, government, creditor, investor, manager and i.e.
- What are the decision problems of financial statement users?
Help accountants will be better prepared to meet the information needs of the users. In other words, tailoring financial statements information to the specific needs of the users of those statements will lead to improved decision making. In this way, the financial statements are made more useful.

B. Single – Person Decision Theory (SPDT)

According to Scott (2009), SPDT is about individuals who must make a decision under conditions of uncertainty. Uncertainty means that situation where the existing condition of knowledge is such that (1) the order or nature of things is

unknown, (2) the consequences, extent, of circumstances, conditions, or events is unpredictable, and (3) credible probabilities to possible outcomes cannot be assigned. SPDT provides individual information to enable good decisions by selecting the best of sets of alternatives. This theory also allows additional information to be obtained to revise the decision after it is made, so as to add value to the decision and ensure it is appropriate with current economic conditions.

C. Rational Decision Theory Model

Scott (2009), using this theory can help users to make decisions. The theory also provides structured and sequential approaches to make decisions. For financial statement information to be useful, it must help to predict future investment returns. Under non-ideal conditions, the financial statements do not show expected future firm performance directly. Nevertheless, financial statements will still be useful to investors to the extent that the good or bad news they contain will persist into the future. Think of a progression, from current good or bad news in the financial statements to future expected firm performance to future expected investment returns. As the word of rational suggests, it brings logic opinion in order to make decisions.

According Godfrey, Hodgson, Holme, & Tarca (2006), the rational decision making model consists of a series of steps, starting with identifying problems or opportunities and ending with the action being taken and monitoring the decision made.

III. METHODOLOGY

The materials for this study were collected from primary sources. This was obtained from interviewing and from questionnaire. The interview was with the Chief Librarian of Universiti Utara Malaysia, Mr. Salleh Huddin Mustafa, whilst the questionnaires were distributed and collected from the staff in the Library as well as a few students.

IV. RESULTS AND DISCUSSION

Decision usefulness is very important to the firm's employees who can be divided into two groups: present and prospective employees. Present employee is a current employee of the company or a former employee at the company; whereas, prospective employee is someone who has the potential to be hired, but has not yet been hired. For example, if a company had one job opening and ten applicants apply, then they would have to choose one person to hire from the prospective employees.

The finding is discussed below:

3. Present employees

➤ Seek information regarding their salary

The salary is the one factor that can affect the performance of employees. Salary is a part of the reward system. Reward system is a key management tool that can contribute to a firm's effectiveness by influencing individual and group behaviors. (Maire and Nick, 2002). Compensation, rewards can be used interchangeably, and it is defined as cash and non-cash remuneration provided by an employer for services rendered. Reward and recognition are consistently acknowledged by organizations and managers as an important element in motivating individual employees. Employee of the month schemes, profit sharing, and monetary payment for higher productivity or commission on sales revenue are widely used. They appear to be a little understanding to drive organizational success. Generally, rewards can be given based on individual behaviors and performance; or to the whole team and then equally divided amongst the individuals based on team performance. (Cheryl, 1998). Positive rewards are generally more effective than negative rewards. (Nalini and Bonnie, 2004).

The financial statement or financial report is of enormous use to the employee of the company for making collective bargaining agreement. The statement can be used for discussing matter of promotion, rankings and salary hike. On the other hand, employees also try to look at the income statement for several reasons. Some employees try to maintain responsibility for managing certain expenses reported on the income statement. Some companies pay bonuses to employees based on the company's net income, which is also reported on the income statement. Employees also review cash flow to estimate if company manages its cash well enough to continue meeting payroll obligations. The firm's employees also look at the annual report to verify the firm's ability to continue paying their salaries at the specific date.

➤ To view company corporate responsibility

Culture has been defined as a pattern of shared basic assumptions that the group for solved its problems (Dianne, Lewis, Erica and Steane, 1997). According Choi and Meek (2011), corporate social responsibility (CSR) refers to measurement and communication of information about a company's effects on company welfare, the local community and the environment. In the Bursa Malaysia, CSR means open and transparent business practices that are based on ethical values and respect for the community, employees, the

environment, shareholders and other stakeholders. It is designed to deliver sustainable value to society. It is not about how a firm spends money, but about how the firm makes money. CSR supports Triple Bottom Line reporting (*profit, people and planet*) which emphasizes the economic, social and environmental bottom-line wellness. In addition, Bursa Malaysia also segregates Corporate Responsibility into four dimensions which include (1) the environment, (2) the community, (3) the market place and, lastly, (4) the work place. dealing with basic human rights or gender issues. A quality work environment, health and safety are obvious considerations, as it is the way in which, we can believe in CSR. The company also inculcate in their employees, the values which the company holds dear.

