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CHAPTER 6 RESULTS OF THE RESEARCH

6.1 Introduction

A claim made by Weirich and Reinstein (1992) gives proper justice to the research undertaken in this work. "Efficient and effective accounting or auditing research is often necessary in order to determine the proper recording, classification, and disclosure of economic events" (Weirich and Reinstein 1992:4). A useful classification framework for accounting information may only be brought about as the result of effective and efficient research. This chapter reports on all three endeavours in this regard, namely, the literature survey, the analysis of financial statements and the use of the questionnaire.

6.1.1 Goal of this chapter

The goal of this chapter is to report on the findings and reasoning from the literature survey, the questionnaire and the analysis of the financial statements (balance sheet and income statement) of JSE listed companies. A discussion of each statement in the questionnaire is also conducted.

6.1.2 Layout of this chapter

In this chapter the results that were obtained from the literature survey are presented in Section 6.2. In Section 6.3 the empirical research done in this thesis is divided into two: Section 6.3.1 presents the analysis of the balance sheet and the income statement of various companies, while the results of the questionnaire are presented in Section 6.3.2. A summary concludes the chapter.

A visual representation of Chapter 6 is given in Figure 6.1.

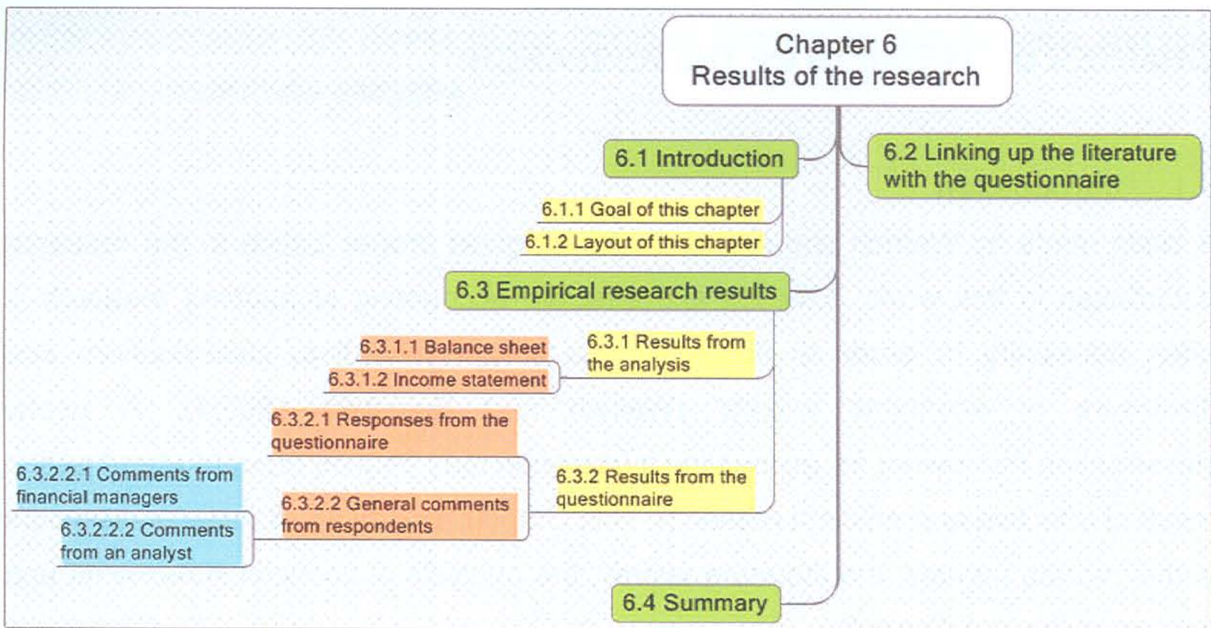

Figure 6.1 A visual representation of the layout of Chapter 6

6.2 Linking the literature to the questionnaire

The majority of the literature consulted supports the main theme of this thesis, namely, that a comprehensive classification framework for accounting information is needed. Many problems in the present classification of accounting information have been revealed over a long period. The following is a visual summary (or mind map) in two figures of the literature review and the questionnaire statements and responses, interrelated with the problem statement that supports the hypothesis of this work. It starts with the problem statement as a basis. Thereafter it links up with the literature survey which it relates to sections in the thesis. Some important quotations from authors, sections from this work and the relevant statements from the questionnaire are displayed as call-outs. The blue dotted lines show the relationships between the relevant sections of this thesis.

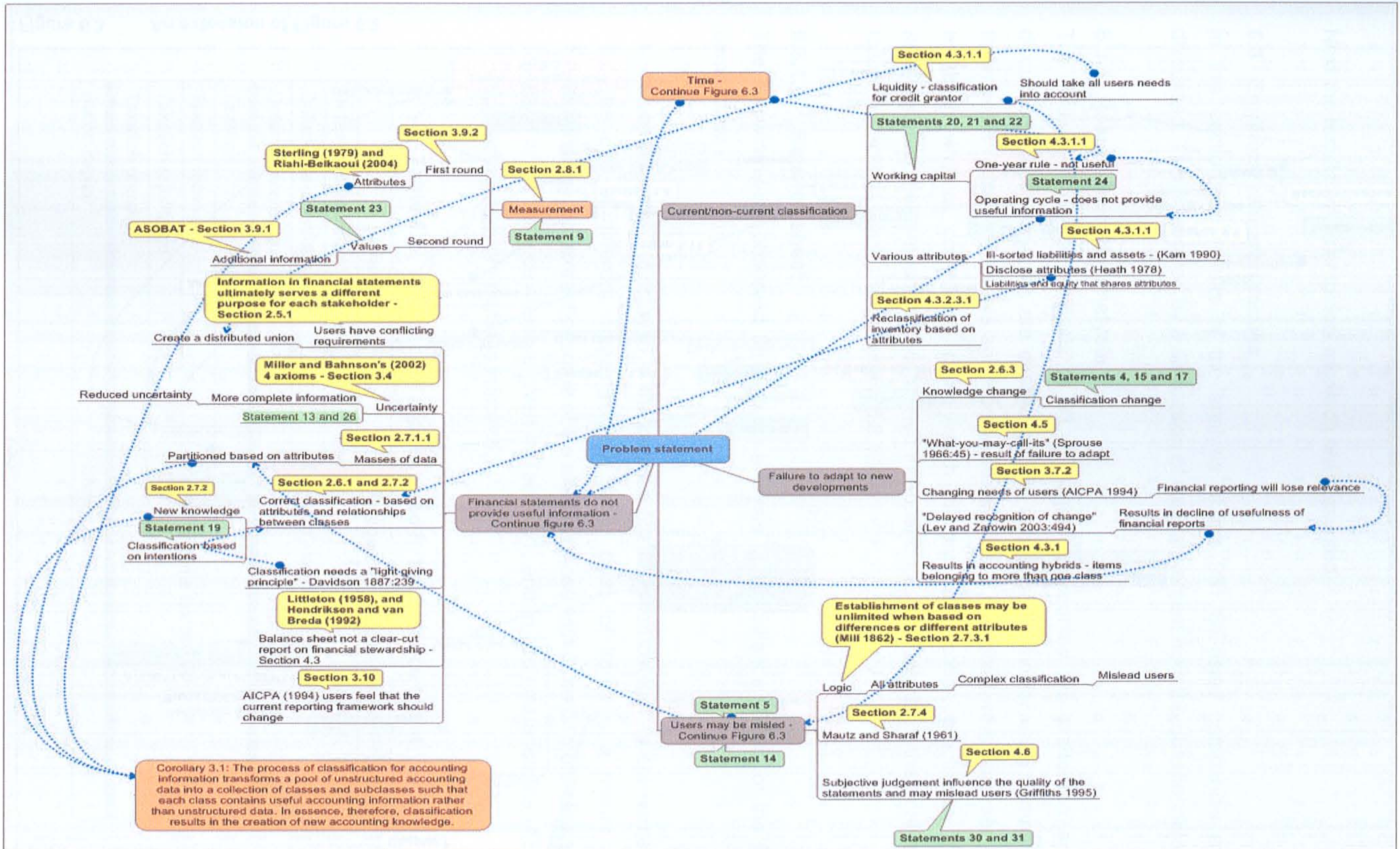

Figure 6.2 A visual presentation (mind map) of the problem statement, literature survey, questionnaire and the relationships between these

