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The usefulness of IFRS-compliant reports: perceptions of Sri Lankan investors and lenders

Saman Bandara
Department of Accountancy, University of Kelaniya, Colombo, Sri Lanka and Department of Accounting and Information Systems, University of Canterbury, Christchurch, New Zealand, and
Michael Falta
Department of Accounting and Information Systems, University of Canterbury, Christchurch, New Zealand

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Abstract

Purpose – This paper aims to examine differential perceptions of lenders and investors on (1) the use, perceived usefulness, importance and adequacy of annual reports, (2) the importance of qualitative characteristics (QCs) and (3) the perceived impact of International Financial Reporting Standards (IFRS) on financial reporting quality (FRQ) in Sri Lanka.

Design/methodology/approach – A questionnaire survey study of practising professionals consisting of Sri Lankan investors ($N = 214$) and lenders ($N = 235$).

Findings – In relation to (1), lenders and investors rank three out of ten information sources ahead of the remaining seven: both include annual reports and personal knowledge. However, the highest average response for lenders is direct communication with clients, and for investors, it is stock market publications. Within annual reports, both decision-makers identify financial statements as the most useful part. Concerning (2), they both identified understandability as the most important QC followed by timeliness. Relevance ranked last, surprisingly. In relation to (3), both groups perceived that the new IFRS reporting environment improved the FRQ compared to the previous Sri Lanka Accounting Standards regime.

Practical implications – Ranking understandability as the most important QC in terms of decision usefulness contradicts IASB's categorisation. The authors provide empirical data on the perceived degree of success of adopting IFRS in a developing economy.

Originality/value – The authors design a decision-oriented (lending vs investing) and context-specific (IASB's financial reporting framework) questionnaire to examine the perceptions of key capital providers separately on the issues mentioned above in "Purpose" within a developing economy. The survey fits into two aspects of the decision-useful theory: useful to make what decisions and useful to whom.

Keywords Usefulness of annual reports, Investment and lending decisions, Qualitative characteristics, IFRS, Sri Lanka

Paper type Research paper

1. Introduction

"The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is *useful* to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about

(1) buying, selling or holding equity and debt instruments;

(2) providing or settling loans and other forms of credit; or

(3) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources."

(IASB, 2018, para. 1.2, italics added).

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Quite clearly, what is deemed "useful" will be context-specific. Predominantly, investors make decisions under various investment strategies, and lenders make decisions based on the capacity of the business to meet debt obligations. Arguably, the information needs are thus quite different. Prior studies (Barth *et al.*, 2008; Cascino *et al.*, 2014; Ehalaiye *et al.*, 2018; Kothari *et al.*, 2010) concur and provide empirical evidence on the varying information needs of investors and lenders. More specifically, information used and deemed useful can be significantly different for the two user groups, which has been shown when the groups have been analysed individually (Chenhall and Juchau, 1977; Epstein, 1975), comparatively (Benjamin and Stanga, 1977), and jointly (Abu-Nassar and Rutherford, 1996; Abdelkarim *et al.*, 2009; Alattar and Al-Khater, 2008; Chatterjee *et al.*, 2010; De Zoysa and Rudkin, 2010; Mirshekary and Saudagaran, 2005; Naser *et al.*, 2003). The context-specificity thus plays out in two dimensions (Gray *et al.*, 1995, who references Staubus' (1977) decision usefulness theory): the accounting process provides relevant information – useful to make what decision (buying, selling or holding equity and debt instruments, or providing and settling loans and other forms of credit)? – to the relevant decision-maker – useful to whom (investor or lender)?

When the usefulness of annual reports is empirically researched, one thus should implement a suitable methodology capable of distinguishing between agents and decision types. The user needs literature (cf. Section 2.1) often identified agents based on occupation titles and professions. However, for example, in a sample of accountants, individuals may respond to survey questions from an investment-type or lending-type context, or both depending on the nature of their (recent) work. If that context is not quizzed explicitly, the responses lack meaningful interpretability, which motivates us to address this issue and examine how the previous studies that put accountants, academics, investors and lenders into the same survey target group examine the usefulness of the information in annual reports accurately. Therefore, in our paper, we resolve this issue that has not been addressed in the literature. We do this by clearly prompting the respondents to give answers with respect to one particular decision type. We thus investigate in research question 1 (RQ1): How useful is the information in annual reports (and other information sources) within a particular decision-making scenario? Our instrument is thus aligned with decision usefulness theory and the International Accounting Standards Board's (IASB) objective of general-purpose financial reporting.

The IASB objective for useful information is grounded in the conceptual framework, which defines the qualitative characteristics (QCs) of information. The QCs form a basis for reporting standards that reporting entities then implement and so provide compulsory and voluntary information to users (cf. Figure 1). In particular, the IASB Conceptual Framework provides the foundation for standards (i.e. IFRS) "that contribute to transparency by enhancing the international comparability and 'quality' of financial information, enabling investors and other market participants to make informed economic decisions" (IASB, 2018,

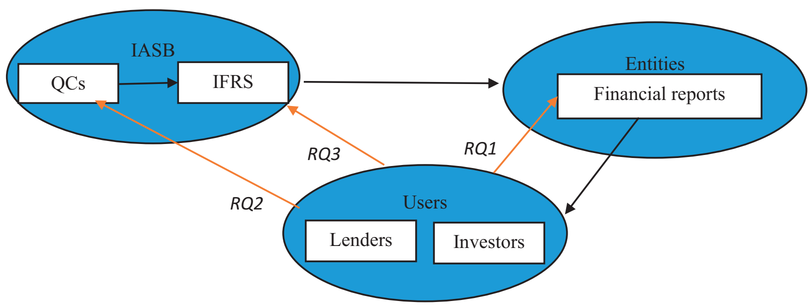

Figure 1.
Relationship between the IASB, reporting entities and users

p. 6) under the premise that "high-quality" financial information is the lifeblood of capital markets [1]. The meaning of "high quality" information is explained through consequences thereof (Jorissen, 2015) and associated with "If financial information is to be useful, it must be 'relevant' and 'faithfully represent' what it purports to represent" (IASB, 2010, p. 16, 2018, p. 14). Furthermore, the IASB mission statement [2] also explicitly refers to the term quality of reporting. Therefore, from an accountability perspective, we suggest there is merit in examining to what extent the IASB achieves their mission goals. Because the IASB is of the view, in all her versions of Conceptual Frameworks, that complying with QCs determines the quality of the information in terms of decision usefulness, we thus investigate the following RQ2 (cf. Figure 1): With respect to their particular decision scenario, do investors and lenders ascribe equal or differing usefulness to QCs? – *And,* what importance ranking do they ascribe to the QCs?

As another motivation to our study, to our knowledge, no other study has examined the role of QCs from investment and lending perspectives. The literature that we review in Section 2 shows that the usefulness of annual reports in terms of the QCs has been analysed (Jonas and Blanchet, 2000; McDaniel *et al.*, 2002), which spurred a research stream that uses various proxies for QCs to assess the usefulness of financial reports which in turn leads to assessments of the quality of reporting (Beest *et al.*, 2009; Braam and Beest, 2013; Herath and Albarqi, 2017; Kythreotis, 2014; Mbobo and Ekpo, 2016).

As the third aspect of our study, through a Sri Lankan case study, we investigate the transferability of information quality and perceived usefulness of annual reports to a different political, social, cultural and economic environment – which is another main mission goal of the IASB. Most developing economies, especially in South Asia, adopted IFRS about a decade after IASB's formation in the year 2001 with the intention of improving the quality of reporting: for example, Sri Lanka adopted IFRS in 2012, Bangladesh in 2013, and Nepal in 2014. While the benefits from adoption seem apparent (for example, comparability and access to a pan-global information standard), we investigate (RQ3): Did the adoption of the IFRS reporting regime in Sri Lanka, a developing economy, improve the quality of reporting in terms of the usefulness of annual reports? Thus, we provide evidence in our study on how the investors and lenders perceived the impact of IFRS adoption, whether or not QCs of useful information in annual reports improved the financial reporting quality (FRQ), and what these professionals had to say about the usefulness of the narrative parts and financial statements of annual reports.

The three aspects of IFRS compliant reports, as formulated through our three RQs, were tested in the context of Sri Lanka. We pay attention to the documented differences between reporting backgrounds within the IFRS context, which may play out differently in developed and developing economies' financial environments. For example, Poudel *et al.* (2014) suggest that social, political, economic, and cultural factors influence accountants' professional judgments. These differences across countries may lead to varying explanations and applications of reporting requirements and perceptions of key accounting information that users such as investors and lenders. Further, Tyrrall *et al.* (2007) report that IFRS was initially implemented in developed countries and later adopted by developing countries. They flagged that IFRS may potentially overlook whether IFRS is appropriate or relevant to such countries. For example, the South-Asian economies adopted IFRS due to international donor organizations' pressure (Poudel *et al.*, 2014; Irvine, 2008; Zaman and Rahaman, 2005) regardless of the suitability of those standards to their country settings. The World Bank also influenced the adoption of IFRS in Sri Lanka under the encouragement of improving the quality of reporting in Sri Lanka (Rahman, 2004). However, no studies have examined whether this expected outcome has actually been achieved. Supporting this argument, scholars (Kimeli, 2017; Nejad *et al.*, 2017; Samaha and Khlif, 2016) also highlighted the insufficiency of studies in developing economies that focus on IFRS and FRQ. Therefore, whether IFRS improved the FRQ in developing economies remains unknown.