To support my research, I also did some research on how companies apply CSR in their business and the company I chose is Air Asia Malaysia, which is the second airline in Malaysia.

4. Retirement plan

Pension Plans is one of the various types of retirement plans, generally enjoying tax-exemptions. Under Financial Statement, an employee contributes a part of his/her income to a fund during his/her service years, to gain its benefits in future, during his/her post-retirement period. The employee's fund is then invested by the company on his/her behalf, permitting him/her to enjoy pension benefits after retirement. In fact, Pension Plans are means by which the employees transfer a part of their income as savings, to enjoy it during the post-retirement days. Pension Fund is a kind of Long Term Liability. According to Liéšana and Vincent (2000), pension plans are categorized into two types. Firstly, *defined-contribution Plans*: enable an employer to make pre-settled contributions on behalf of the employee. However, the final benefit amount received by the employee is based upon the performance of the investment. Secondly, *defined-benefit Plans*: Here, the employers assure the employee that he/she will derive a definite amount of the benefit at the time of his/her retirement, irrespective of the underlying investment performance.

5. To know company plans in the future

According to Gassen (2008), Financial Statement Forecasting is very important in the business sector for predicting the financial position and company can forecast the future events and providing them advantages over other competitors. The forecasting of the financial statements entails a comprehensive method and is a time consuming process. But it is valuable for the business organizations. The financial

statements forecasting begins with the sales forecast and ends with recording the amount of money that would be spent by the company to get those sales. So, employee can use the information by looking the sales company to ensuring whether the company achieves the objective or not. It gives a clear picture of the financial options that can be beneficial for the company. (Holthausen, and Watts, 2001).

A company strategic plan it used to set goals for the future. Business plan also known as strategic plan, investment plan, operating plan and annual plan that needed for company to lead in their market. By looking the financial reporting of the company it help employee to know the future plan that will implement by the companies. Additionally, a company should have a feasibility plan that act as keys to success. This plan is good because for deciding whether proceed or not the plan. (Gassen, Fülbie, and Sellhorn, 2006).

It is important for the employees to know strategic plan of the company's' because: -

- i) Motivation – when employee knows his/her company's plan for the future, he/she is more motivated to perform their job. This is because he/she will know what goal he/she working and believe the company will reward for their performance.
- ii) Confidence - give inspires and confidence in employees toward company. By knowing the plan of company, employee can predict the condition of the company whether ready for any situations or not and it help employer has vision for the future to protect their employees.
- iii) Goal setting – when employees known his/her company's strategic plan, employee also will be setting their goals and align same to the goal of the company.

6. To view transparency of company

Financial Statement Fraud has emerged as a major problem in present days. The instances of corporate fraud are increasing at an alarming rate despite formulating laws pertaining to the act of fraud. Many people including the creditors, shareholders and investors have suffered a lot due to the financial statement fraud. A major impediment towards tracing the frauds is that they cannot be recognized instantly but need an experienced eye to trace them. This kind of fraud is difficult to discover since it is often managed by the management. These mostly get recognized when the company is going through any kind of financial crisis; otherwise they are hidden from the eyes of the auditors, investors and stakeholders.

According to Michele and Cynthia (2010), corporate frauds might result in a takeover. According to a survey conducted

by the Association of Certificate Fraud Examiners (ACFE) in 2005, it was revealed that most of the companies indulged in the frauds are small-scale companies with less employees. This revelation breaks the popular notion that the large companies indulge in frauds. According Pricewaterhouse Coopers. Economic Crime in a Downturn: The 5th Global Economic Crime Survey - United States Supplement. 2009, to a famous criminologist, fraud occurs due to certain circumstances. The factors culminating into fraud are:

- Pressure
- Rationalization
- Opportunity

According to a survey report published by the Association of Certificate Fraud Examiners (ACFE) in 2006, the most common form of fraud which a company indulges in is asset misappropriation; this type of fraud accounted for 91.5% of corporate frauds, followed by bribery, extortion and conflict of interests which accounted for 30.8% of corporate frauds. Changing numbers in the financial statements is the least committed fraud in the corporate sector. In case of asset misappropriation, the company has to deal with the loss of faith on the part of the investor, negative reputation and penalty.

The identification of fraud leads to informing the audit committee and forensic accountants. But before appointing a forensic accountant, the experience and efficiency of the accountant needs to be assessed. The Securities and Exchange Commission (SEC) and Sarbanes-Oxley Act of 2002 and corporate governance have formulated rules and regulations to abolish fraud from the industrial scenario. But unfortunately, despite such bindings, corporate fraud is increasing day by day. So, as an employee, we should act as whistle blowers to control the fraud.