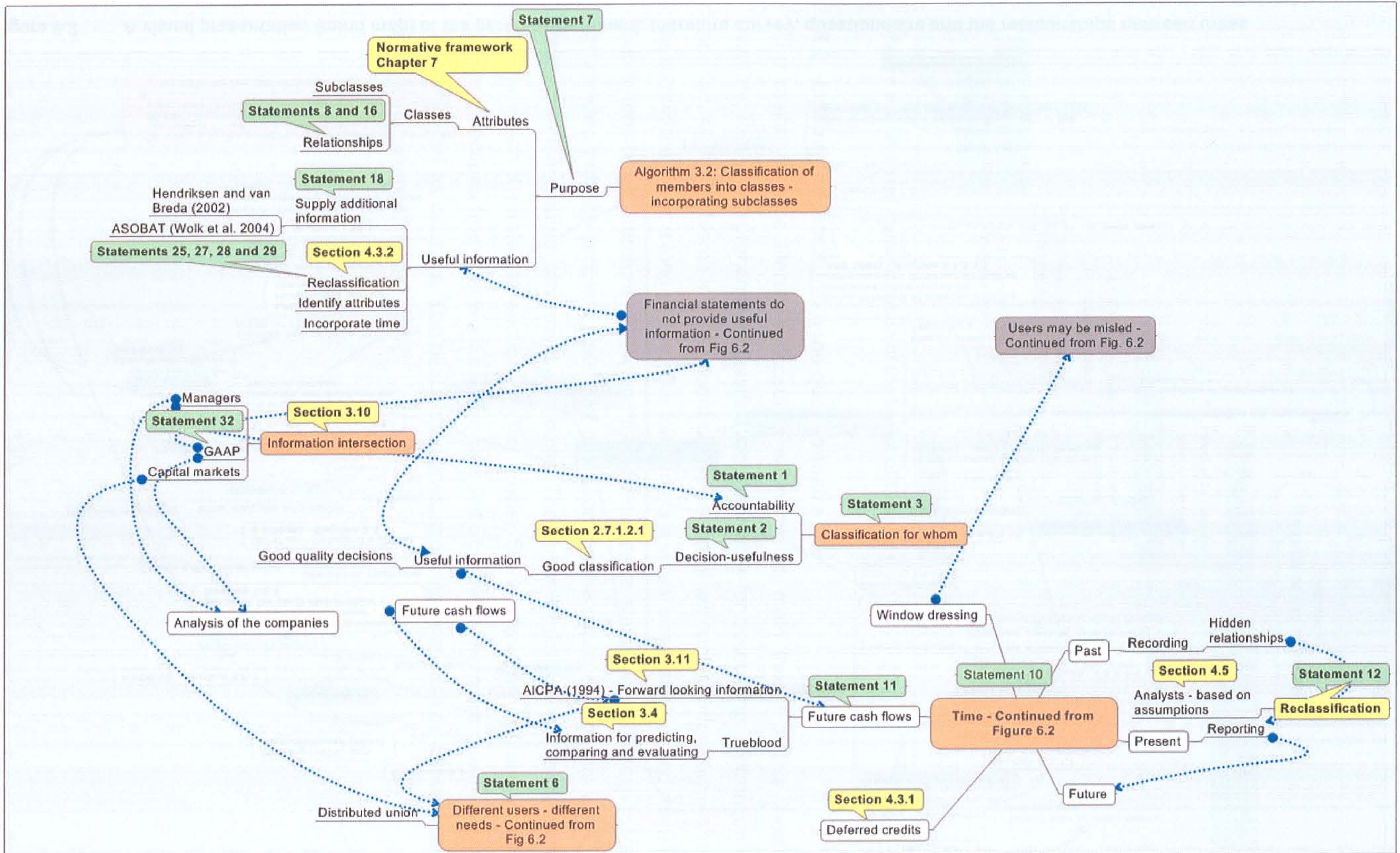

Figure 6.3 An extension of Figure 6.2

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Next the results of the empirical research are presented.

6.3 Empirical research results

In this section the results of the analysis of the 93 JSE-listed companies are discussed. This is followed by a discussion of each statement from the questionnaire.

6.3.1 Results from the analysis

The findings from the analysis of 93 JSE-listed companies are presented and discussed. The companies are divided into 28 sub-sectors, and for each company three years of balance sheets and income statements, if available, were analysed to establish whether companies comply with current classification practices. The analysis of all the companies is contained in Appendix E. The results of the analysis follow in Sections 6.3.1.1 and Section 6.3.1.2.

6.3.1.1 Balance sheet

The following were observed through an analysis of the balance sheets of the 93 companies:

1. Much diversity is displayed in the balance sheets when categories are named. The use of different names for the same class of items is a matter of terminology. An extract of some of the aliases (those with three or more aliases) used in the balance sheet is given in Table 6.1, and in each instance the IASB suggested category name is supplied.

Table 6.1 Abstract of aliases used in the balance sheet

Aliases	Suggested category name (IFRS)
Deferred taxation/tax	Deferred income tax assets
Deferred taxation/tax asset	
Deferred income tax	
Taxation	Current income tax assets
Taxation receivable	
Taxation refundable	
Taxation prepaid	
Stated capital	Share capital

Aliases	Suggested category name (IFRS)
Share capital	
Ordinary shares	
Shareholders' equity	
Ordinary share capital	
Issued capital	
Long term debt	Borrowings
Interest-bearing debt	
Long-term borrowings	
Borrowings	
Long-term liabilities	
Long-term loans	
Interest-bearing liabilities	
Interest-bearing borrowings	
Current taxation/tax	Current income tax liabilities
Current tax payable	
Current income tax liabilities	
Taxation/tax	
Taxation/tax payable	
Income tax payable	
Provision for tax	
Taxation/tax liabilities	
Taxation owing	
Receiver of revenue	
South African Revenue Services	
Current taxation liabilities	
Trade and other receivables	Trade and other receivables
Trade receivables	
Trade debtors and other receivables	
Accounts receivable	
Debtors	
Receivables and prepayments	
Receivables	
Debtors and other receivables	
Creditors	Trade and other payables
Trade and other payables	
Trade payables and provisions	

Aliases	Suggested category name (IFRS)
Accounts payable	
Accounts payables and accruals	
Payables	
Trade creditors and accruals	
Retained income/loss	Retained earnings
Retained earnings/loss	
Revenue reserves	
Accumulated losses/profit	
Accumulated loss/earnings	
Retained surplus	
Retained profit	
Retained profits and reserves	
Bank overdraft balances	Bank overdrafts
Bank loans and overdrafts	
Bank overdrafts and trade finance advances	
Bank overdrafts	
Bank overdrafts and short-term loans	
Cash and cash equivalents	Cash and cash equivalents
Deposits and cash	
Bank balances and cash	
Bank balance	
Bank balances and cash equivalents	
Bank and cash	
Cash on call, at bank and on hand	
Cash	
Cash on hand	
Cash on hand and at bank	
Bank deposits and balances	
Cash and cash deposits	
Cash at bank	
Cash balances	
Cash resources	
Deferred tax/taxation liability	Deferred income taxation liabilities
Deferred tax/taxation	
Deferred income tax	

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2. Companies sometimes change the order of items around, for instance, while deferred taxation is sometimes reflected as the first *non-current liability*, it sometimes occurs in the middle, and is sometimes given as the last item under *non-current liabilities*. Companies may have different viewpoints of liquidity, which result in different classifications. Liquidity has already been shown as a "crude ranking" by Wolk *et al.* (2004), and it was also suggested that a correct measure for liquidity is not available.
3. The only company of the 93 selected companies to adhere to FRED 32 (*non-current assets held for sale*) was Tiger Wheel and Tyre in 2005. This may be because companies are not aware of this exposure draft as yet, but may classify information in accordance with FRED 32 as soon as an accounting statement is released. Another reason could be that it was the only company that had *fixed assets held for sale.*
4. Ceramic was the only company to display *payments in advance* as a *non-current asset.* When a company makes a payment in advance it may be viewed as a *non-current asset* or even a deferred asset based on the attributes of the transaction. In this work it is argued that a payment which is made in advance should be classified as a deferred asset based on the future benefit.
5. Sabvest did not separate assets and liabilities as *current/non-current*. This is the prescribed procedure if the company considers the information provided in this way to be more relevant and reliable (Cilliers *et al.* 2004), for example, when time is not an issue in the separation. The information is, however, classified according to a liquidity ranking from fixed to liquid.
6. Network Healthcare Holdings displayed short-term borrowings, long-term borrowings and cash equivalents under the subheading: *net interest bearing debt.* This is in contrast with current classification practice where long-term borrowings are classified as *non-current liabilities*, short-term borrowings are classified as *current liabilities* and cash equivalents are classified as *current assets*. The way Network Healthcare Holdings classifies all interest-bearing debt may prove to be a useful classification, since entities with similar attributes are grouped together.
7. Capitec Bank Holdings Limited and Cadiz Holdings Limited classified all *liabilities* before *equity*, with no division between current and non-current. Standard practice is to first classify equity items, whereafter non-current

liabilities and current liabilities are classified. However, in the banking sector and financial sector, assets and liabilities should be grouped together in an order that reflects their liquidity, without a split between current and non-current items, but not all the financial sector companies adhered to this rule. Therefore, it appears that companies do not always strictly follow the practice laid down by GAAP.

8. Caxton and CTP Publishers and Printers LTD classified deferred taxation as a separate item just after minority interest. According to IAS 12 (IASB 2004), deferred taxation should be classified as equity if the tax relates to items that are credited or charged to equity in the same or different period. An instance where deferred taxation was classified as equity was when there was a change in the carrying amount of property, plant or equipment based on revaluation. This may be the reason why these two companies classified deferred taxation as part of equity.
9. Minority interest was reflected as a *non-current* asset by The House of Busby Limited. Current practice (IAS 27) is to classify minority interest as part of equity.
10. Pacific Holdings Limited classifies VAT as a separate item under *current liabilities.* This classification may be in conflict with current practice as VAT is usually classified as part of taxation.

Despite the deviations encountered with naming conventions, in general companies tend to adhere strictly to the rules and regulations prescribed by GAAP and IFRS .

6.3.1.2 Income statement

In the income statements the following deviations were detected:

1. Not all the companies divide the income statement into *continuing* and *discontinuing* activities. In accordance with IFRS 5, companies should classify operations that are discontinued separately. The possible non-compliance with IFRS 5 may be because the companies do not have discontinued operations.
2. Sappi Limited and Richemont Securities AG use the term *sales* instead of *revenue*. The use of the category *revenue* is prescribed by AC 111 and IAS 18. However, sales may be viewed as part of revenue.

3. Spectrum Shipping Limited uses the terms *gross billings* and *cost of billings* instead of following current practice, and using the terms *cost of sales* and *gross profit*.
4. There is no conformity when it comes to labelling the various items in the income statement. An extract of some of the aliases (again three or more aliases) used in the income statement is shown in Table 6.2.

Table 6.2 Abstract of aliases used in the income statement

<table>
<tr><th>Aliases</th><th>Suggested category name (IFRS)</th></tr>
<tr><td>Net revenue</td><td rowspan="5">Revenue</td></tr>
<tr><td>Gross operating revenue</td></tr>
<tr><td>Gross revenue</td></tr>
<tr><td>Revenue</td></tr>
<tr><td>Income</td></tr>
<tr><td>Gross profit/loss</td><td rowspan="4">Gross profit</td></tr>
<tr><td>Gross profit for the year</td></tr>
<tr><td>Gross turnover</td></tr>
<tr><td>Gross margin</td></tr>
<tr><td>Operating costs</td><td rowspan="3">Operating expenses</td></tr>
<tr><td>Operating expenses</td></tr>
<tr><td>Operating expenditure</td></tr>
<tr><td>Net financing costs</td><td rowspan="15">Finance costs</td></tr>
<tr><td>Net finance income/costs</td></tr>
<tr><td>Finance income</td></tr>
<tr><td>Financing costs</td></tr>
<tr><td>Finance costs</td></tr>
<tr><td>Finance expense</td></tr>
<tr><td>Net interest</td></tr>
<tr><td>Interest paid</td></tr>
<tr><td>Interest expense</td></tr>
<tr><td>Interest received</td></tr>
<tr><td>Interest income</td></tr>
<tr><td>Interest earned</td></tr>
<tr><td>Net finance charges</td></tr>
<tr><td>Finance charges</td></tr>
<tr><td>Financing activities</td></tr>
</table>

Aliases	Suggested category name (IFRS)
Profit/loss before taxation	Profit/loss before income tax
Income/loss before taxation	
Net profit/loss before taxation	
Earnings before taxation	
Operating profit before taxation	
Net income/loss before taxation	
Profit before taxation on ordinary activities	
Profit/loss before taxation and States share of profit	
Tax/taxation	Income tax expense
Income tax/taxation expense/gain	
Taxation provided	
Taxation benefit	
Taxation and States share of profit	
Taxation expense	
Profit/loss for the period	Profit/loss for the year
Profit/loss after taxation	
Profit/loss for the year	
Income/loss after taxation	
Net profit/loss for the year	
Net profit/loss	
Net profit/loss after tax/taxation	
Earnings after taxation	
Net income/loss attributable to ordinary shareholders	
Net income/loss attributable to equity shareholders	
Profit/loss for the year before dividends	
Retained profits for the year	
Net income for the year	
Net income after taxation	
Profit/loss from ordinary activities	
Profit/loss after taxation on ordinary activities	

As is the case with the balance sheet, most companies adhere strictly to the rules and regulations of IFRS and GAAP, despite the deviations encountered with naming conventions.