Another associated factor with IFRS and FRQ in developing economies is that some indirect indicators that are expected to produce positive results to economies have either yielded none or negative signals in the Sri Lankan context. For example, one indirect factor is that the empirical evidence' support that IFRS improves Foreign Direct Investments (FDI) (Gordon *et al.*, 2012; Pricope, 2016) of a country. Pricope (2016) stated that convergence with IFRS eases access to foreign capital due to improved comparability of information and transparency. Gordon *et al.* (2012) reported that IFRS adoption has a more considerable increase in FDI in developing economies than in developed economies. These findings suggest that adopting IFRS in Sri Lanka might have a more significant increase in FDI. However, according to the World Bank economic data, Sri Lanka reported a decrease in FDI after IFRS [3] adoption compared to the period before IFRS adoption. Another indirect factor is that IFRS adoption has been related to lowering corruption levels (Houqe *et al.*, 2012; Houqe and Monem, 2016; La Porta *et al.*, 2000) in developing economies in particular. For example, Houqe *et al.* (2012) discussed that accounting corruption [4] is likely to accompany socio-political corruption due to the low investor protection environment. Houqe and Monem (2016) identified that adopting IFRS reduces perceived corruption proportionately with the length of the IFRS experience and the quality and extent of the new disclosure regime. Before the above indirect economic and political tendencies can be related to IFRS adoption in developing economies, such as Sri Lanka, we first must study whether or not there is a perceived and actual direct positive benefit from IFRS adoption, which is best measured by FRQ.

Our study is the first perception study tailored to distil between investors' and lenders' decision scenarios considering the two dimensions in decision usefulness theory. This methodologically driven research produces some novel insights into our research questions. The remainder of this article is structured as follows. In Section 2, we review three literature streams relevant to our research goals: these are articles on the use/usefulness of annual reports, the perceived importance of QCs and the impact of IFRS adoption. Section 3 discusses the questionnaire development and its administration, followed by the analysis and results' Section 4, addressing the three research questions. The last Section 5 is a concluding summary that contains a discussion of the implications of the study.

2. Literature review

2.1 Use and usefulness of annual reports

Table 1 provides an overview of the literature on the perceptions of the usefulness of annual reports. We identify three themes. Firstly, there are lender and investor only studies that consider a particular job role or profession within one of the two user groups (Table 1, Section A). For example, Bean and Irvine (2015) and Stanga and Tiller (1983) conducted their studies with respect to lending decisions from the lenders perspective. Many single-user studies focus on investors and investment decisions (Al-Ajmi, 2009; Babu and Hossain, 2019; Bartlett and Chandler, 1997; Bence *et al.*, 1995; Biswas and Bala, 2016; Chenhall and Juchau, 1977; Dang *et al.*, 2020; Epstein, 1975; Hjelstrom *et al.*, 2014; Joshi and Abdulla, 1994; Mohamed *et al.*, 2019; Scott and Smith, 1992). Those studies discuss how the different types of investor groups such as institutional investors, individual investors, sophisticated and non-sophisticated investors would use annual report information for investment decisions. Secondly, there are multi-user studies on the usefulness of annual reports (Table 1, Section B) where users were identified based on their profession and job title and put into one survey group without referring to their specific decision role (Alattar and Al-Khater, 2008; Abdelkarim *et al.*, 2009; Al-Razeen and Karbhari, 2004; De Zoysa and Rudkin, 2010; Drake *et al.*, 2019; Mirshekary and Saudagaran, 2005; Naser *et al.*, 2003). On the other hand, Abu-Nassar and Rutherford (1996) surveyed a

Author/s Section A	Country	Method/Users	Major findings
Lenders only Studies			
Stanga and Tiller (1983)	USA	Questionnaire survey with bank loan officers (154)	Informational needs of bank loan officers do not vary significantly between large public companies and small private companies
Bean and Irvine (2015)	Australia	Semi-structured interviews risk analysts from the four largest banks (16)	The usefulness of disclosures for derivative financial instruments is limited because the disclosures fail to show companies' real use of derivatives and the incapability of users to understand off-balance sheet risks of companies
Investors only Studies			
Epstein (1975)	USA	Survey of individual shareholders (1766)	Only 15% trusted the annual report as the primary source for investment decisions, whereas 49% depended on the advice of stockbrokers
Chenhall and Juchau (1977)	Australia	Survey of individual investors (100)	Financial statements are the major element of annual reports and the most useful sources for share investment decisions
Scott and Smith (1992)	USA	Survey of individual investors	Newspapers, trade journals, other financial reports, advisory services and direct contact with company officials are important sources of information for investment decisions
Joshi and Abdulla (1994)	India	Postal survey with sophisticated and unsophisticated investors (212)	Sophisticated and non-sophisticated investors show significantly different preferences for 37 information items out of 59 information items included in the survey
Bence *et al.* (1995)	UK	Structured interviews with financialanalysts forstockbrokers (21) and institutional investors (12)	Investment analysts tend to use short-term information that is regularly received, whereas institutional investors look for information about the long-term nature
Bartlett and Chandler (1997)	UK	Survey of private shareholders (76)	Annual reports are widely read, and there is an increase of information in the narrative section of the annual reports from the 1970s to the 1990s
Chatterjee (2008)	India	Sophisticated and non-sophisticated investors	Companies in India do not disclose information items that are perceived by users in the financial highlights section of annual reports

(*continued*)

Table 1.
Literature summary for use and usefulness of annual reports

Author/s Section A	Country	Method/Users	Major findings
Al-Ajmi (2009)	Bahrain	Mail survey with individual investors (340) followed interviews (26)	Corporate financial statements were perceived to be the most important source of information, and there is no significant difference in the responses between large and small (<10,000 shares), albeit large investors would make more use of cash-flow and income statements
Hjelstrom *et al.* (2014)	Sweden, the UK, and the USA	In-depth interviews (40) of corporate investors	Information usage from annual reports depends on the purpose of use and accessibility to resources
Biswas and Bala (2016)	Bangladesh	Survey of individual investors (316)	Over one-third of the investors regularly read annual reports. The income statement, balance sheet and cash flow statement are the most read and important sections for them. The corporate environmental report and information on operations are the least read and the least important sections in an annual report. Reasons that restrict the readership (readability) of annual reports are lack of time, lack of usefulness and lack of interest
Mohamed *et al.* (2019)	Egypt	Survey (114) of Institutional investors and financial analysts	Investors view that voluntary disclosures are more useful than mandatory disclosures in management reports, which shows a gap between the regulations and information needs of users
Babu and Hossain (2019)	Bangladesh	Survey (38) of investors and stockbrokers	Investors and stockbrokers perceive corporate annual reports as one of the most significant sources of information to make investment decisions. The most significant components of the annual reports for investors are audit committee report, balance sheet, income statement, and statement of changes in equity, whereas the stockbrokers focus on the annual report are auditor's report to shareholders, balance sheet, income statement, and balance sheet notes

Table 1.

(*continued*)

Author/s Section A	Country	Method/Users	Major findings
Dang *et al.* (2020)	Vietnam	Top 30 listed non-financial companies Vs survey of individual investors (527)	There is a gap between the perception of individual investors on the useful information requirements and the disclosed information by the listed companies' corporate reports
Section B			
Multi-user group studies			
Abu-Nassar and Rutherford (1996)	Jordan	Survey (224) of loan officers, academics, stockbrokers and individual shareholders	Bank loan officers were the users who most often read annual reports, followed by shareholders for investment decisions. They also found that the income statement and balance sheet were the most extensively read parts of the annual reports by all user groups
Naser *et al.* (2003)	Kuwait	A survey (306) of investors, government officials, financial analysts, academics, auditors, loan officers, and stockbrokers	All user groups rely mainly on information published by the company and do not consider intermediary sources such as friends' advice, newspapers, magazines or market rumours to make informed decisions
Al-Razeen and Karbhari (2004)	Saudi Arabia	Survey (303) of Individual investors, institutional investors, creditors, governmental officials, and financial analysts	The corporate annual report was the most important source of corporate information to all of the user groups. Individual investors show lower importance of obtaining information directly from companies than the other groups. Creditors valued direct information from companies more important than the other groups
Mirshekary and Saudagaran (2005)	Iran	Survey (245) of Bank loan officers, academics, stockbrokers, investment officers, institutional investors, auditors, tax officers	Annual reports are regularly used as a basis for making investments, and all users depend on the information obtained from the published annual reports more than on advice from stockbrokers, tips or rumours. Users ranked the income statement, the auditors' report, and the balance sheet as the three most important sections of an annual report. The respondents also revealed a delay in publishing annual reports, lack of reliability of the information, and lack of adequate disclosure as factors that restrict the use of annual reports

(continued)

Table 1.

