ACCOUNTING CLARITY THROUGH THE PROPOSED TWO COLUMN PROFIT AND LOSS ACCOUNT; A COMPARATIVE STUDY OF ACCOUNTANTS AND INVESTORS' PERCEPTIONS

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ABSTRACT

This paper titled 'accounting clarity through the proposed two column profit and loss account; a comparative study of accountants and investors' perceptions, investigates the Relevance, Understanding, Reliability, Importance and Clarity (RURIC) of the proposed Two Column Profit and Loss Account (TCPLA) among accountants and investors in Edo State of Nigeria. The survey questionnaire was employed as the study's tool to elicit information from the selected respondents. The mean scores of both units of analysis were compared using stata 9 software and the hypotheses were tested using the t-test statistics. The results showed that, both investors and accountants perceived the TCPLA to be RURIC in absolute terms, but Investors' perception is greater than those of the Accountants and showing higher support for TCPLA as an indication of improvement in the quality of accounting report with the characteristics of clarity or transparency.

Key Words: Income statement, Accounting clarity, Qualitative characteristics of income statement, Two column profit and loss account, Transparency and accountability.

INTRODUCTION

Financial accounting information is the product of corporate accounting and external reporting systems that measure and routinely disclose audited, qualitative data concerning the financial position and performance of publicly held firms. Audited income statement, balance sheets, and cash -flow statements, along with supporting disclosures, form the foundation of the firm- specific information set available to investors and regulators (Robert, M. and Abbie J. 2003). Farlex, (2010) in Okwo, I. ;Ugwunta, D. and Agu, S.(2012), defined Performance evaluation as the assessment of a manager's results, which involves, first, determining whether the money managed by manager added value by out-performing the established benchmark (performance measurement) and second, determining how the money managed achieved the calculated return. Users of accounting reports

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would like to assess the performance of a company and this is only achievable if the report is clear and transparent.

Accounting clarity is not new to the accounting literatures. The term accounting clarity is not different from transparency, full disclosure, true and fair, etc. They all mean the same thing. Clarity has been defined by the online dictionary as something with the quality of being clear and easy to perceive or understand, while accounting is the act of reporting transactions. Therefore, accounting clarity simply means reporting transactions clearly. The question is; should accountants expose the entity's privacy?

Privacy is defined by Scotter et al, (2009) as the non disclosure of relevant information. Hence, the answer to the above question can be gotten from Luco, Pacioli (1494) which states "It is always good to close the books each year, especially if you are in a partnership with others. Frequent accounting makes for long friendship". In addition, Mueller, (1968, 95) puts it "In society, accounting performs a service function. This function is put in jeopardy unless accounting remains, above all, practically useful. Thus, it must respond to the ever-changing needs of society and must reflect the social, political, legal, and economic conditions within which it operates. Its meaningfulness depends on its ability to mirror these conditions. " With these in mind, accountants should know now that a clear and concise stitch in time will save nine.

In an era of threat to the profession resulting from the various collapses experienced since the early 2000s, the public's confidence in the profession shaken. Investors, analysts, even accountants themselves, have advocated for calls for change and improvements in the mode of accounting reports.

Obasi R. and Ekwueme C. (2011a) proposed a Two Column Profit and Loss Account (TCPLA) in place of the Traditional Income Statement (TIS) with the view that it would provide a better way of preparing and understanding the accountants report. This study, investigates the opinions of users (investors) of financial statement as against those of the preparers (Accountants) as it relates to TCPLA's relevancy, reliability, adequacy, importance and clarity. This is important because, for any accounting principles to be generally accepted and recognized as a standard, it must pass through the users / preparers test of relevance, reliability etc. Thus, the main objective of this study is to compare the opinions of investors to those of accountants concerning the relevance, reliability, importance, adequacy and clarity of TCPLA. The following questions will investors and accountants both equally perceive TCPLA as relevant, reliable, adequate, important and clear or would their perceptions be different?