6.3.2 Results of the questionnaire

A total of 71 completed questionnaires were received by the cut-off date, and one was received thereafter. The distribution from the respondents could be proportioned as follows: companies – 40 responses, analysts – 8 responses and academics – 24 responses.

The other responses received have been classified in Table 6.3 below:

Table 6.3 List of responses

Response	Number of responses
Companies refrained (Not their policy to complete surveys)	11
Academics refrained (Not their subject)	5
Email bounced back (Address invalid)	40
Forwarded (No other reply received)	12
Too busy to partake	7
Financial manager of two listed companies, therefore returning only one response	8
Total	**83**

Given the feedback in Table 6.3 of 83 questionnaires not filled in plus the 72 completed questionnaires, a response rate of 155 out of a possible 507, i.e. 30.6% was achieved. A response rate of 30-35% is viewed as a good response (Walonick 2006). However, if the emails that failed to be delivered because the address was incorrect (40 in total), are not taken into account, a response rate of 22.68% was achieved.

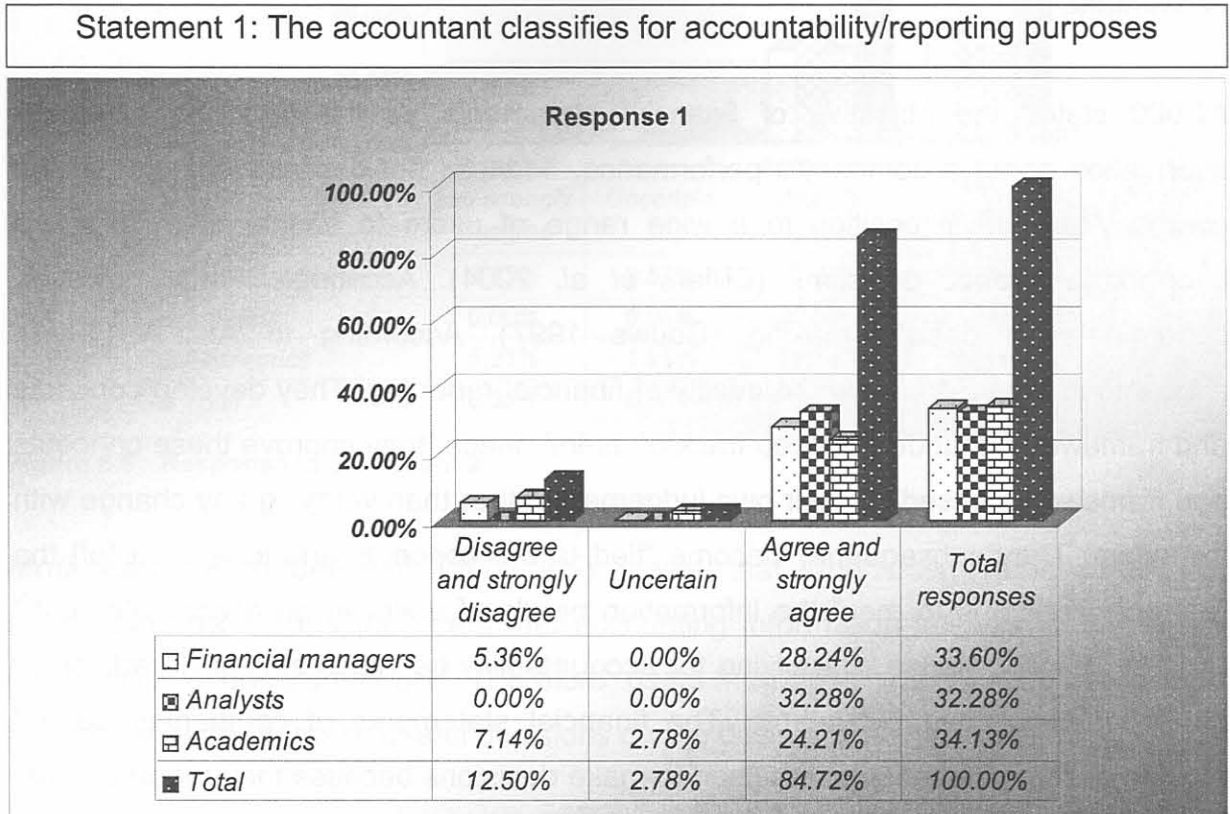
The questionnaire and the covering letter that were sent to the financial managers of the listed companies are reproduced in Appendix A and Appendix B respectively.

In the following section the responses received per statement are presented and analysed.

6.3.2.1 Responses from the questionnaire

In this section the responses received per statement are presented along the following lines: first the statement is given, followed by a histogram and an analysis of the responses. Thereafter a motivation for the statement is given and finally a discussion of the outcome is conducted. The questionnaire consisted of 32 statements.

Statement 1: The accountant classifies for accountability/reporting purposes



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	5.36%	0.00%	28.24%	33.60%
Analysts	0.00%	0.00%	32.28%	32.28%
Academics	7.14%	2.78%	24.21%	34.13%
Total	12.50%	2.78%	84.72%	100.00%

Figure 6.4 Response to Statement 1

Motivation: One of the primary objectives of corporate financial reporting is to provide information on the accountability of management (Riahi-Belkaoui 2004) and accountability is the oldest objective of accounting (Mattessich 1995:9), therefore, accountants currently classify for accountability. "It is up to the accountant to provide information about the events and leave to the user the task of fitting the events to their decision-models" (Riahi-Belkaoui 2004:365). Accountants may, therefore, follow the accountability objective and provide the information to the user to reclassify the information for their own decision-making purposes.

Discussion: The overall reaction on this question was positive, since 84% of the financial managers, 100% of the analysts and 71% of the academics agreed that an accountant classifies for accountability or reporting purposes. The response shows that the respondents agree on the historical reason for classifying, namely, accountability. The *accountability classification* was based on and influenced by the needs of the credit grantor (Esquerre 1927). Classification based on accountability is a way to close off and report on a certain stage in the past. It is practical for the accountant.

AC000 states the objective of financial statements as the provision of useful information about a company's performance, financial position and changes in the company's financial position to a wide range of users to enable them to make informed economic decisions (Cilliers *et al.* 2004). Accountability is, however, subordinate to decision-making (Gouws 1997). According to AICPA (1994), accountants rarely measure the quality of financial reporting. They develop concepts and frameworks that do not keep track of users' needs; they improve these concepts and frameworks based on their own judgement rather than verifying any change with the users. They subsequently become "tied to the concepts and lose sight [of] the real goal (which is to meet the information needs of users at an acceptable cost)" (AICPA 1994:7). Hence, classifying for accountability becomes almost a tradition or ritual performed by accountants. The financial statements of companies do not provide all the information users need to make decisions because they report on past events and do not necessarily furnish users with non-financial information (IASB 2004). It may be necessary to include additional information in the financial statements to enable users to make their own predictions and reclassifications.

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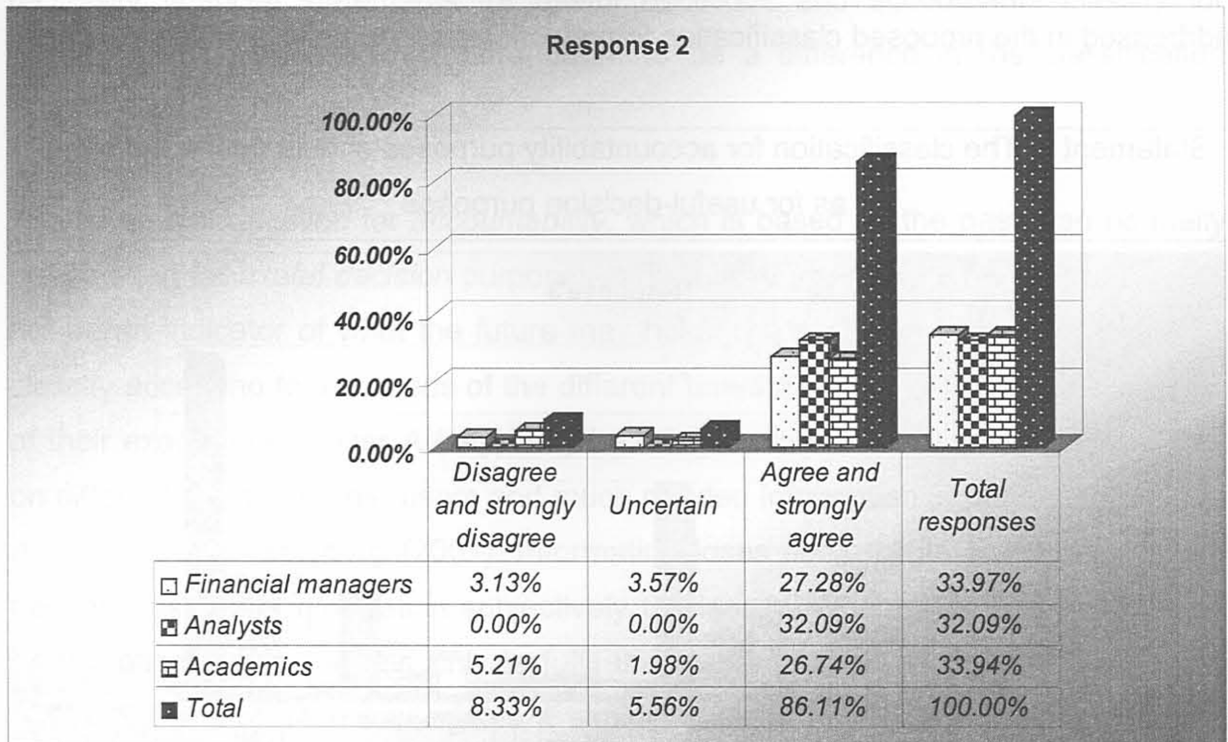
Statement 2: Analysts/users classify for useful-decision purposes