Section B			
Son *et al.* (2006)	Vietnam	Interviews (19) of Bank credit managers, financial advisors, statistics officers, tax officers, chief accountants, owner/directors	Reliability of information is the main concern of external users, and cash flow information and forecasts are important for users but are unavailable or poorly presented
Alattar and Al-Khater (2008)	Qatar	Survey (150) of individual investors, institutional investors, financial analysts, bank credit officers and government officers who involved	(1) Respondents considered annual reports as important, useful, and the primary source of information for investment decisions, and (2) the balance sheet, auditor's report, cash flow statement, income statement and notes to financial statements were the most important and understandable sections of annual reports
Abdelkarim *et al.* (2009)	Palestine	Survey (180) of individual and institutional investors, analysts, academics, and intermediaries	Users perceive reported information as neither adequate nor relevant to investment decisions due to credibility issues and bad timeliness of the disclosures
De Zoysa and Rudkin (2010)	Sri Lanka	Survey (264) of accountants, managers, bankers, assessors, academics, financial analysts and investors	Majority of users viewed annual reports as the most important source of company information. Long delays in publishing annual reports and a lack of availability of these reports to the general public were considered factors that restricted annual reports
Drake *et al.* (2019)	USA	Survey (408) diverse group of professional financial statement users (Bloomberg Professional)	Many professional users who use financial statements expect more information disclosures in financial statements and believe that information overload is not a problem to use financial statements
Section C			
Comparative studies between two specific groups			
Benjamin and Stanga (1977)	Australia	Survey (408) of Certified Financial Analysts (CFAs) as investment decision-makers and bank loan officers as lending decision-makers	There is a significant difference between the perceived importance of information between CFAs and bank loan officers
Stainbank and Peebles (2006)	South African	Survey users (72) (managers of equity unit trusts to represent investors) and preparers (financial managers in companies)	Respondents preferred the study found that "stockbroker advice" was preferred by the preparers and "communicate with management directly" by users. Concerning respondents' perception of different types of information, preparers considered annual reports as the most useful source of information, whereas users preferred the preliminary announcement made by companies

Table 1.

(*continued*)

Section C			
Dawd *et al.* (2018)	Kuwait	Survey (137) preparers (financial managers) and users (financial analysts)	Preparers identified the auditor's reports as the most important section of the annual report, while the Income statement and balance sheet were the most important for users
Ehalaiye *et al.* (2018)	New Zealand	Online survey (162) of users (advisors, investors, lenders and regulators) of public entities vs private entities	Both user groups show a similar perception of the usefulness of financial statements. The income statement and balance sheet are the most useful components whereas, private users perceive financial statements as the most important against the public users have a greater interest in supplementary information as a source of information for decision making

Table 1.

combination of Jordanian loan officers, academics, stockbrokers and individual shareholders. They then identify different decision roles of user groups such as investment decisions for individual investors, teaching- and research-related purposes for academics, advisory statements for stockbrokers and granting and monitoring loans for loan officers. Third, we find comparative studies (Table 1, section C) between two specific groups in the domain of usefulness of financial reporting (Dawd *et al.*, 2018; Ehalaiye *et al.*, 2018; Stainbank and Peebles, 2006).

To our knowledge, the only study that was developed to account for investment and lending decisions is Benjamin and Stanga (1977). They studied the difference between Certified Financial Analysts (CFAs) as investment decision-makers and bank loan officers as lending decision-makers in Australia. Based on 79 information items included in the questionnaire, the study concluded that there is a significant difference between the perceived importance of information between CFAs and bank loan officers.

From the above literature, we distil three issues. Firstly, we reviewed studies to examine the use and usefulness of annual reports as a source of information and to understand the importance of different sections in annual reports. Set within different contexts, many studies neither differentiate between the job role of user groups nor account for different decision roles. Thus, the findings are unclear in the context of decision usefulness because the responses are made regarding decision scenarios that the researchers will not know about. As we deem the identification of a decision role important, our study focuses on decision scenarios of investment and lending, consistent with the IASB Conceptual Framework's view.

Secondly, the terms "use", "usefulness" and "useful" are frequently used interchangeably in the financial reporting and decision usefulness literature. The Oxford English Dictionary defines the term "use" as "take, hold, or deploy (something) as a means of accomplishing or achieving something; employ"; the term "usefulness' is defined as "the quality or fact of being useful"; and "useful" means "able to be used for a practical purpose or in several ways". The IASB Conceptual Framework defines "useful" indirectly, stating that useful information must be relevant and faithfully represent what it purports to represent. In our study, "use" refers to how frequently users refer to annual reports to make their decisions, and "usefulness" is used in the context of "able to be used for decision-making scenarios on investment or lending".

Third, there is a consensus that the information in annual reports is useful. However, within particular decision contexts, users prefer other sources of information over annual reports, such as, for example, stock market publications. This shows that, although the information is *useful*, it is not *sufficient* to make their decisions. Therefore, in our study, we differentiate between "use" and "useful" from a sufficiency viewpoint: does the information source contain sufficiently adequate information, i.e., is the useful information sufficient for investing and lending decision-making scenarios?

In summary, we incorporate into our questionnaire the emerging themes from the literature review on the use and usefulness of annual reports for either investment decisions or lending decisions to answer our RQ1. The themes are (1) the frequency with which particular information is sought for the two decision types, (2) the importance of the various sources of information (important: of great significance or value to make decisions), (3) the usefulness of the various parts of annual reports (useful: able to be used for decision-making), and (4) the adequacy of information provided (adequate: sufficient or enough for decision-making) in annual reports.

2.2 QCs and useful information

QCs are the axiomatic basis for how useful information is defined by the IASB's Conceptual Framework for financial reporting. Arguably, the QCs then should be used to assess (measure) the level of useful information. Jonas and Blanchet (2000) concurred that the quality of financial reporting should be determined in relation to the usefulness of financial information and the QCs. However, QCs are qualitatively formulated principles and not easily translated into a quality measurement context (Beattie *et al.*, 2004; Nobes and Stadler, 2015). Developing a financial reporting quality index based on QCs is research reported elsewhere (Beest *et al.*, 2009; Bandara, 2021). Here we examine users' perceptions of how important the QCs are for investment and lending decisions.

Early studies (Parry and Groves, 1990; Davies and Whittred, 1980; Jonas and Blanchet, 2000; McDaniel *et al.*, 2002; Wolk *et al.*, 1992) found that QCs are useful in presenting information to users and that the QCs are possible measures for assessing reporting quality in terms of usefulness. The early studies developed proxies to measure QCs individually and used these as measures for reporting quality. Based on this groundwork, studies from the past two decades have applied the different QC measures as part of extended research agendas, such as examinations of the importance of QCs for decision-makers. The following are of relevance to our research.

Abu-Nassar and Rutherford (1996) reported that Jordanian bank loan officers find that corporate reports contain information that tenuously embodies QCs. On the other hand, Naser *et al.* (2003) identified that Kuwaiti user groups relied on credibility and timeliness as the most important characteristics of useful corporate information. Tasios and Bekiaris (2012) also investigated auditors' perceptions of QCs and indicated that the most important QC is the faithful representation, and the least important is timeliness. In contrast, Abdelkarim *et al.* (2009) show that Palestinian users, such as individual and institutional investors, analysts, academics and intermediaries, consider timeliness the most important QC. A similar study conducted by Stainbank and Peebles (2006) in South Africa with preparers and users of annual reports disclosed that users identify comparability as the most important QC while preparers identify faithful representation (they call it "fair presentation") as the most important QC. Under the conceptual framework of the Corporate Report of the Accounting Standards Steering Committee of ICAEW (ICAEW, 1975), Smith (1996) discussed the trade-off between QCs and reveals that both MBA students and accounting practitioners prefer to sacrifice completeness, comparability, timeliness and understandability in disclosures in return for reliability, objectivity and relevance. The study further highlighted that MBA students indicate that understandability is the most important QC, while accounting practitioners consider timeliness to be the most important QC. Ho and Wong (2001) examine the perception of the importance of QCs by CFOs in listed entities and financial analysts in stock brokering firms in Hong Kong. They identify that CFOs considered readability as the most important QC, whereas analysts opted for ease in understanding. Similar results were noted in a comparative study between users and preparers of financial statements conducted by Dawd *et al.* (2018) in Kuwait. They revealed that reliability is the most important QC for users, whereas it is undestandabiliy for preparers.

In summary, the above studies provide inconclusive results about the importance of QCs for users. The studies do not consider the investing and lending decision situations, which prohibits inferring any comparative importance and ranking of QCs between investing and lending decisions. A QC importance ranking has two benefits. Firstly, it justifies (or not) the IASB classification of QCs into fundamental and enhancing groups. Secondly, it yields practical guidance to preparers of the financial report in the form of a priority list. In our RQ2, we thus have examined the differences investors and lenders identify based on their perceived importance of QCs in relation to their decision scenarios; buying, selling or holding debt or equity instruments for investors and granting loans or trade credits to customers, and assess the ability to repay loans for lenders.

2.3 QCs, financial reporting quality and IFRS adoption in Sri Lanka

Brüggemann *et al.* (2013) suggested that high-quality accounting standards alone are insufficient to provide high-quality information. Scholars (Ball *et al.*, 2003; Lourenço *et al.*, 2015) revealed that high-quality information depends on several factors such as a country's legal and political system, financial reporting incentives, financial market developments, tax systems, capital structures, and the ownership structure of a firm. Ball *et al.* (2003) and Ball (2006) proposed that differences in the institutional environment are likely to lead to differences in the quality of financial reporting, even where the same accounting standards are applied.

Then, there are numerous methods such as accrual models (Aboody *et al.*, 2005; Francis *et al.*, 2005; Gregoriou *et al.*, 2019; Rampershad and de Villiers, 2019; Phuong and Hung, 2020), value relevance models (Aboody *et al.*, 2002; Barth *et al.*, 2001; Burgstahler and Dichev, 1997; Yasas and Perera, 2019), and specific QCs as proxies to assess FRQ. Early attempts used individual QCs as a proxy for FRQ. Jonas and Blanchet (2000) developed questions for individual QCs in order to assess the information quality of the Financial Accounting Standards Board (FASB, 1980) and the IASB (1989) frameworks. McDaniel *et al.* (2002) used the pronouncements of the FASB to identify a small set of QCs. Woods and Marginson (2004) followed a similar approach and developed a small set of QCs based on the pronouncements of the IASB to assess the quality of reporting. Kythreotis (2014) measured the quality of financial statements produced by listed companies of fifteen European countries by using QCs specified in the Conceptual Framework of IASB. He showed that "relevance" is increased in the post-adoption period of IFRS while "reliability" remained constant.