The result of this study is relevant to researchers in the accounting field of study. It also will add to the vast literatures on accounting theory and concept. A concept is generally accepted if it passes the test of relevance, adequacy, reliability, clarity, etc. This study is centered on two key users of

the income statement (ie the preparers and the investors) to help test the acceptability of the TCPLA. Hence, the findings are of importance to accounting professionals.

Regulators and standard setters need this sort of study to assess the opinions of key groups that apply and rely on their standards. A theoretical concept aids the formulation of a standard; as a result, this study's findings will enable standard setters to know the kinds of adjustments the public expect in the respective standards.

In formulating the hypotheses, the researcher expects that accountants will be more knowledgeable in this area of study; hence, they will show more understanding of the phenomenon under study. The mean of their perception in every question item will be higher than the investors' perceptions because the investor may not easily assimilate the report. However, the accountants may perceive the report as being too explicit and this may make them find it to be impracticable or they could refer to the report as 'immaterial disclosure', thus, making their perception of the report lower than investors do. In this case, the expectation here will be that investors perceptions mean would be greater than accountants' perceptions. Based on these assumptions, the hypothesis of the study is that both the investors and accountants will both perceive TCPLA equally (H_o; $\mu_2 = \mu_1$), while the alternative hypothesis is that their perceptions would be different (H_A; $\mu_2 \neq \mu_1$).

The study finds out that, the perceptions of accountants and investors were different. Investors were found to have perceived that TCPLA is relevant, reliable, adequate, important, and it is transparent than the Accountants. This result was significant in every question item at the 5% level of significance.

LITERATURE REVIEW

Financial statements are the means of communicating to interested parties information on the resources, obligations and performances of the reporting entity or enterprise. Meaningful information can be gathered, collated and presented in different forms. Analysts believe that in the present financial statement, every line item is subject to management's discretion. Hence, users of this statement have been agitating for improved transparency, such that, on reading an annual report, they should be able to know what the business is doing and also know the key drivers.

Paul (1975) says,

The idea of a criterion of success or failure in income statement can be explained by reference to a concept that can for convenience be called the 'standard resource'. Economic activities, such as purchase and sales are also related to a standard resource. The use of money as the standard resource is so engraved in accounting that the fact that it is only one of the standard resources that may be used is generally overlooked. However, in times of price stability using money as the standard resource is generally considered satisfactory.

He went further, "if money is selected as the standard resource, a criterion of success or failure is whether over a period an enterprise has had an increase or a decrease in its holding command, over

or prospects of obtaining money. Money means success less money means failure". All he was saying can be summarized as more cash more success and less cash less success or failure. The question therefore is, does our income statement help us to know if an entity has made more cash in a period?

Paul,(1975) concludes "However, several things limit the usefulness of that income statement information; (1) The information is not as timely as possible (2) The trend of success or failure may be somewhat obscured (3) Arbitrary allocations are used that do not represent real world events or conditions etc''. It is of importance to input Professor Ray's suggestion "… technological needs for improved plant are a main cause of investment, and that in cases where such needs are not predominant, the sales outlook rather than profit is what counts. Large firms may be less influenced by a wish to maximize profits than we formerly supposed; and that, even if business want to invest more, their cash position puts a ceiling on their programmes".

The emphasis on cash should be of note. This still reminds us of those questions again; can our present income statement at first glance tell us the success of a company for a period? Can the statement be used over the years to know if an entity is 'on top of the tree'? (Obasi and Ekwueme, 2011a) have proposed answers to such questions. They proposed an income statement with the quality of accounting clarity, known as Two Column Profit and Loss Account (TCPLA).

Two Column Profit and Loss Account (TCPLA)

The profit and loss account is one of the accounts reported in the entity's financial statement. It communicates the financial performance of the entity to users of the financial statement. It comprises of revenues, costs, gains, expenses etc. the product of an income statement (herein referred to as profit and loss account) is the net profit. This net profit is usually interpreted as the inflow generated from the trade or business. That is, it reflects the level of financial increase of an entity; if an account of this sort is available, why TCPLA?