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	3.13%	3.57%	27.28%	33.97%
Analysts	0.00%	0.00%	32.09%	32.09%
Academics	5.21%	1.98%	26.74%	33.94%
Total	8.33%	5.56%	86.11%	100.00%

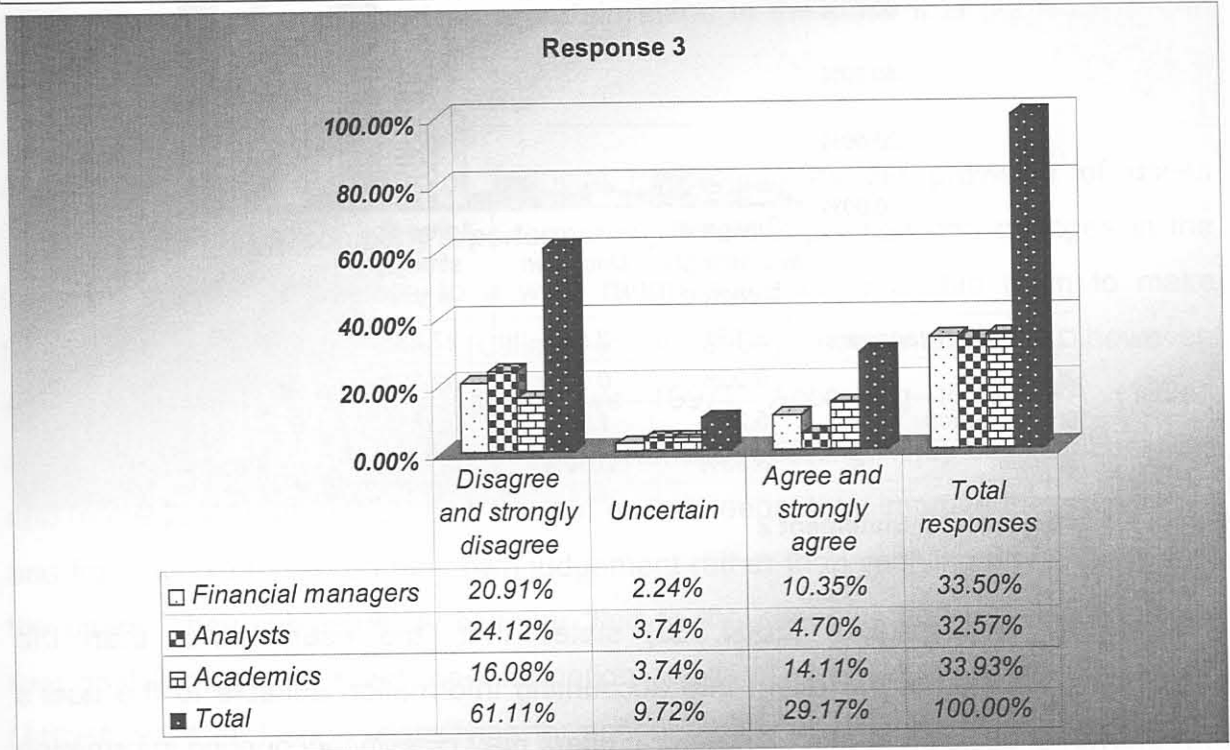
Figure 6.5 Response to Statement 2

Motivation: Riahi-Belkaoui (2004:365) states that "the user, rather than the accountant, transforms the event into accounting information suitable to the user's own individual decision model". Therefore, users may classify accounting information primarily in order to make useful decisions on the basis of this information.

Discussion: Financial managers (80%), analysts (100%) and academics (79%) agree with this statement. Referring back to AC000 (Cilliers *et al.* 2004), users need useful information for their decisions. To classify for useful decisions, the classification will have a forward-looking (future) perspective. From the responses it is apparent that accountability and useful-decision purposes are viewed by the respondents as the same idea. There are two schools of thought in accounting: 1) classification for accountability (Gray, Owen and Adams 1996) and 2) classification for useful decision-making (Miller and Bahnson 2002; Riahi-Belkaoui 2004; AICPA 1994). The objective of classification for accountability is based on the past, while for decision usefulness, it is based on the future and should, therefore, differ.

The fact that analysts and other users reclassify information (refer to Section 4.5) shows that they currently have different information needs which may need to be addressed in the proposed classification framework for accounting information.

Statement 3: The classification for accountability purposes should not be the same as for useful-decision purposes



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	20.91%	2.24%	10.35%	33.50%
Analysts	24.12%	3.74%	4.70%	32.57%
Academics	16.08%	3.74%	14.11%	33.93%
Total	61.11%	9.72%	29.17%	100.00%

Figure 6.6 Response to Statement 3

Motivation: Accountability is mainly concerned with equity among competitors and claims for the distribution of wealth and income (Williams 1987). Both these are concerned with fairness whereas decision usefulness, also called predictive ability, is not based on the same concerns (Williams 1987). As motivated in statements 1 and 2, accountability and decision usefulness may be viewed as two different objectives and this may be why analysts and other users reclassify accounting information when making decisions. These two objectives may be viewed as accountability for reporting and predictive ability for useful decisions.

Discussion: Only 31% of the financial managers, 14% of the analysts and 42% of the academics agreed with this statement. As stated before, respondents view the objective of classifying for accountability on the one hand and for useful decision-

making on the other, as being the same objective. If analysts and other users reclassify financial statements for useful decisions and accountants classify for accountability, it follows that there ought to be a difference in the classification system used.

The same classification for *accountability*, which is based on the past, can normally not be used for *useful decision* purposes in the future as well, since past events may not be an indicator of what the future may hold. The accountant will not be able to classify according to the needs of the different users as he or she may not be aware of their exact needs. User *A* (say) may be misinformed if the classification is based on different needs of other users and much needed information is withheld from user *A*, as stated by Goldberg (2001). Information loses some of its potential when an observer uses the information subjectively to classify. When classification is based on the observer, it will tend only to fulfil the needs of such an observer (Wheatley 1993). Statement 14 below makes a similar claim in this regard. Goldberg (2001) further states that the accountant may not express any judgement, since he or she may only be the observer and as far as possible should report financial facts objectively. The response to this statement also reveals that the notion of time, whether it is past (recording of a transaction aimed at accountability), present (reporting for accountability and decision-making) or future (decision-making), may need to form part of a framework for the classification of accounting information.

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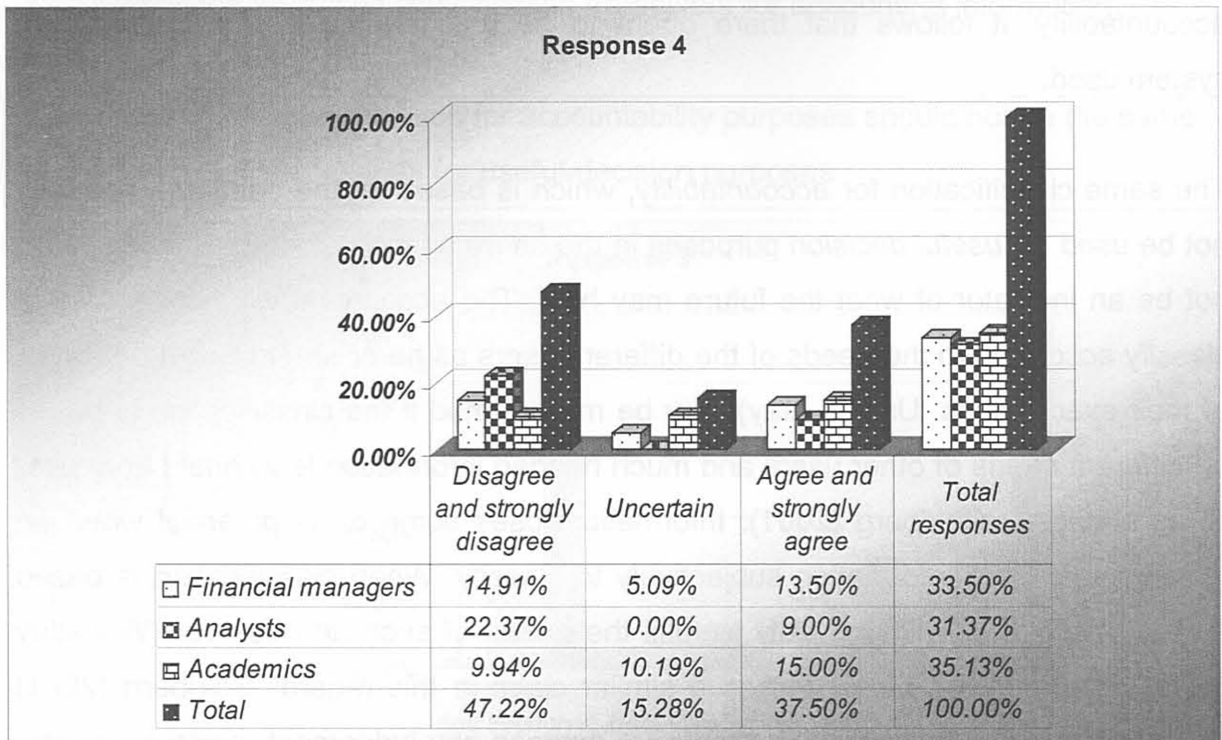
Statement 4: New types of transactions emerge continually, rendering the current classification system inadequate



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	14.91%	5.09%	13.50%	33.50%
Analysts	22.37%	0.00%	9.00%	31.37%
Academics	9.94%	10.19%	15.00%	35.13%
Total	47.22%	15.28%	37.50%	100.00%