7. To analysis stabilities of the company's in the market

Financial analysis can be explained as an assessment of the stability, viability, and profitability of a business, sub-business, or project. A financial analysis is carried out by professionals who prepare reports through the use of information obtained from financial statements and other reports. Besides, one key area of financial analysis is the extrapolation of company's past performance into an estimate of its future performance. Accounting analysis is one of the most common techniques as accounting analysis calculates ratios from the data to compare with those of other companies or with the past performance of the company. For instance, return on assets is a common ratio which is used for determining the efficiency of a company in utilization of its assets as well as a measure of its profitability.

Gibson (2009) said the ratio analysis method is used by experts to analyze the financial data that is available to them. That financial ratio may be the ratio between the company's assets to its liabilities. It may also be the ratio between the accounts receivables and the annual sales. Ratios provide a good amount of information about the company. However there are certain limitations pertaining to the informative structure of the ratios. They can provide a good insight about the strengths and weaknesses of a company. But these numbers, when used for comparing with other companies, can reveal much about the firm. The ratios are immensely important for the analysts and they are the people who ascribe value to the ratios based on their utility, (Asthana, 1999).

The financial ratio makes sense only when there is a yardstick with which it is compared and employees can view the stability of the company when it ratio to compare which other competitor. The yardstick may be the ratio trend of any company. Analysis ratio can be divided into two. Firstly, *Trend analysis*: In the case of trend analysis, a comparison of the financial statements is made over a period of time. Trend analysis is generally made over a period of five years. Secondly, *Cross Sectional Analysis*: In cross sectional analysis, a comparison is made between the financial ratios of two or more companies along same business lines. The best way is to compare the financial ratio of a specific company with the industry average. The other forms of ratios are liquid ratios, current ratio, cash ratio, profitability ratio, financial leverage ratio, efficiency ratio, additional ratio, bad-debt to sales ratio and current-liability ratio.

8. User point of view financial statement

The questions established the point of view from which users of financial statement looked at their latest set of such statements. Their responses are shown in Figure 1. The survey to base on staff who working at library and from a few master students. The sample included a diverse range of users, including manager (20%), investor (17%), creditor (13%), government (11%), tax authorities (8%), auditor (28%) and employee (3%). *Figure 1 (appendix)*.

9. Ranking of importance items used on financial statement

Table 2 shows the ranking that users of financial statements placed on different items in financial statements. This list of items was initially based on a list which appeared in Cole (2009). As can be seen from the table, respondents ranked the majority of the items as either *important* or *very important*. The scores for *important* and *very important* are

combined, then the five most important items on the financial statements from the perspective of the users in the sample were sale or revenue (75%), operation profit (73%), working capital (70%), level of debt (68%) and the cash flow statement (63%). The five least important were dividend policy (30%), information about share (33%), wages (41%), ratio (43%) and other expenses (44%). *Table 2 (appendix) D.*

V. REASON THAT INFORMATION ON REPORT WAS IMPORTANT AND VERY IMPORTANT

Respondents were asked to identify why they use the information that they indicated was *Important* or *Very Important*. Respondents were able to select multiple options from a given list in answer to this question. The responses are shown in Table 3, listed from most frequently selected to least frequently select. From the list, most a common reasons for using the financial statements of are related to comparison of the entity's performance to its performance in previous periods.

VI. RECOMMENDATIONS AND CONCLUSION

The company must transparency during disclosure information in the financial statement because many users will use it. For example, to protect the employee, the unions were establish to representing the employees and negotiate on their behalf for wage increase. The financial show the position (balance sheet), performance (income statement). If firm able generate the profit, the unions will try to negotiate a bigger piece to the employees. While the company not perform well such as losses, the topic negotiate may be not around the wages, but regarding the job securities, termination benefit and etc. It is important financial statements for employees to know whether they have a stable job. Some of the employees prefer financial rewards and others prefer increased vacation time to spend with family or friends. The most essential element to remember is flexibility. The best way to reward employees depends on what they want. Below, are some of the suggestions for rewarding employees. For instance, reward can be in the form of financial reward and non-financial reward. Non-financial reward can be categorized as recognition, appreciation, holidays or increased vacation time, insurance, gain sharing and others. The reward system should fit all the needs of employees to ensure the reward system is effective to motivate every employee to work. The identification of fraud leads to informing the audit committee and forensic accountants. But, before appointing a forensic accountant the experience and efficiency of the accountant needs to be

assessed. As a conclusion, all method to organize employees has their strengths and weakness or their pros and cons. Therefore, a company has to choose an appropriate method to organize the employ.

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