In Obasi and Ekwueme, (2011a), the researchers observed that the traditional income statement (ie, profit and loss) is obscure and the Net profit does not reflect the true financial increase in the entity. They carried out a study to examine why most profitable companies' reports are cashless and mere book profit. They find that, the cause of the cashless profit is credit profits. Credit transactions that resulted in credit profits swell up the Net profit. By implication, the company makes profit in paper but cannot meet its obligations without eroding its foundation (capital); constant erosion of capital could result to un-informed liquidation. As a result, they proposed the Two Column Profit and Loss Account (TCPLA), which will enable the company and the users of its financial statement monitor the company's performance effectively (see appendix for a format).

The TCPLA is an income statement that reflects profit by showing the profit attributable to cash as well as differed profit (credit profit). The implication of this type of income statement is that it enables every user to know the real financial capacity of the entity as well as what to expect in the future which is subject to probability. Tax authority can now assess the entity based on its

disposable income (cash profit) since the in-disposable income (credit profit) is been separated. Dividend will be subject to disposable income and real expansion of business can be achieved considering the capacity of the disposable income.

Related Works

PriceWaterhouse Cooper (PWC) (2007) carried out a study on "corporate reporting: is it what investment professionals expect?" This study looked at the information that companies provide, and ascertained whether investors and analysts have the information that they need to assess gap between the importance investors attach to key information and the adequacy of the information they received. Top-level observation includes; GAAP remains the bedrock for financial analysis. Participants expressed an overriding need to be able to understand the underling operating performance of companies. A number of the areas in which investors and analyst commonly want better information, such as revenue recognition and segment reporting, can be remedied through better disclosure with little or no change to the existing accounting framework. In addition, Obasi and Ekwueme (2011b) sort to find out investors' perceptions on the relevance of credit transactions disclosures in income statement. They discovered that investors are agitating for change to the traditional income statement (here after known as TIS) and they preferred the TCPLA to the TIS.

Edwards, (1975) suggests, "Accounting income should be portioned into current operating income and holding gains. In addition, many accounting researchers have requested for the expansion of conventional accounting disclosures to accommodate the public groups rather than the usual general public. Bedford (1973) proposed an expanded disclosure based on the notion of fairness. Lev (1988), argued that progress in addressing the fundamental accounting issue can be achieved by including the explicit concern of policy makers – equity of the capital market. This is very relevant in this modern business era of globalisation, because globalisation is successful today because of the various capital markets. The capital market plays a key role in the compliance principles of various listed entities. Freedman, (2007) suggested that ''clarity of the relationship between the rules and improved accounting disclosure requirements might be achieved with less distortion to either tax or financial accounting. Gaa, (1986) reported that full disclosure is user primacy. Scotter, et al (2009) as the release of relevant information, has defined disclosure. They referred to the non-disclosure of relevant information as privacy. If privacy means the state of being alone and not watched or disturbed by other people or a state of being free from the attention of the public -Oxford Advance Learner's Dictionary (2006) then we all agrees that privacy has no business in business report.

Deegan G. and Undertown (2006 329) explained the stewardship approach to financial reporting theory as the major factor which supports the cash based method of valuation. It may be argued, however, that if it is objectivity that the accountant is seeking, he should restrict himself purely to counting cash, since this asset is virtually the only one in respect of which complete objectivity is possible. As soon as the accountant moves away from cash, he is dealing with subjectivity factors.

Well, this is a statement of fact but what about when the accountant combines cash as well as 'moves away' from cash? In life, we have seen that combinations are always better than single. As it is usually said, "two good heads are better than one". Although, they conclude with "the usefulness and relevance of the information provided in financial reports lies in the effectiveness with which it allows the investor to formulate valuations with some degree of accuracy".