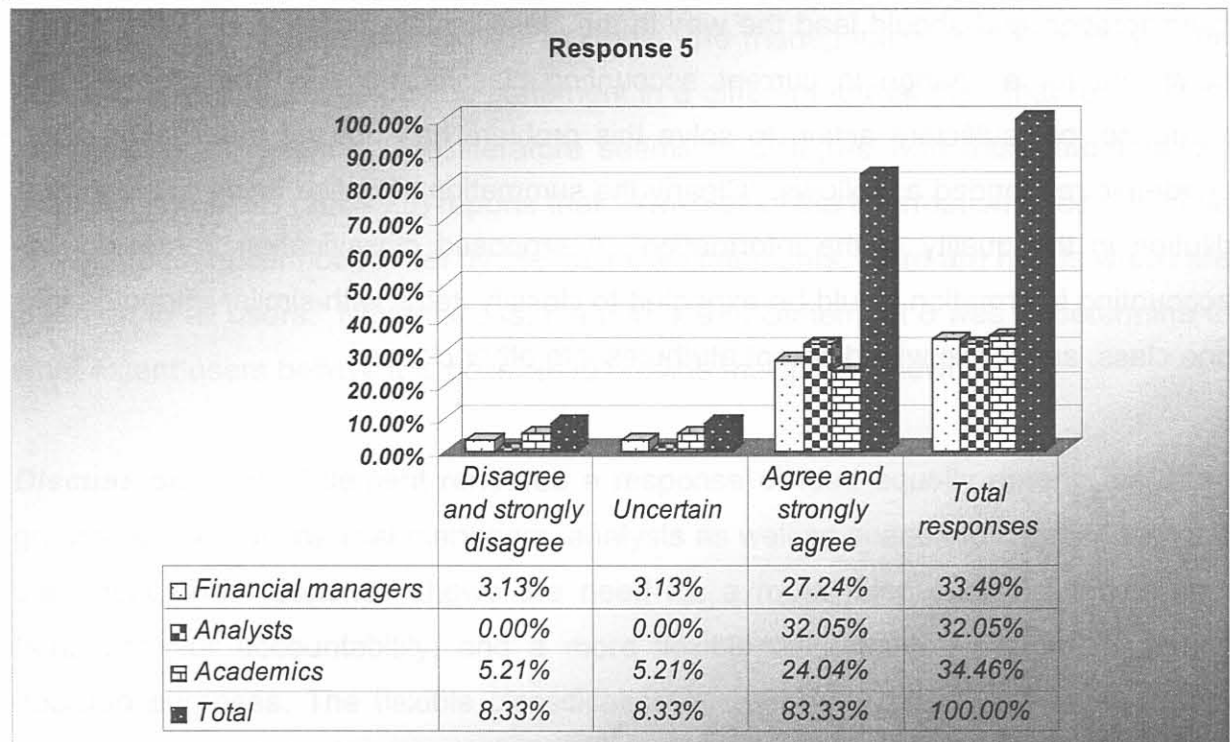
Figure 6.7 Response to Statement 4

Motivation: As argued by Wolk *et al.* (2004:318), "it is remarkable that the categoric[al] framework used to classify accounting transactions is virtually unchanged since Pacioli's time". Since the time of Pacioli, a vast number of changes have taken place in industry and new types of transactions have been developed. New types of transactions have been included in the current (old) framework, although they may have different attributes and their attributes may even overlap between two or more categories, resulting in accounting hybrids. The FASB (2003) issued FAS 150 for the "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" which is a result of new financial instruments that have been developed and need to be classified. In this regard Lev and Zarowin (2003) also state that the accounting system has a delayed recognition of change (e.g. new financial instruments), which leads to information that is less useful.

Discussion: In this instance 40% of the financial managers, 29% of the analysts and 43% of the academics agreed with the statement. The responses may be divided into

two groups, namely, those who believe that new kinds of transaction will not fit into current static structures (38%) and those who believe that the new items should be forced into an inadequate structure (47%). The classification currently in use is based on a structure provided by Wolk *et al.* (2004) (refer to Section 7.2.2), and this structure is inherently static. Structures are not flexible but systems are. It is therefore difficult to make structural changes. New kinds of transactions may introduce new attributes and relationships, and may not fit into the present classification structure (refer to Step 4 of Algorithm 3.2 in Section 3.8). Sprouse (1966:46) names some items "what you may call its" because they do not fit into just one category based on their attributes. This may be the result of new transactions being forced into an existing structure. As Einstein claimed, to solve a problem, one should start with a new way of thinking (Quotations 2006). Therefore, a proposed classification framework for accounting information may need to be flexible enough to accommodate new transactions by possibly incorporating time and also by moving beyond mere static structures.

Statement 5: Classified facts may become distorted when unlike elements are classified in the same account (Littleton 1958:45)



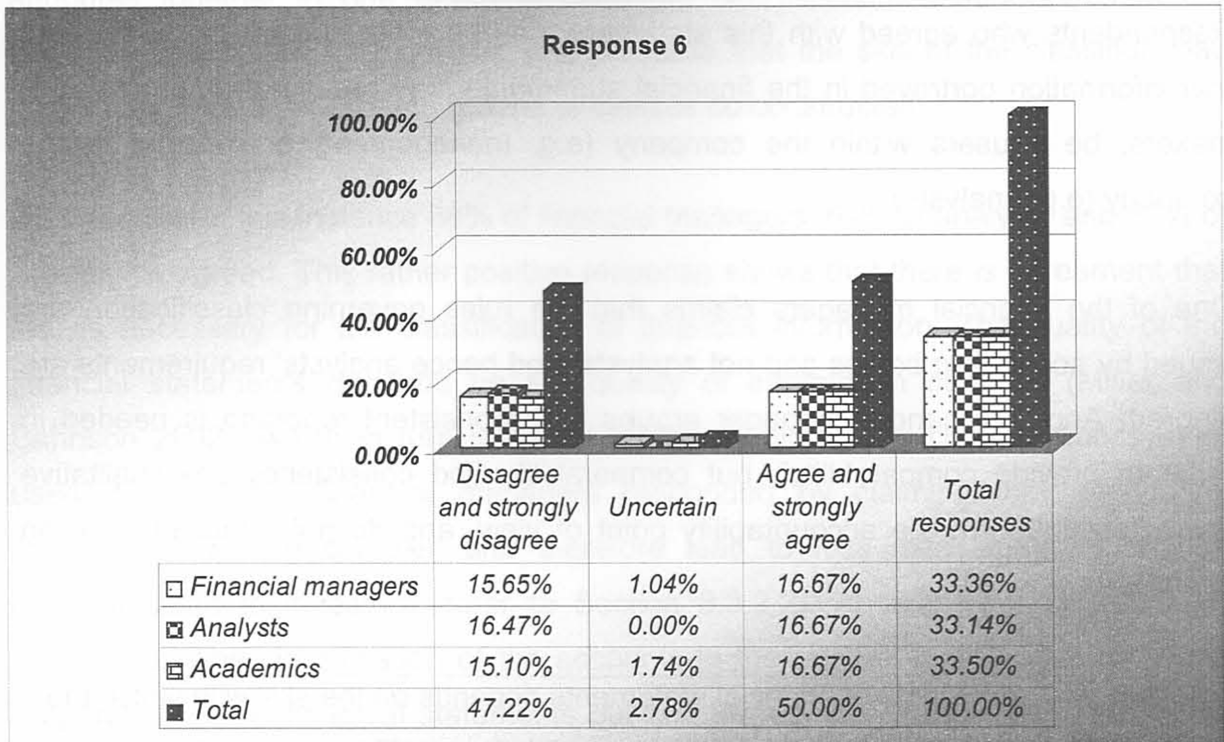
	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	3.13%	3.13%	27.24%	33.49%
Analysts	0.00%	0.00%	32.05%	32.05%
Academics	5.21%	5.21%	24.04%	34.46%
Total	8.33%	8.33%	83.33%	100.00%

Figure 6.8 Response to Statement 5

Motivation: As indicated by Littleton (1958:45), "probably no other feature of [a] system is more sensitive to transaction changes than accounts, and probably more unsuspected distortion of the classified facts comes from crowding unlike elements into the same account than from any other fault". Schroeder *et al.* (2005) explained that adding items with a different measurement basis together is much like "adding apples and oranges". Items with the same attributes may need to be classified together to provide information that is relevant and comparable, while unlike items ought to be in different classes.

Discussion: This statement rendered a very positive response, as 81% of the financial managers, 100% of the analysts and 70% of the academics agreed. AC Littleton is viewed as a "founder of [accounting's] intellectual database" as he did much for the development of Accounting thought and theory (Bedford and Ziegler 1975:435). When facts are classified together they should share the same attributes, e.g. the same valuation method. It follows that a proposed classification framework for accounting information should take into account that elements of different kinds (type) should not be grouped together. Following the proposed initial measurement (Corollary 3.2), the attributes and relationships between items should be taken into consideration and should lead the way in the classification process. A rather strong sentiment for a change in current accounting classifications is proposed by this response, but sufficient action to solve this problem has not yet been taken. One academic responded as follows: "Clearly the summation of unlike items will lead to a dilution in the quality of the information". A proposed classification framework for accounting information would be expected to classify items with similar attributes into one class, and those with different attributes into other classes.

Statement 6: A different classification system should be in place for different users



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	15.65%	1.04%	16.67%	33.36%
Analysts	16.47%	0.00%	16.67%	33.14%
Academics	15.10%	1.74%	16.67%	33.50%
Total	47.22%	2.78%	50.00%	100.00%

Figure 6.9 **Response to Statement 6**

Motivation: Users have different accounting information needs and such needs may be in conflict with one another. For example, the management of a company often needs information in the income statement in a different format than that required by the receiver of revenue. The literature seems to disagree with this statement, for example, the IASB (2004:25) reports that: "While all of the information needs of these [differing] users *cannot be met* by the financial statements, there are needs which are common to all users." Nevertheless, the purpose of Statement 6 was to determine to what extent users believe it is possible to provide multiple frameworks.