In contrast to the above methods, Beest *et al.* (2009) developed a reporting quality assessment tool that jointly considers all the QCs laid out by the IASB. A justifying criterion is that compliance with QCs is a valid and reliable approach to assess the quality of financial reports. Braam and Beest (2013) compared the quality of US and UK annual reports using 33 items index from assessing the compliance level of the reports with IASB's QCs. The results suggested that UK reports' overall quality is better than US 10-K reports, on average. Later, the QCs-based approaches developed by Beest *et al.* (2009) and Braam and Beest (2013) were used by scholars (Agyei-Mensah, 2013; Chakroun and Hussainey, 2014; Dimi *et al.*, 2014; Haarburger *et al.*, 2020; Jerry and Saidu, 2018; Masruki *et al.*, 2018; Mbobo and Ekpo, 2016;

Rashid, 2020; Tasios and Bekiaris, 2012) to assess the quality of information set in different contexts, such as financial reporting, corporate governance, and stock market research. Beest and Braams' seminal work on the quality measurement of annual reports allows for cross-sectionally and longitudinally comparisons. The latter aspect allowed Yurisandi and Puspitasari (2015) and others to test if IFRS had increased the quality of financial reporting after IFRS adoption. Agyei-Mensah (2013), Agienohuwa and Ilaboya (2018), and Tasios and Bekiaris (2012) studied the impact of IFRS in developing countries and revealed that IFRS improved the quality of financial reporting.

The above approaches inherently suggest that FRQ can be measured. However, this view is not held globally: Achim and Chiş (2014) suggested that FRQ cannot be uniquely defined. Others (Cheung *et al.*, 2010; Jorissen, 2015) state that defining and measuring FRQ has remained an issue of major concern among professional accountants, regulators and other users of financial information. The difficulty lies not only within the range of approaches used by researchers (Barth *et al.*, 2008; Beest *et al.*, 2009; Cheung *et al.*, 2010; Kythreotis, 2014; Tasios and Bekiaris, 2012) but mainly in that the notion of "quality" is subjective due to conflicting preferences from user groups' different judgments and decisions (Beattie *et al.*, 2004). Mai (2013) argued accordingly that information quality ultimately is a subjective construct and that users of the information have to make judgments about its quality for themselves. This critical stream of the literature suggests that the perceptions of users and their decision scenarios matter – and it is them to experience the impact of the QCs in financial reports.

Evidently, the debate is ongoing about the expected reporting quality of financial statements, improvements under IFRS guidelines, and how the quality relates to QCs. For example, IFRS adoption in every country unfolds differently. De George *et al.* (2016) discussed the varying conclusions found with respect to IFRS adoption and its impact on improving quality. Daske and Gebhardt (2006), for example, show that disclosure quality has increased under IFRS in their sample, but they do not suggest this be a finding from which to generalise. IFRS seem to produce positive results for adopters at large, and the benefits will differ, however, from country to country (Jeanjean and Stolowy, 2008) depending on (1) the level of preparedness to adopt new regulation (Joshi *et al.*, 2008), (2) the language and culture (Schipper, 2005), and (3) the economic conditions and legal enforcement (Kimeli, 2017). The regulatory adoption is challenged by the costs associated with implementation, awareness, education, staffing, training and the information technology infrastructure necessary to operationalise IFRS (Jermakowicz and Gornik-Tomaszewski, 2006; Poudel *et al.*, 2014; Sharma *et al.*, 2017; Weaver and Woods, 2015).

The IFRS adoption literature has mainly focussed on developed economies such as those in the European Union (Ballas *et al.*, 2010; Nijam, 2016). From these results, we are interested here to elicit what is transferable to the developing economy of Sri Lanka. Because the conditions vary, as Jun Lin and Wang (2001) and Samaha and Khlif (2016) suggest, the profession in many developing countries is not in a position to regulate accounting and financial reporting effectively and struggle to enforce accounting standards generally. Most Asian economies adopted IFRS due to international donor organisations' pressure (Irvine, 2008; Poudel *et al.*, 2014; Zaman and Rahaman, 2005). Sri Lanka, in an endeavour to be compatible with the contemporary international developments in accounting and financial reporting (Nijam, 2016), and under the influence of the World Bank (Rahman, 2004), fully converged to IFRS with effect from January 1st, 2012. The adoption of IFRS was encouraged to improve the quality of reporting in Sri Lanka (Rahman, 2004). However, Tyrrall *et al.* (2007) questioned whether IFRS is appropriate or indeed relevant to such developing economies. They flagged that IFRS may potentially be overlooking the concerns of whether IFRS is appropriate or relevant to such countries.

Nagirikandalage and Binsardi (2017) noted that Sri Lanka was affected by unplanned changes in business policies, governments' changes with two different political ideologies and civil war, which lasted from the 1980s to 2009. These have led to the instabilities of Sri Lankan accounting and economic systems over the past few decades: Athukorala and Jayasuriya (2013) noted that the development of Sri Lankan's information infrastructure and information systems remains a challenge post-conflict. Also, they further argue that if a developing economy such as Sri Lanka is to adopt a developed economy's accounting systems, the adoption may not be optimal for the implementer because Sri Lanka has a lower financial literacy rate, low adoption of IT, economic imperfections, and other social, political and cultural differences. It thus is an empirical question if the quality of financial reports prepared under IFRS in Sri Lanka varies from that of other developed (and developing) economies. After IFRS adoption, Joshi *et al.* (2016) also emphasised the importance of investigating the impact of IFRS during the post-adoption period to understand the IFRS adoption experience in developing countries. Scholars (Kimeli, 2017; Nejad *et al.*, 2017; Samaha and Khlif, 2016) also highlighted the need for developing country-specific studies on IFRS and FRQ.

Within our relatively substantive literature review, we have not found a study focusing on and comparing the quality perceptions of investors and lenders separately and how the quality is related to the QCs of the IASB Conceptual Framework. Thus, compounded with the challenges of a developing Sri Lankan economy, in our RQ3, we examine the perceptions of Sri Lankan investing and lending decision-makers with respect to the impact of IFRS adoption: Did IFRS adoption improve, FRQ, QCs, the usefulness of the narrative parts in annual reports and the perceived usefulness of the financial statements? In the following sub-section, we draw our attention to explain the development of accounting regulations in Sri Lanka briefly.

2.4 Evolution of accounting regulation in Sri Lanka

Sri Lanka is an economy that recorded an average below 5% GDP growth [5] over the last ten years, and the economy was affected by two significant events after its independence in 1948. The first event was the civil war from the 1980s to 2009, costing thousands of civilians' lives and billions of dollars of physical assets. The second event was the tsunami in December 2004, which brought the biggest natural disaster to the country in its documented history.

As reported by Liyanarachchi (2009), the financial reporting history in Sri Lanka can be traced back to the ninth century. He reported that rock inscriptions were relied upon to limit the misuse of monastic property and to increase openness and accountability. Much later, the British colonial period (1815–1948) influenced and initiated Sri Lankan accounting practices (Narayan *et al.*, 2002). Narayan *et al.* (2002) stated that the establishment of the Chartered Accountants of Ceylon in 1950 was the official commencement of the accountancy profession in Sri Lanka. Before 1970, until the Institute of Chartered Accountants of Sri Lanka (ICASL) issued the first Sri Lanka Accounting Standard (SLAS), financial reporting requirements of Sri Lanka were mainly based upon the Companies' Ordinance of Ceylon, UK legislation and the recommendations of the ICAEW. Later, as another significant milestone, the Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995 made provisions to establish the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB). The SLAASMB operationalised the Accounting and Auditing Standard Act and was empowered to examine the compilation to SLAS of Specified Business Entities (SBEs) [6] in Sri Lanka. Moreover, the first committee under the Sri Lanka Accounting and Auditing Standards Act was established in 1996 as the Accounting Standards Committee (ASC) to recommend SLAS adoption in the country through ICASL and published a book of SLAS in 1996. Twenty-eight SLASs were effective as of 30 June 2001.

The "*Diagnostic Study of Accounting and Auditing in Sri Lanka*", published by the Asian Development Bank (ADB) in 2001, made one of its suggestions that SLASs were already slightly out-of-step with IASs. The report recommended closing the emerging gaps between SLASs and IASs (Narayan *et al.*, 2002). In 2004, the World Bank conducted a review of accounting and auditing practices in Sri Lanka. It issued the Report on the Observance of Standards and Codes (ROSC), which evaluated the weaknesses and strengths of the accounting and auditing requirements and suggested closing gaps between SLAS and the International Accounting Standards (Rahman, 2004). In the same year, the SLAASMB decided to encouraged Sri Lankan listed companies to adopt IFRS voluntarily. In 2007, responding to the ADB and World Bank recommendations, CASL agreed to converge with IFRS with effect from 2012. The financial reporting system is currently regulated mainly by CASL, SLAASMB, the Central Bank of Sri Lanka, the Securities and the Exchange Commission of Sri Lanka, and the Inland Revenue Department (IRD). The reporting environment is governed by many pieces of legislation passed by the parliament of Sri Lanka. Among them, the Sri Lanka Accounting and Auditing Standards Act (No. 15) 1995, the Companies Act (No. 07) 2007, the Finance Companies Act (No. 78) 1988, the Banking Act (No. 30) 1995, and the Inland Revenue Act (No 10) of 2006 play leading roles.

3. Methodology

3.1 Development of survey instrument

We have developed a questionnaire with four Sections A to D. The first section collects demographic information on gender, age, qualification, and the type and level of experience with respect to lending and investment decisions. Respondents had to state their highest experience category as either;

(1) Investment decision-maker

- Advisor: advising clients on buying, selling, or holding debt or equity instruments;
- Investor: decision on buying, selling, or holding debt or equity instruments;

or

(2) Lending decision-maker

- Lender: granting loans or trade credits to customers and assess the ability to repay loans.

The specific contents of Sections B and C of the questionnaire are based on (1) our literature review of academic user need studies and also surveys conducted by professional bodies, and (2) existing annual reporting practices of Sri Lankan entities, which we learnt from several professional investors and lenders during the testing phase of the survey instrument. In particular, Section B collects information about the use and usefulness of annual reports. Section C collects information about the importance of QCs and the impact of IFRS on them. There is a fourth Section D which purpose and data are discussed in Bandara (2021).

We have pilot tested the questionnaire with 16 participants in January 2019. We then considered and included the comments and feedback from the responses, which were also viewed and discussed with two chartered accountants, one CFA and three senior accounting academics. To ensure the final questionnaire is consistent, a separate test-retest reliability study was conducted with eight participants from Sri Lanka.

3.2 Survey administration and survey statistics

Our target survey participants are Sri Lankan individuals who are investors with investment experience, advisers who advise third parties on investment decisions and lenders who have experience lending decisions. The questionnaire questions have been customised to each of the three participant groups by explicitly stating the corresponding type of investing, advising or lending decisions at the root of each question. To maximise the reach of participants, we have used a paper-based and electronic version of the questionnaire. We are aware of the potential problems from the mixed survey mode, but we have not observed these to materially bias any of the data received [7]. The paper-based questionnaire was administered in February 2019 to the following participants who we could personally reach and for whom the decision scenario can be identified:

(1) Professionals who attend a diploma course in credit management delivered by the College of Banking and Finance (COBAF) of Sri Lanka. One hundred five questionnaires were distributed, yielding 89 responses on lending decisions.

(2) Floor investors who are trading on the Colombo Stock Exchange either at Colombo, Kurunegala, Kandy, or Negombo branches. Thirty-six questionnaires were distributed, yielding 34 responses on investing decisions.

(3) Staff from and customers of three stock brokering firms. Sixty questionnaires, 20 each, were distributed, yielding a total of 33 responses on either investment or lending decisions.

In total, 156 responses (78% response rate) were obtained from the paper-based method from these three groups.

When the decision type of users is not clearly identifiable, and when we could not directly approach the participants, we have used the electronic version of the questionnaire. Again, we reached three different groups of respondents:

(1) We obtained approval from the Chartered Accountants of Sri Lanka (CASL) to email a link to our questionnaire to all their members. A total of 5,649 active members; 295 have clicked the survey link yielding 102 completed questionnaires responses on either investment and lending decisions.

(2) The Certified Financial Analysts (CFA) Society of Sri Lanka agreed to send the survey link to its 123 members. Twenty-two members responded to either investment and lending decisions.

(3) Alumni from the Department of Accountancy, the University of Kelaniya, who now work in banks, financial institutes and stock brokering companies. Two hundred forty-seven emails were sent out through the alumni association yielding 169 responses on either investment or lending roles.

In total, 293 responses (44% response rate) were obtained from the online email questionnaire from these three groups.

Table 2 shows that the survey participants are well-diversified across various jobs, yet each respondent is non-ambiguously associated with one of the two decision scenarios: 235 (52.3%) investing and 214 (47.7%) lending decision respondents. Notably, we observe that the job role for accountants, employees and managers may involve investment or lending decisions, highlighting the point made earlier about user information needs research tied to job roles (occupational titles or professions) instead of the decision processes involved.

From the first section of the survey, we also find that 60% of the respondents are male, 91% of all respondents are above 25 years of age, and the average number of years of

Table 2. Numbers of respondents

	Investing decisions (235)						Lending decisions (214)		
	Advisors (88)			Investors (147)			Lenders (214)		
Job/title	Paper	Email	Total	Paper	Email	Total	Paper	Email	Total
Financial analysts	3	7	10	2	2	4	–	–	–
Financial consultants	6	8	14	0	3	3	–	–	–
Stockbroker	13	9	22	8	1	9	–	–	–
Partners in audit firm	3	12	15	2	6	8	–	–	–
Accountants in companies	1	7	8	–	27	27	–	17	17
Employees in companies	1	3	4	2	4	6	1	7	8
Managers in companies	6	9	15	3	30	33	7	11	18
Individual investors	–	–	–	17	40	57	–	–	
Bank loan officers	–	–	–	–	–	–	81	90	171
Total	33	55	88	34	113	147	89	125	214

Note(s): Job roles versus investing and lending decisions

experience is eight years for investment decisions and five years for lending decisions. The level of financial literacy is high among the respondents in that 92% of advisors, 88% of investors and 77% of lenders have either academic (above diploma level) or professional qualifications (any professional membership), and one-third of all respondents have both. Considering our respondents' calibre, we are confident that the information provided in the second and third sections of the questionnaire is well-informed and based on an exceptional level of technical understanding of the content and terminologies in annual reports.

4. Analysis of survey results

4.1 Frequency of using annual reports

Annual reports are generally viewed as useful sources of information which support investing and lending decisions. Therefore, we have asked the survey participants to indicate on a 5-point Likert scale how often they use annual reports when making investment and lending decisions. The latter we split into three questions that are synonymous with the main scenarios that a lender may face. This information is readily displayed in Table 3.

Approximately two out of three respondents use annual reports "frequently" or "always" in all decision roles. De Zoysa and Rudkin (2010) provide a reference point using data from the year 2000 when 48% of the surveyed Sri Lankan respondents indicated they use annual reports "frequently" or "always", albeit unknown what purpose. As far as two different studies can be compared, this increase seems significant and reassures the level of professionalism in personal decision-making and, in particular, in providing financial services. However, one out of three respondents indicated that annual reports do not play a significant role in their investment and lending decisions. Notably, 3%–5% of respondents, which translates to approximately 4–6 respondents, indicated never to have used annual reports within the particular decision scenario. We find that these people have very short experience times and have recently taken up their job roles. Generally, the group that "never", "rarely" or "sometimes" use annual reports must be using other information sources to support their respective decision-making, as indeed may anyone of the 449 respondents, which leads to the next question of Section B of our questionnaire.

4.2 Type and the importance of information sources

Other than the annual reports, the literature (Al-Ajmi, 2009; De Zoysa and Rudkin, 2010; Ehalaiye *et al.*, 2018; Ho and Wong, 2001; Naser *et al.*, 2003; Stainbank and Peebles, 2006) suggests that there are other sources of information which decision-makers use to facilitate

	Decision scenario	Responses [%] Never (0)	Rarely (1)	Sometimes (2)	Frequently (3)	Always (4)	N/A	Statistics Mean	Stdev
Advisers (88)	Advise clients on trading equity or debt instruments	0	9.1	20.4	30.7	39.8	0	3.01	0.99
Investors (147)	Buy, sell or hold equity or debt instruments	3.4	6.8	26.5	27.9	35.4	0	2.75	1.09
Lenders (214)	Grant loans to customers	4.7	8.8	24.8	27.1	34.6	0	2.78	1.15
	Assess the ability to repay loans	3.2	9.8	18.2	22.9	45.9	0	2.98	1.16
	Provide trade credit to customers	3.7	7.9	23.4	30.4	34.6	0	2.84	1.10

Note(s): Measurement on a 5-point Likert scale

Table 3. Frequency of using annual reports

their investment and lending decisions. We have listed some of the most common information sources and asked our respondents to indicate a 5-point Likert scale of their importance in relation to their decision role.

Table 4-Part A shows that stock market publications and annual reports are the two most frequently used sources of information for investment decisions; however, communication with the company is the most important for lending decisions. Lenders, in fact, are in a position to request needed information directly from the clients rather than trust in annual reports. This result is consistent with Naser *et al.* (2003). However, De Zoysa and Rudkin (2010) reported that annual reports were the most important information source for all user groups. Further, it is not surprising that the most highly experienced respondents' rate "tips and rumours" and "advisors from friends" the least important source of information, which result is consistent with Al-Razeen and Karbhari (2007), Mirshekary and Saudagaran (2005) and Naser *et al.* (2003). The Internet as a source of information for decision making has been selected in the 5th and 6th positions for investment and lending decisions, respectively. This suggests that disclosures on company websites are not timely, useful or available.

The difference the two groups ascribe to the importance of annual reports does neither vary statistically nor practically (the medians are 3, i.e. "very important"). This finding is in line with Al-Ajmi (2009) and Mirshekary and Saudagaran (2005). However, the bottom rows of Table 4 show, using the Mann–Whitney *U* test, a statistically significant difference between the actual importance investors and lenders ascribe to seven out of the ten resources.