Discussion: This statement rendered a response divided equally among the three groups as 50% of financial managers, analysts as well as academics agreed with the statement. This response shows the need for a more fixed classification system (structure) for accountability, and a more flexible classification system for useful decision purposes. The flexible classification system may provide users with more information, contained in the financial statements as well as in supplementary contributions (Miller and Bahnson 2002), but reclassification will be their privilege and responsibility, since a classification system that can fulfil all the needs of all the users

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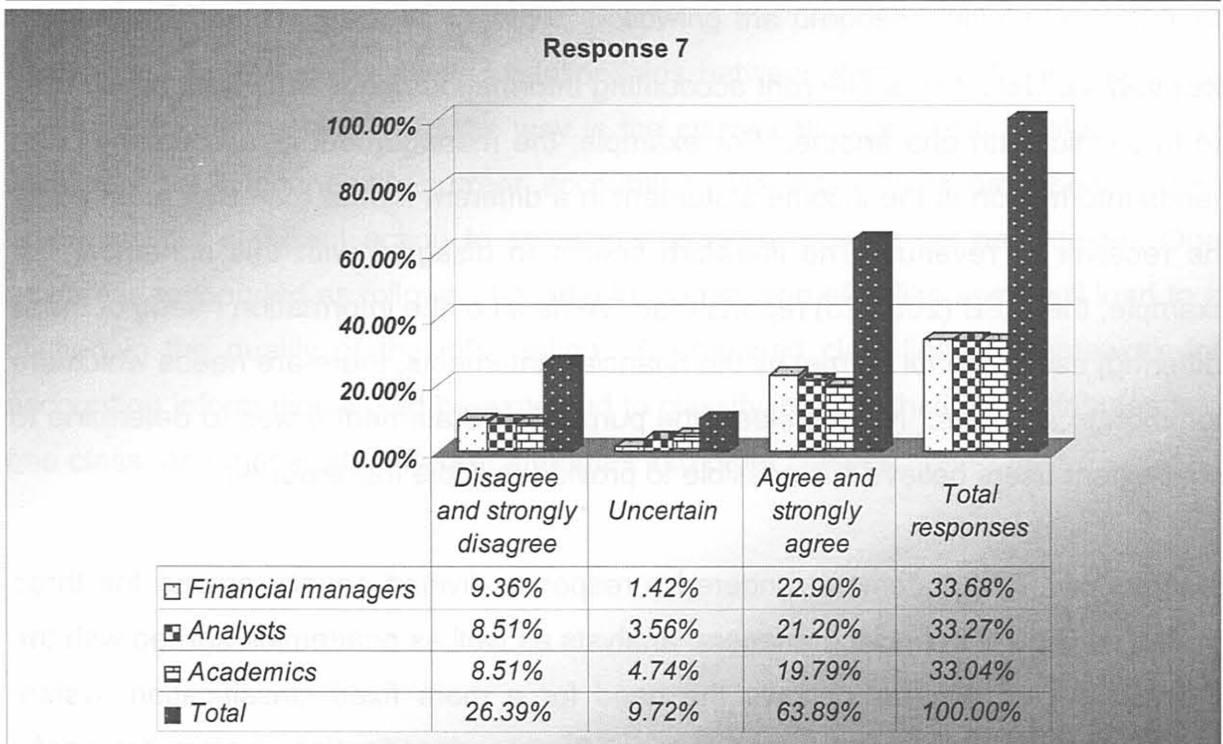
will be near to impossible (IASB 2004), because users have vastly different information needs, different backgrounds and different purposes (Goldberg 2001). Respondents who agreed with this statement may be more susceptible to the fact that information portrayed in the financial statements may be useful to all decision-makers, be it users within the company (e.g. management) or external to the company (e.g. analysts).

One of the financial managers claims that the rules governing classification are issued by accounting bodies and not analysts, and hence analysts' requirements are ignored. Another financial manager argues that "consistent reporting is needed in order to provide comparability", but comparability and consistency are qualitative characteristics from the accountability point of view, and do not relate to decision usefulness.

Statement 7: The value of financial statements depends on the skill with which the ledger accounts are arranged into groups and classes (Fitzgerald 1938a:249)



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	9.36%	1.42%	22.90%	33.68%
Analysts	8.51%	3.56%	21.20%	33.27%
Academics	8.51%	4.74%	19.79%	33.04%
Total	26.39%	9.72%	63.89%	100.00%

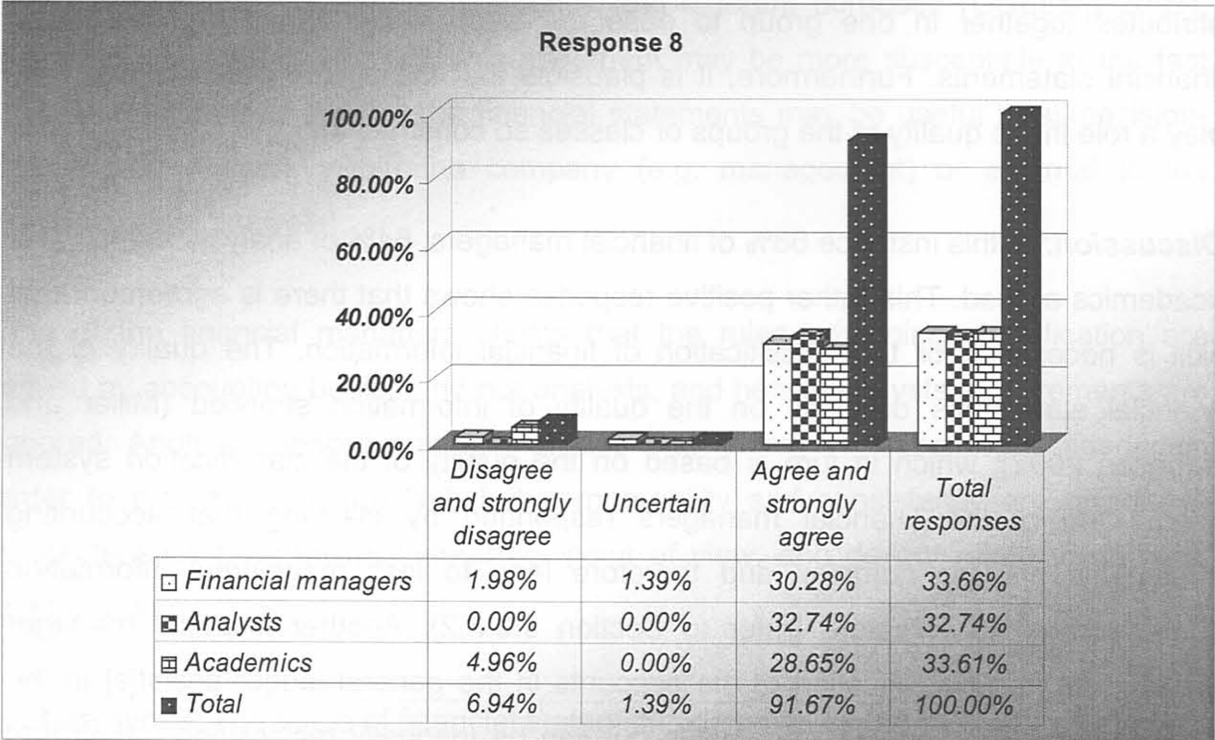
Figure 6.10 Response to Statement 7

Motivation: This question was motivated by the statement of Fitzgerald (1938a). An example of one such a class in the financial statements is assets. When a group of

ledger accounts are combined into a class, it makes sense to keep items with similar attributes together in one group to ease the classification of information in the financial statements. Furthermore, it is plausible that the skill of the classifier may play a role in the quality of the groups or classes so constructed.

Discussion: In this instance 68% of financial managers, 64% of analysts and 60% of academics agreed. This rather positive response shows that there is agreement that skill is necessary for the classification of financial information. The quality of the financial statements depends on the quality of information supplied (Miller and Bahnson 2002), which in turn is based on the quality of the classification system used. One of the financial managers responded by claiming that accounting statements are too complex and therefore lead to less meaningful information communicated to investors (refer to Section 6.3.2.2). Another financial manager argues that "the classification of the accounts in the general ledger assist[s] in the preparation of the financial statements but can be manually reclassified (albeit that this is [a] manual intervention and cost ineffective)". It is hard to conceive of classification as being cast into a fixed structure since it needs to be flexible (refer to the discussion in Statement 4 above) to incorporate new members with new attributes. The accountant of the future has to be skilfully alert to opportunities of new transactions being developed to fit them into a classification framework for accounting information.

Statement 8: Classification is a way of making meaningful relationships visible



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	1.98%	1.39%	30.28%	33.66%
Analysts	0.00%	0.00%	32.74%	32.74%
Academics	4.96%	0.00%	28.65%	33.61%
Total	6.94%	1.39%	91.67%	100.00%

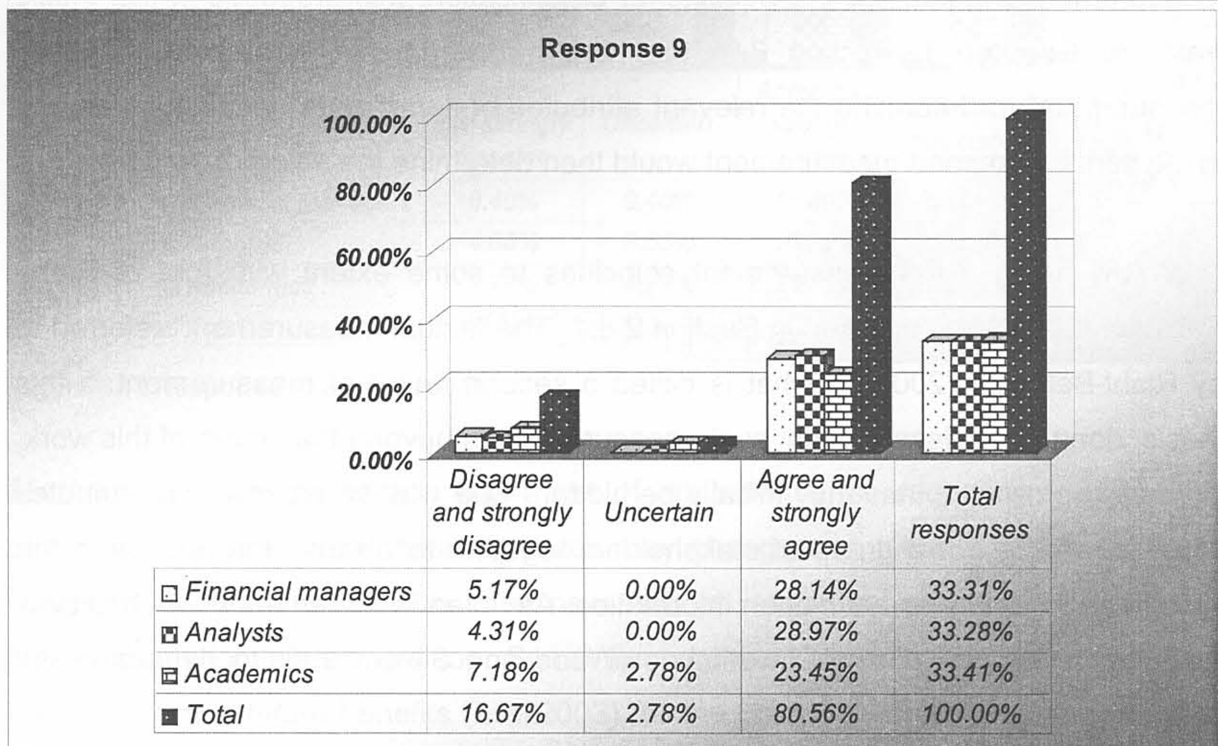
Figure 6.11 Response to Statement 8

Motivation: According to Goldberg (2001:45), classification may not provide new knowledge but "the search for relationships which it entails may lead to a recognition of otherwise unsuspected characteristics whose relationships with other occurrences or phenomena may prove of interest or value in the search for knowledge". In a way, therefore, establishing previously unknown relationships may lead to the creation of new knowledge.