Further, we examined the statistical significance among the different sources of information based on the two groups' rankings (cf. Table 4-Part B). We have not found a statistically significant difference among the first three places of rankings made by either investment or lending decision-makers. These are stock market publications (1st), annual reports (2nd), and personal knowledge (3rd) for investment decision-makers, and communication with the company (1st), annual reports (2nd), and personal knowledge (3rd) for lending decision-makers.

Table 4.
Type and ranking of various information sources

		Advice from a friend	Communication with the company	Annual report	Information provided on the Internet	Newspaper and media	Personal knowledge	Stock market publication	Tips and rumours	Stock broker advise	Advisory services of accounting firms
Part A											
Investment decision	Rank	10	4	2	5	5	3	1	9	7	8
	Mean	1.66	2.51	2.80	2.27	2.27	2.74	2.81	1.92	2.25	2.18
	Stdev	0.93	1.08	0.91	0.96	0.89	0.89	0.90	1.15	0.98	0.86
	Median	1	3	3	2	2	3	3	2	2	2
Lending decisions	Rank	10	1	2	6	5	3	4	9	7	8
	Mean	1.47	2.83	2.74	2.06	2.09	2.71	2.50	1.71	1.77	1.98
	Stdev	0.87	0.87	0.97	0.79	0.85	0.87	0.89	1.0	0.95	0.90
	Median	1	3	3	2	2	3	2	2	2	2
Z (Mann–Whitney)		−2.28	−3.07	−0.30	−2.53	−2.0	−0.47	−3.83	−1.62	−4.65	−4.46
p (2-tailed)		0.02*	0.00**	0.76	0.01**	0.04*	0.64	0.00**	0.11	00**	0.00**

Part B

Statistical significance among the ranking of investment decision-makers

Ranks	1	2	3	4
2	$Z = -0.366$, $p = 0.714$	–		
3	$Z = -0.904$, $p = 0.366$	$Z = -0.493$, $p = 0.622$	–	
4	$Z = -2.893$, $p = 0.004$**	$Z = -2.512$, $p = 0.012$*	$Z = -2.072$, $p = 0.038$*	–
5	$Z = -6.227$, $p = 0.000$**	$Z = -5.757$ $p = 0.000$**	$Z = -5.440$, $p = 0.000$**	$Z = -3.50$, $p = 0.002$**
Statistical significance among the ranking of lending decision-makers				
2	$Z = -0.830$, $p = 0.406$	–		
3	$Z = -1.416$, $p = 0.157$	$Z = -0.429$, $p = 0.688$	–	
4	$Z = -4.036$, $p = 0.000$**	$Z = -2.935$, $p = 0.003$**	$Z = -2.739$, $p = 0.006$**	–
5	$Z = -8.407$, $p = 0.000$**	$Z = -7.172$, $p = 0.000$**	$Z = -7.385$, $p = 0.000$**	$Z = -4.710$, $p = 0.000$**

Note(s): Level of significance: *: significant at 5%; **: significant at 1%
(We have not provided statistics after 5th ranking since all the rankings after 5th place are statistically significant)
Measurement on a 5-point Likert scale where 0 is “not important”, 1 is “somewhat important”, 2 is “important”, 3 is “very important”, and 4 is “extremely important”

4.3 The usefulness of various parts of annual reports

Next to the financial statements, annual reports contain several other mandatory and voluntary reports that may contain quantitative and qualitative information useful to support investment and lending decisions. However, several studies (Al-Ajmi, 2009; Alattar and Al-Khater, 2008; De Zoysa and Rudkin, 2010; Stainbank and Peebles, 2006) reported that the usefulness of those sections might vary significantly among different user groups. Table 5 shows Sri Lankan decision-makers responses to 15 frequently included sections of an annual report.

In line with earlier studies (Abu-Nassar and Rutherford, 1996; Al-Razeen and Karbhari, 2004; Alattar and Al-Khater, 2008; De Zoysa and Rudkin, 2010; Ehalaiye *et al.*, 2018; Mirshekary and Saudagaran, 2005), it is perhaps not surprising to see in Table 5 that the financial statements of an annual report, including the auditors' report, are considered the most useful sections to investing and lending decision-makers. All other narrative reports are deemed less useful for their purpose as the within-group statistical and practical differences are large.

Considering that the auditors' report ranks higher in usefulness than any other of the remaining sections, including the statement of changes in equity, suggests that the Sri Lankan respondents consider the verifiability of the financial data a major factor. Additionally, results show that verifiability is deemed the second most important QC for both investors and lenders, which provides a natural link to its continuing presence in the Conceptual Framework.

Our in-between group analysis shows statistically significant differences in group central tendencies for the usefulness in the cash flow statement, the chairman's report/directors'

	Investors			Lenders			Mann–Whitney	
	Mean	Rank	Median	Mean	Rank	Median	Z	p (2-tailed)
Statement of financial position	3.07	3	3	3.15	3	3	−1.03	0.301
Profit and loss, or income statement	3.10	1	3	3.20	1	3	−1.17	0.242
Cash flow statement	3.09	2	3	3.29	2	3	−2.61	0.009**
Statement of changes in equity	2.73	6	3	2.85	6	3	−1.22	0.224
Notes to financial statements	2.95	4	3	2.91	5	3	−0.67	0.506
Accounting policies	2.45	11	2	2.51	8	3	−0.68	0.494
Statement of other comprehensive income	2.53	7	3	2.68	7	3	−1.46	0.146
Auditors' report	2.87	5	3	3.01	4	3	−1.63	0.103
Chairman's report/directors' report	2.30	14	2	2.07	13	2	−2.30	0.021*
Management discussion and Analysis	2.48	10	2	2.44	9	2	−0.53	0.595
Corporate governance report/ information	2.33	12	2	2.17	11	2	−1.71	0.087
Social responsibility report/ information	2.00	15	2	1.79	15	2	−2.07	0.038*
Segmental information	2.50	9	2	1.99	14	2	−5.43	0.000**
Statistical summary	2.63	3	2	2.36	10	2	−3.02	0.003**
Sustainability report	2.21	13	2	2.11	12	2	−0.79	0.432
Total average	2.62			2.57				

Note(s): Level of significance: *: significant at 5%; **: significant at 1%
Measurement on a 5-point Likert scale where 0 is "not useful", 1 is "somewhat useful", 2 is "useful", 3 is "very useful", and 4 is "extremely useful"

Table 5. The usefulness of parts of annual reports

report, the social responsibility report, segmental information, and the statistical summary. For example, lenders consider the cash flow statement more useful than investors: lenders focus more on the firm's capacity to repay debt.

4.4 Usefulness and adequacy of the information

This section analyses the level of usefulness and adequacy of information for investment and lending decisions. These two aspects go to the heart of IASB's goal to set a financial reporting environment that allows reporting entities to provide useful information to capital providers. Our questionnaire defined usefulness as "able to be used for decision making" and adequacy as "sufficient or enough to make a decision". Thus, usefulness is synonymous with the necessary condition for a decision to occur; adequacy, on the other hand, is the sufficiency condition to actually produce an investing or lending decision. Therefore, it is important to analyse both usefulness and adequacy together to understand the "usefulness" of annual reports.

Table 6 shows the degree of usefulness that investors and lenders perceive annual reports for their decision making.

Table 6 shows that 51.1% of investment decision-makers and 51.3% lending decision-makers find annual reports "very useful" and "extremely useful". The corresponding averages of 2.60 and 2.54 are robust in that they rank-match the averages 2.62 and 2.57 from the annual report component usefulness data in Section 4.3 (cf. Table 5). Overall, we conclude that both groups accept that information contained in annual reports is a useful source of information concerning their particular decision processes.

Group differences using the Mann–Whitney test ($Z = -0.55$, $p = 0.59$) suggest that there are no statistically significant differences between investment decisions and lending decisions regarding the usefulness of the information contained in annual reports. These results concur with the literature described in Section 2.1.

Table 7 shows the degree of adequacy that investors and lenders perceive annual reports for their decision-making.

As per Table 7, most investors and lenders aggregate around the mean of the scale. A healthy proportion finds the annual reports "very much adequate". Surprisingly, however, about the same proportion finds annual reports "not adequate". Lenders, in particular, indicated that annual reports are useful (cf. Table 6) but, given the result above, how important to pose the adequacy question. It reveals that almost a third of all lenders (and investors) do not solely rely on the annual report when making lending (and investing) decisions. Further, we examined the responses with the Mann–Whitney U statistics. The test statistic ($p = 0.48$, $Z = -0.71$) reveals that there is no statistically significant difference in the

	Investors		Lenders	
The usefulness of annual reports	N	%	N	%
Not Useful (0)	0	0	1	0.5
Somewhat Useful (1)	19	8.1	26	12.1
Useful (2)	96	40.8	77	35.9
Very Useful (3)	80	34.0	77	35.9
Extremely Useful (4)	40	17.1	33	15.4
Total	235	100	214	100
Mean	2.60		2.54	
Stdev	0.86		0.91	
Median	3		3	

Note(s): Measurement on a 5-point Likert scale as per Column 1

Table 6.
Usefulness of annual reports

Adequacy of annual reports	Investors N	Investors %	Lenders N	Lenders %
Not Adequate (0)	39	16.6	59	27.6
Somewhat Adequate (1)	30	12.8	0	0
Adequate (2)	112	47.7	89	41.6
Very Much Adequate (3)	47	20.0	55	25.7
Extremely Adequate (4)	7	2.9	11	5.1
Total	235	100	214	100
Mean	1.80		1.81	
Stdev	1.04		1.40	
Median	2		2	

Note(s): Measurement on a 5-point Likert scale as indicated in Column 1

Table 7. Adequacy of annual reports

responses between investment decisions and lending decisions about the adequacy of the information contained in annual reports.

These findings comply with Abu-Nassar and Rutherford (1996), who stated that annual reports are adequate to different user needs in Jordan. However, our results are different from the findings of De Zoysa and Rudkin (2010). They identified that, in 2000, 75% of Sri Lankan respondents had stated that annual reports are "not adequate" or "partially adequate": our study records the corresponding number below 30%. This shows a significant improvement in the adequacy of annual reports. A possible explanation is due to the increased report size of Sri Lankan entities so that more information is included under IFRS to facilitate user decisions compared to 2 decades ago under a different reporting regime. This explanation is based on our observation of up to quadruplicating page numbers of annual reports over the ten years from 2010 to 2018.

When the importance, usefulness, and adequacy of annual report information are compared between the investment and lending decision makers solely on the frequency of responses and the mean response, a respective decreasing trend for both decision scenarios can be observed (cf. Table 8).

The data in the table suggest that when the importance (great significance or value), usefulness (able to be used for decision-making) and adequacy (sufficient or enough to decide) of annual report information are compared between investment and lending decisions, the annual report information is more important but less useful and less adequate to make investment and lending decisions; the mean response for importance is close to 3 ("very important") for both the investment and lending decision; the mean response for the usefulness of annual report information is just above 2.5 (close to "very useful") for both the investment and lending decision. The mean response for the adequacy of annual reports is below 2.0 ("adequate") for both the investment and lending decisions. The decrease from importance to usefulness to the adequacy of annual report information possibly arises because annual reports are not the only source of information for investment and lending decisions.

4.5 Importance of QCs

We have asked our survey participants to rate the importance of QCs in relation to their respective decision types. The results are presented in Table 9.

The importance is high for all QCs and from both investment and lending decision perspectives. That is, 93%–99% of all respondents in both groups ticked one of the top three categories "important", "very important or "extremely important" on the 5-point Likert scale. Their mean responses are close to the median value of three, and we do not observe any

	Investors Mean	Investors Average responses (%)	Lenders Mean	Lenders Average responses (%)
Importance (significance or value) Sum of Important (2), Very Important (3), Extremely Important (4)	2.80	94	2.74	89
Usefulness (able to be used for decision making) Sum of Useful (2), Very Useful (3), Extremely Useful (4)	2.60	92	2.54	87
Adequacy (sufficient or enough to make a decision) Sum of Adequate (2), Very Much Adequate (3), Extremely Adequate (4)	1.80	71	1.81	72

Note(s): Averages are calculated for the top three response categories on the 5-point Likert scales, where "0" and "4" are the lowest and highest values, respectively. The respective wordings for importance, usefulness and adequacy scales are given on the 2nd line of the corresponding rows

Table 8. Comparison of importance, usefulness and adequacy of annual report information

QCs	% of responses ID	% of responses LD	Mean (Stdev) ID	Mean (Stdev) LD	Rank ID	Rank LD	Mann–Whitney Z	Mann–Whitney p (2-tailed)	Median
Relevance	93	98	2.79 (0.91)	2.84 (0.85)	6	6	−0.50	0.62	3
Faithful Representation	94	98	2.93 (0.96)	2.96 (0.83)	3	4	0.0	1.0	3
Comparability	95	94	2.89 (0.86)	2.87 (0.88)	4	5	−0.22	0.83	3
Verifiability	96	98	2.88 (0.89)	2.98 (0.77)	5	2	−1.1	0.83	3
Timeliness	97	97	3.03 (0.83)	2.97 (0.86)	2	3	−0.87	0.28	3
Understandability	99	98	3.12 (0.82)	3.07 (0.80)	1	1	−0.72	0.47	3

Note(s): Measurement on a 5-point Likert scale where 0 indicates Not Important, 1 is Somewhat Important, 2 is Important, 3 is Very Important, and 4 is Extremely Important. Column 2 groups the top 3 rating categories Important, Very Important and Extremely Important

Table 9. Importance of QCs in investment (ID) and lending (IL) decisions

statistical differences between the lenders' and investors' mean response rates for any of the QCs.

The ranking of QCs based on the mean response puts understandability as the most important QC for both groups, and relevance is considered the least important. This result is surprising and may associate with Lev's (2018) finding that investors and corporate executives are dissatisfied with the relevance of the information in the financial reports.

Interestingly, faithful representation was also not selected into the first two ranking places, which one may have expected for both are classified as "fundamental" in the current IASB Conceptual Framework. Ahead of the two fundamental QCs ranks also timeliness for both decision-making groups. The importance of timeliness has been observed by De Zoysa and Rudkin (2010), who revealed that publication delay was a major problem faced by the users of annual reports in Sri Lanka. Also, Smith (1996) showed that accounting practitioners considered timeliness the most important QC. The other ranking results find precedencies in the literature: Tasios and Bekiaris (2012) examined the perception of Greek auditors who put relevance in fourth place but ranking faithful representation to be the most important QC.

FASB (2008, pp. CON2-1) states that "the characteristics of information that make it a desirable commodity can be viewed as a hierarchy of qualities, with usefulness for decision making of most importance". Our findings of understandability ranking on the top by investment and lending decision-makers in terms of decision usefulness viewpoint contradict 1) the IASB two-group QC classification, and 2) the notion that apparently the enhancing QC, understandability, enhances the two fundamental QCs, relevance and faithful representation. But why would understandability rank top? This plays into the environmental context of a developing economy and the corresponding financial and English language literacy, even at our respondents' educational and experience levels [8]. Smith (1996) showed that UK MBA students ranked understandability as the most important QC. Al-Ajmi (2009) observed that their mixed-group respondents identified that financial statements are difficult to understand. The early IASC framework for the preparation and presentation of financial statements (IASC, 1989) also clearly recognised QCs as essential qualities of information and that "An essential 'quality' of the information provided in financial statements is that it is readily understandable by users . . ." (IASC, 1989, para. 25). FASB (2008, pp. CON2-1) also states that information cannot be useful to decision-makers who cannot understand it, even though it may otherwise be relevant to a decision and be reliable. Further, it stated that "understandability of information is related to the characteristics of the decision-maker as well as the characteristics of the information itself and, therefore, understandability cannot be evaluated in overall terms but must be judged in relation to a specific class of decision-makers". Thus, ranking understandability as the most important QC in terms of investment and lending decision-usefulness viewpoint seems a rational and practical choice in the Sri Lankan context.

4.6 Impact of IFRS in Sri Lanka

Our final examination relates to the perceived effects of IFRS adoption in Sri Lanka. To this effect, we elicited the opinion from our questionnaire participants in relation to (1) if the QCs of useful information in annual reports improved, (2) the FRQ, (3) the usefulness of the narrative parts of annual reports, and (4) the usefulness of the financial statements. Formally, we assessed the transition strength between two reporting regimes: financial reporting before 2012 under the Sri Lanka Accounting Standards (SLASs) and the compulsory IFRS adoption in 2012.

The numbers presented in Table 10 suggest that Sri Lankan investors and lenders perceived that IFRS adoption had improved QCs and FRQ in Sri Lanka: the accumulated frequency of responses on "agree" and "strongly agree" by investors and lenders are consistently high at between 66% and 86% across all nine questions stated in the top row of Table 10. In particular, at 83% for investors and 81% for lenders, it was found that the FRQ has improved after the adoption of IFRS. In relation to individual QCs, investors stated that relevance is the most improved QC and lenders stated that both the relevance and faithful representation are the most improved QCs. However, both the investment and lending decision-makers agreed that timeliness is the least improved QCs, which given its importance, would suggest an area of focus to the disclosure enforcement arm.

Comparing the responses for the impact of IFRS on financial statements vs other narrative reports, both user groups recognised that IFRS improved the former somewhat more. This result was expected because IFRS applies to financial statements and not the other narrative non-financial signals disclosed. The Mann–Whitney statistics suggest there is no statistically significant between the responses made by investors and lenders on the impact of IFRS adoption on any of the QCs and FRQ.

Additionally, a sensitivity check was conducted removing the 41 respondents who are below the age of 25 (in 2019), given that they may not have sufficient experience to compare SLAS and IFRS, since Sri Lanka adopted IFRS in the year 2012 (at which time they would be 17 at most). There was no statistically significant difference between the mean values with and without the below 25 age respondents using the Mann–Whitney U test statistic.