Discussion: This statement is widely supported by the respondents: 90% of the financial managers, 100% of the analysts and 85% of the academics supported the statement. Relationships among the various items of the financial statements are very important when classification takes place, and respondents seem to acknowledge the importance of relationships in classification. Relationships show how the quality of information can be improved to provide more useful information for the decisions to be made by various statement users. Relationships may need to be made visible to users of financial statements. However, sometimes there are hidden (tacit) relationships (Prigogine and Stengers 1983) or hidden connections (Capra 2002), and the question is how to discover these relationships. One way to explore

hidden relationships is to get several stakeholders together in a JAD (Joint Application Development) session and to discuss various possibilities. During a JAD session a number of stakeholders come together to brainstorm a number of issues about which decisions have to be made (Wood and Silver 1995). In this instance the JAD session would be about eliciting relationships. It should be noted, however, that the presence or absence of relationships between entities depends on the attributes applicable to these entities.

Statement 9: Classification is a prerequisite for measuring



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	5.17%	0.00%	28.14%	33.31%
Analysts	4.31%	0.00%	28.97%	33.28%
Academics	7.18%	2.78%	23.45%	33.41%
Total	16.67%	2.78%	80.56%	100.00%

Figure 6.12 Response to Statement 9

Motivation: The idea behind this statement was to determine how respondents see the role of measurement with relation to classification. One may argue that a classifier first has to classify something before it can be measured. This view makes sense if one thinks of a measurement as a valuation of an item, e.g. inventory valued as LIFO, FIFO or fair value. Hence classification may be a prerequisite for measuring. There is, however, another view of this problem and this view is motivated below.

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Discussion: The positive response of 84% of the financial managers, 87% of the analysts and 70% of the academics who agreed indicate that these respondents were thinking about measurement as described above when they answered this question. Hence they are of the opinion that one has to classify before you can measure. However, items are classified according to their common attributes and, looking at the issue of measurement at a more detailed level, one may argue that, before one can classify, attributes have to be identified. This may be viewed as "measuring" or evaluating the item to determine relevant attributes. If one calls this an initial measurement (refer to Corollary 3.2), then it follows that a certain form of measurement is actually a prerequisite for classification. It is proposed in this thesis (refer to Chapter 3, Section 3.9) that two measurements be taken: an initial measurement to determine the relevant attributes of items and relationships among these items. A second measurement would then determine the value of an item.

The view of an initial measurement coincides to some extent with that of Riahi-Belkaoui (2004) as discussed in Section 2.8.1. The "actual measurement" referred to by Riahi-Belkaoui (2004) is what is called a second round of measurement in this thesis, done after classification; such measurement is beyond the scope of this work. Naturally some attributes may initially be hidden. One way to extract such attributes of an item is to get a group of stakeholders together to discuss the entities in the system and thereby reveal hidden information. As noted in Statement 8, such activity is generally known as a JAD workshop (Wood and Silver 1995) to determine the needs of users.

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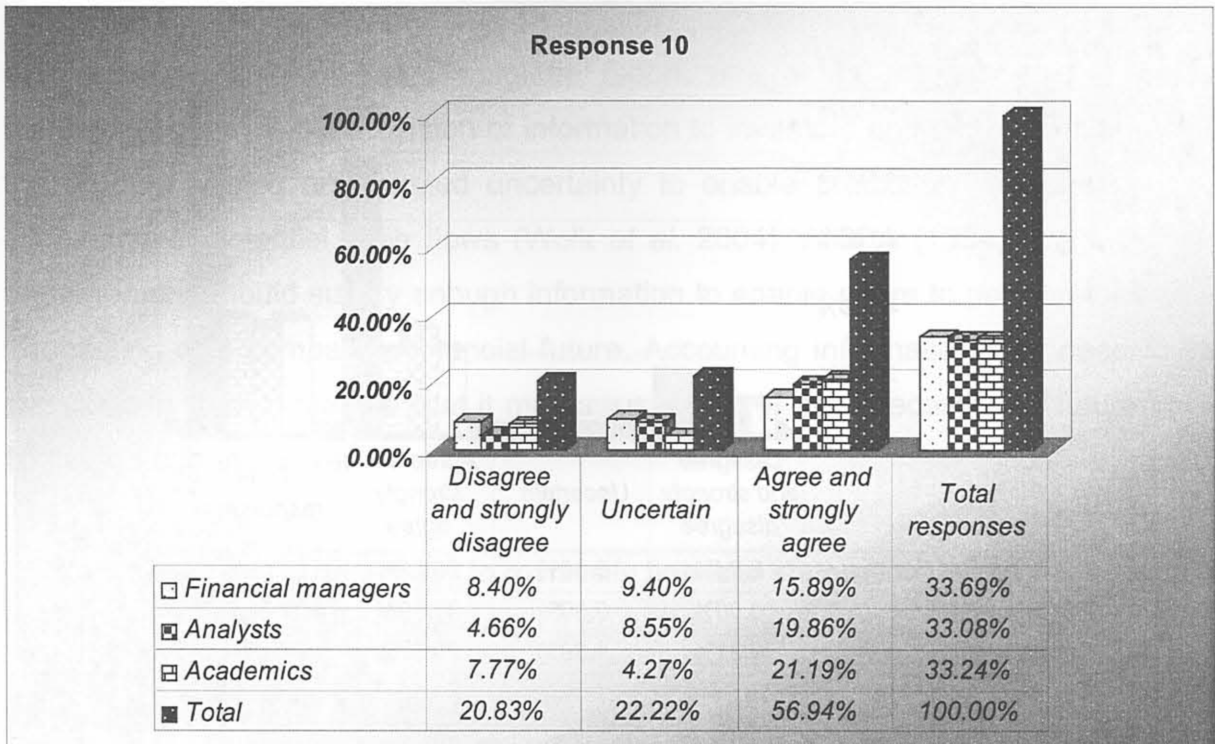
Statement 10: Past, present and future-orientated recordings must be classified separately



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	8.40%	9.40%	15.89%	33.69%
Analysts	4.66%	8.55%	19.86%	33.08%
Academics	7.77%	4.27%	21.19%	33.24%
Total	20.83%	22.22%	56.94%	100.00%

Figure 6.13 Response to Statement 10

Motivation: Each transaction has a set of attributes when recording (*past*) takes place. As time passes by these attributes may change and, when it is time to report (*present*) on this transaction, the new set of attributes may lead to a new classification for this transaction. Some transactions, for instance R&D expenses, may even have *future* benefits (Lev 2003) for the company which are not known at the time of recording but may be realised later and may lead to another classification.

Discussion: The response is mostly positive as 47% of the financial managers, 60% of the analysts and 64% of the academics agree with this statement. The financial managers seem to be more in doubt as to whether this kind of classification is necessary or not. The reason for this may be that in practice three different classifications may result from the proposal made by this statement, leading to more complex reporting structures and a possible information overload. Nevertheless, a proposed classification framework for accounting information may need to take time into account, which is the topic of Chapter 7.

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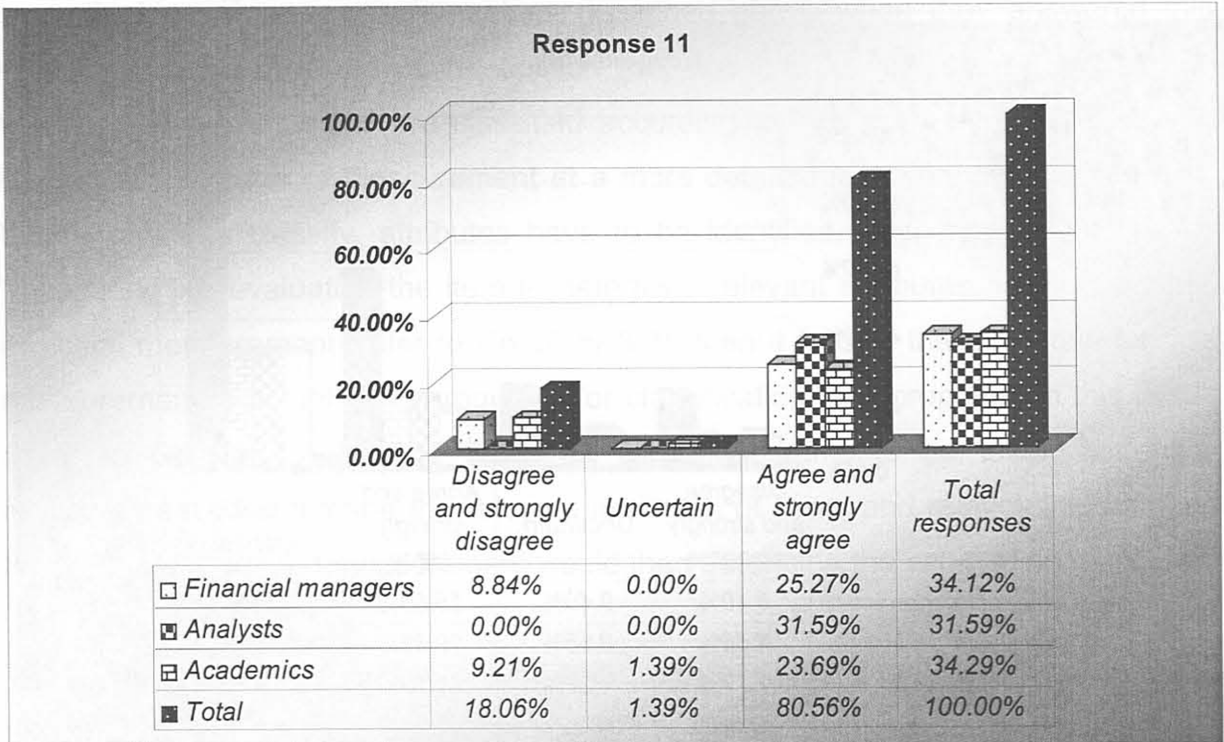
Statement 11: Accounting information should be classified in such a manner that it facilitates the forecasting of future earnings and cash flows



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	8.84%	0.00%	25.27%	34.12%
Analysts	0.00%	0.00%	31.59%	31.59%
Academics	9.21%	1.39%	23.69%	34.29%
Total	18.06%	1.39%	80.56%	100.00%