Table 10.
The impact of IFRS on QCs and FRQ

		Compared to the previous SLASs, IFRS has improved . . .								
		Relevance	Faithful representation	Understandability	Timeliness	Comparability	Verifiability	Usefulness of financial statements	Usefulness of narrative reports	overall FRQ
Investors [%]		86	72	75	66	76	68	80	70	83
Lenders [%]		79	79	78	69	78	75	79	69	81
Investors	Mean	2.96	2.80	2.80	2.70	2.83	2.71	2.95	2.77	3.00
	Stdev	0.56	0.68	0.68	0.76	0.72	0.71	0.70	0.76	0.69
Lenders	Mean	2.88	2.88	2.89	2.73	2.89	2.83	2.89	2.68	2.91
	Stdev	0.70	0.64	0.72	0.76	0.65	0.70	0.72	0.80	0.77
Z (Mann–Whitney)		−1.04	−1.14	−1.43	−0.51	−0.58	−1.81	−0.78	−0.84	−1.07
p (2-tailed)		0.30	0.15	0.15	0.55	0.56	0.07	0.44	0.40	0.28

Note(s): Measurement on a 5-point Likert scale where 0 is Strongly Disagree, 1 is Disagree, 2 is Neither Agree nor Disagree, 3 is Agree, and 4 is Strongly Agree. The % of investment ($N = 214$) and lending ($N = 235$) decisions groups the two highest categories Agree and Strongly Agree

Our results concur with previous studies (Kim *et al.*, 2012; Maines and Wahlen, 2006; Schipper and Vincent, 2003), which found that financial statements prepared using IFRS offer more relevant information than the local accounting standards. In relation to the improvement of individual QCs as a measure for reporting quality, our findings concur with an individual users' perspective with Tasios and Bekiaris (2012) and Yurisandi and Puspitasari (2015). They proposed that IFRS adoption in Greece and Indonesia improved the reporting quality through improved compliance with QCs. Similarly, Bozkurt *et al.* (2013) suggested that the comprehensibility and reliability of financial statements in Turkey increased after IFRS adoption. Kythreotis (2014) showed several European Union countries that relevance increased post-adoption, while reliability remained unchanged. Agyei-Mensah (2013) studied the impact of IFRS in Ghana and concluded that IFRS had improved the reporting quality post-adoption.

5. Discussion of findings and implications of the study

The usefulness and validity of our work depend, among other things, on the quality of our questionnaire participants. We have quizzed the perceptions of 449 Sri Lankan investing and lending decision-makers. Our sample consists of practising professionals who operate in the Sri Lankan financial environment. They are expected to be well-versed with the technical terms used in the IASB Conceptual Framework and literate about annual reporting practices in Sri Lanka. Based on this expert sample, our study contributes to the financial reporting literature in three ways.

Firstly, we investigate the premise that the IASB reporting regime provides useful information to existing and potential investors and lenders. This objective lists two different decision making groups, who, based on their decision making context (1) may have different opinions about how useful the information provided is, and (2) may have different interpretations about what "useful" means, absent any clear definition. Contrary to much of the user needs literature, we develop a questionnaire that makes explicit differentiation between the investing and lending contexts, and we formalise "useful" through two concepts: useful as in "it can be used for making a decision" and adequate as in "it is sufficient or enough for making a decision making".

We find that within annual reports, both the decision-makers identified financial statements (i.e. income statement, cash flow and statement of financial position) as the most useful sections, and 80% of our respondents rate annual reports as "useful" or better (all measurements are on a balanced, quasi-symmetric 5-Point Likert scale of which "useful" and "adequate" measure the central element). However, 66% of respondents rate annual report information as "adequate" or better: annual reports are thus regarded as more useful than adequate to make investment and lending decisions. Because of this difference and the fact that both numbers are significantly different from 100%, which one would expect to obtain, these investing and lending decision-makers may access other sources of information.

Indeed, we find that investment decision-makers gave, among ten information sources, the highest average response score for stock market publications. In contrast, lending decision-makers did so for communication with company management. In addition to the above information sources, both identify annual reports and personal knowledge well ahead of the remaining seven information sources, i.e. the effect size in the difference of average scores is not due to chance. However, we find no statistical difference between the average scores within the top three information sources for lenders and investors. All studies reviewed in Section 2.1 and Table 1 do not test for statistical differences in their rankings, which does not allow us to draw definite comparative inferences. Furthermore, our results demonstrate the importance of distinguishing decision-making scenarios, as is expected by the IASB's focus on lenders and investors, by developing contextual survey questionnaires, which no other study has attempted to date.

When asked about the importance, the third proxy to "useful" meaning "of great significance or value to make a decision", the two different decision-making contexts showed a more pronounced disagreement: seven out of ten information sources had a statistically significant difference in the mean responses. We conclude that the term "useful" can be interpreted in at least three different ways – useful, adequate, and important – and users in different decision-making contexts may ascribe different valuations to each. Whichever approach is used in the user needs and value relevance literature, we suggest the perceptions are elicited from people within the same decision-making context. For the IASB, who may be interested in measuring to what degree their objective (as stated in the introduction) has been understood and implemented, may repeat our experiment globally.

Secondly, we note that a few studies [9] (Abu-Nassar and Rutherford, 1996; Abdelkarim *et al.*, 2009; Ho and Wong, 2001; Stainbank and Peebles, 2006; Tasios and Bekiaris, 2012) have discussed the usefulness of financial reports in relation to QCs and from a specific stakeholder's perspective. The IASB and many accounting textbook authors represent the QCs in a hierarchy of two fundamental QCs and four enhancing QCs. We have asked our participants what they believe is the relative importance of each of the six QCs. We find that both decision-making groups consider all QCs to be important for their respective decisions. Surprisingly they both ranked, on average, understandability as the most important QC followed by timeliness. The fundamental QCs, relevance and faithful representation ranked low. Thus, our respondents believe that no matter what the degree of relevance and faithful representation, information must be communicated understandably and timely to be useful. This observation provides different aspect of classification in terms of decision usefulness viewpoint apart from the IASB's "fundamental" and "enhancing" classification scheme, but we also must recognise that this result is to be understood in the context in which it was asked: Sri Lanka. Would more studies from developing economies uphold our findings and challenge the way elements of the Conceptual Framework are defined?

Third, we note that a few studies have discussed the factors for the impact of IFRS from a specific stakeholder's perspective. Considering the IFRS are rooted in the Conceptual Framework and the QCs, it seems natural to measure compliance with IFRS, the impact of IFRS, and FRQ directly associated with QCs. Both respondent groups agree that 1) the features of the information in annual reports that the QCs represent improved as a result of adopting IFRS in Sri Lanka in 2012, and 2) the overall reporting quality has improved in Sri Lanka post-IFRS adoption when compared under the Sri Lanka Accounting Standards (SLASs) reporting regime. While putting in good light the IASB objectives and IFRS standards, these results are perceptions of events over a longer period of time.

It thus clearly emanates to substantiate the perceptions presented here about the usefulness, adequacy and importance of QCs and the information in annual reports for context-dependent decision making through a comprehensive numeric FRQ measurement model (extending Beest and Braam's seminal work). This would allow measuring the actual contribution of individual QCs towards the FRQ of an annual report and thus allow comparisons of these reports over time and across firms and deductions of the impact of IFRS on financial reporting.

Readers should interpret our study findings under two main limitations. Importantly, our study is country-specific which limits the generalisability of our findings. On the other hand, it suggests that future research could examine the investors and lenders' decision-oriented perceived usefulness of annual reports in other countries and compare with our results. Further, we admit the general issues in survey design. In particular 5-point Likert scales, the choice of wordings of these ordinal scales [10] and issues within the scope of survey design is long survey fatigue [11].

Notes

1. See https://www.ifrs.org/about-us/who-we-are/
2. See http://www.ifrs.org/use-around-the-world/why-global-accounting-standards/
3. Aaverage of FDI as a percentage of GDP, before 5 years of adoption is 1.39% and 5-years average after the adoption of IFRS 1.08%. According to the World Investment Report, FDI – US$941 M in 2012 and US$756 M in 2019 (UNCTAD, 2020, p. 240).
4. Accounting corruption includes illegal cash payments, misallocation of assets, and other inappropriate economically driven transactions (Houqe *et al.*, 2012).
5. According to statistics of the Central Bank of Sri Lanka, Sri Lanka recorded a GDP growth rate of 6% in the year 2000, and in 2009 when the civil war ended, it was 3.5%. It increased to 9.1% by 2012, the year Sri Lanka adopted IFRS, and drastically decreased to 4.4% by 2016 and 3.5% in 2019.
6. According to Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 SBEs include: 1. Companies listed on a stock exchange. 2. Banks. 3. Insurance companies. 4. Factoring companies. 5. Finance companies. 6. Leasing companies. 7. Unit trusts. 8. Fund management companies. 9. Stockbrokers and stock dealers. 10. Stock exchanges. 11. Public corporations engaged in the sale of goods or the provision of services. 12. Non-listed companies that have; – annual turnover in excess of Rs500 million; – shareholders' equity in excess of Rs100 million; – gross assets in excess of Rs300 million; – liabilities to banks and other financial institutions in excess of Rs100 million; – staff in excess of 1,000 persons. See http://slaasmb.gov.lk/specified-business-enterprises/
7. To minimise the mode effect, we used the same questions in the same order with the same wordings in both questionnaires. Three versions of both questionnaires were designed based on participants' experience in investment, advising (both together investment decisions) or lending decisions, and these versions were in the same for each mode. The questionnaire was pre-tested before starting the survey. Respondents were not given a choice of selecting the mode of responding. To test the size of the mode effect numerically, we used the Mann-Whitney-U test to examine whether the distribution of the responses for the different items in the survey (excluding demographic data) was the same across online email and paper-based questionnaires. In conclusion, we found a low level of mode effect in responses to a small fraction of the information items in the survey.
8. Education First English Language Proficiency score shows that Sri Lanka is in the 58th place out of 88 non English speaking countries. Showing less English proficiency. See https://www.ef.co.nz/epi/regions/asia/sri-lanka/
9. These studies have been discussed in Section 2.2
10. To mitigate this problem, we informed the survey participants about the most crucial aspects and provided technical explanations about, for example, the definition of QCs.
11. We included the approximate time to complete the survey (15–20 min) in the cover letter and divided the survey into subsections using a re-freshening graphical arrangement of questions, such that long survey fatigue is minimised.

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Corresponding author
Saman Bandara can be contacted at: samanbandara93@gmail.com, samanb@kln.ac.lk