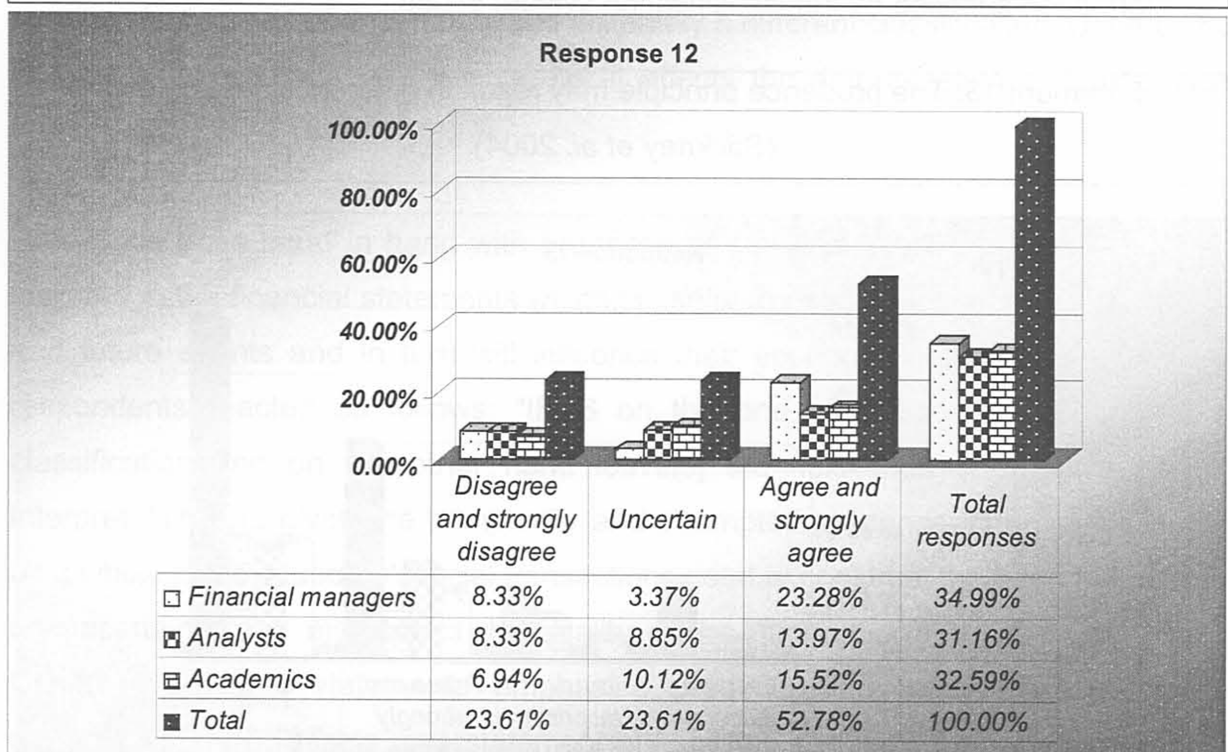
Figure 6.14 Response to Statement 11

Motivation: "Each event should be described in a manner facilitating the forecasting of the same event in a future time period given exogenous changes" (Sorter 1969:17). The Trueblood Committee (Trueblood 2004) states that the objective of financial statements should be to supply useful information for the prediction, comparison and evaluation of potential cash flows and earning power. The AICPA Committee (AICPA 1994:33) suggests that "in an ideal world, the most relevant accounting data would be those that reported assets and liabilities in a way that would allow analysts to impute the future cash flows emanating from them individually and collectively". The literature, therefore, seems to support the claim made in this statement, since it may (amongst other things) assist users in the prediction of future cash flows.

Discussion: A total of 74% of the financial managers, 100% of the analysts and 69% of the academics agreed. Analysts are concerned with a company's future earnings and cash flows hence it would be to the benefit of analysts if accounting information could be classified in such a manner that it facilitates this forecasting. Financial

managers also need information about forecasting to enable them to make decisions about the future. The information portrayed in the financial statements should be classified in such a manner that the information facilitates forecasting of future earnings. In the Trueblood Committee report, one of the objectives of financial statements given is the provision of information to investors and creditors in terms of the amount, timing and related uncertainty to enable prediction, comparison and evaluation of potential cash flows (Wolk *et al.* 2004). AICPA (1994) suggests that management should supply enough information to enable users to perform their own forecasting of a company's financial future. Accounting information may need to be classified in such a manner that it may assist users in the forecasting of future cash flows and earning power.

Statement 12: It is necessary to reclassify financial statements in order to reflect economic reality (Lev & Thiagarajan 1991)



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	8.33%	3.37%	23.28%	34.99%
Analysts	8.33%	8.85%	13.97%	31.16%
Academics	6.94%	10.12%	15.52%	32.59%
Total	23.61%	23.61%	52.78%	100.00%

Figure 6.15 Response to Statement 12

Motivation: This statement is motivated by Lev and Thiagarajan (1991). Lev and Zarowin (2003) claim that information should be reclassified over a period when, for example, a company has a restructuring exercise to enable the reflection of economic reality. Investors and other users need to make changes (reclassify)

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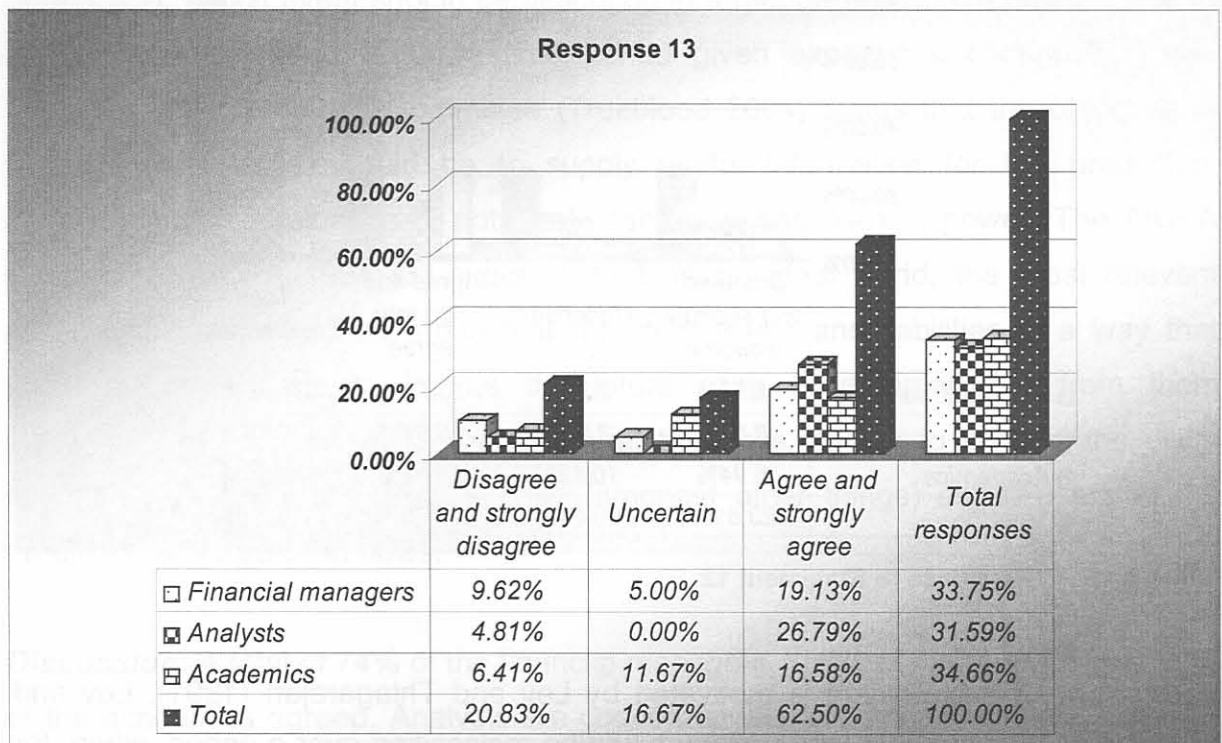
routinely to the financial statements and the information they contain to enable them to use the information for decision-making (CFA 2005). A proposed classification framework addressing the needs of those who currently have reasons to reclassify information may reduce such reclassification needs.

Discussion: Financial managers (67%) mostly agree with the statement, whereas 45% of the analysts and 48% of the academics agree. The responses show that a classification of information in financial statements, as well as a reclassification of information published in financial statements may be needed. The number of respondents that are uncertain (24%) reflect that classification is a grey area that needs to be addressed and developed further. New relationships may be revealed when reclassification takes place. Economic reality is often based on the personal perception of the user. A user needs information to create his or her own economic reality and such information should be supplied by the classification system. Reclassification may be necessary for some users and would normally be based on the information supplied by the classification system in use.

Statement 13: The prudence principle may result in different classifications (Stickney *et al.* 2004)



	Disagree and strongly disagree	Uncertain	Agree and strongly agree	Total responses
Financial managers	9.62%	5.00%	19.13%	33.75%
Analysts	4.81%	0.00%	26.79%	31.59%
Academics	6.41%	11.67%	16.58%	34.66%
Total	20.83%	16.67%	62.50%	100.00%

Figure 6.16 Response to Statement 13

Motivation: Based on the prudence principle, excessive income may be classified in the following financial year or excessive expenses may be classified in the current year (Wolk *et al.* 2004). The prudence principle or conservatism may result in different classifications since the experiences of individuals regarding uncertainty may differ.

Discussion: A total of 57% of financial managers, 85% of analysts and 48% of academics agreed. Prudence is a building block of reliability and results in statements that can be relied upon because they do not include material errors or bias (Cilliers *et al.* 2004). The prudence principle is practised where uncertainty surrounds a transaction but does not permit the formation of *hidden reserves* or *excessive provisions* (IASB 2004). Naturally, people's views of uncertainty will necessarily be different since it is based on human judgement. Therefore, the degree to which the prudence principle will be practiced varies from one person to the next, resulting in degrees of uncertainty and ultimately a different classification. Uncertainty is mostly part of the future events, i.e. it affects the determination of future cash flows.

Relevance goes hand in hand with prudence as it will only allow information to be included in the financial statements which is useful to users to evaluate past, present and future events and in turn will influence their economic decisions. One of the respondents reacted as follows: "IFRS on the one hand specifically describe[s] classification and on the other hand leave[s] the field wide open for personal interpretation and given the complexity and attempted prudence, financial reporting as a whole is 'devalued'". Artificial transactions used to construct the future are based on uncertainty and may affect the quality of the information (van der Poll 2003). Users of financial statements emphasise prudence but stress that deliberate understatement of assets, overstatement of liabilities and income smoothing should be discarded (AICPA 1994). The prudence principle may result in different classifications but should not result in understatements, overstatements and smoothing.