METHODOLOGY

To test the difference in means, this study used five variables with the qualities of accounting clarity. The basic source of data is the data profiled from the surveyed questionnaire sent to accountants and investors. Two different questionnaires were designed for the two groups but the same facts were captured. The variables of interest are; understanding, relevance, importance, reliable and greater clarity. The questionnaires were structured to be able to elicit respondents' perceptions of the phenomenon under study to a significant level of accuracy.

The survey of enlightened investors and accountants (mostly chartered accountants) in Edo State was carried out through field work questionnaire administration. Research assistants were employed to assist in this venture. The estimated total number of investors from the various localities could not be ascertained directly but the population of the localities was ascertained from the National Population Commission's report (NPC), (2006). The number of investors was then estimated considering the locality's level of exposure, development and sources of income. Therefore, the first three regions were based on 20% of the NPC population figure and Edo (Benin) was based on 30%. The population and estimated population of investors are presented below in table 3.1. The population of accountants in the state was gathered from the various district societies database as shown on table 3.2 below. The Yaro Yamane's formula was adopted to determine the sample size of the investors because of the large number. It resulted to 400 investors and 340 accountants and these formed the sample size of the study. The investors and accountants were clustered in four main localities of Edo State and proportional allocation technique was used to ensure that members were represented in the proportion of their locality's population. Estimated sample sizes of both units of analysis are shown in table 3.3 below.

The sample size of the accountants remained the same as the population. The reason is, to ensure an equal or near equal number of size between both units of analysis. Four hundred questionnaires were distributed to investors while three hundred and forty were distributed to accountants. The response rate was seventy-four percent and sixty-five percent respectively. These represent two hundred and ninety-four and two hundred and twenty respectively. Variables measured were scaled as shown on table 3.4 below.

To ensure content validity of the instrument for data collection, the survey questions were developed based on a careful review of related researches as well as the correction and suggestions

of colleagues were sorted to ensure that the questions are capable of eliciting responses that are necessary for the study.

The data collected was analyzed using the stata 9 statistical software package. The mean scores of the responses were reported as an acceptable descriptive statistical analysis measure in order to facilitate computations necessary for conclusions to be expressed. The opinion mean for each of the question items of investors were compared with those of the accountants. The t – test statistics was employed to test the hypothesis, using the t – test denoted as:

$$T = \frac{\overline{x}_2 - \overline{x}_1}{\sqrt{\dfrac{S_1}{N_1} + \dfrac{S_2}{N_2}}}$$

Where;

$\overline{x}_2$	=	mean of investors opinions
$\overline{x}_1$	=	mean of accountants opinions
S_2	=	standard deviation of investors
S_1	=	standard deviation of accountants
N_1 & N_2 =		no of respondents
α		=level of significance.

5% level of significance was used and the degree of free is $(n_1 + n_2 - 2)$. The two-tailed t- distribution's acceptance region is ± 1.960. The decision rule is to reject the H_o and accept the H_a if $(t < -t\alpha/2, n-1; t > t\alpha/2, n-1; /t/ > t\alpha/2, n-1)$.

DATA ANALYSIS AND RESULTS

Four hundred questionnaires were distributed to the investors while three hundred and forty were distributed to the accountants. Fifty-seven out of the four hundred sent to the investors were disqualified on the basis that the respondents were not investors and forty-nine were not returned by the investors. The remaining two hundred and ninety-four respondents constituted the data used for our investors' analysis. Two hundred and twenty out of the three hundred and forty sent to accountants constituted the data used for our accountants' analysis. Those they were administered to did not return the one hundred and twenty questionnaires. The following tables 4.1 and 4.2 represent the response rate, the means and standard deviations of the responses for the various question items.

The response rates from both respondents are adequate for this study. That is they are 2/3 compliant or at best they are more than fifty percent represented (see table 4.1 below).

The perceptions mean of the accountants are greater than those of the investors; while their standard deviations are close except for the variable 'understand' whose standard deviation is 1.000569 compared to 0.9419706 of that of investors. This signifies that the distance between investors who chose that they understand TCPLA are closer than those of the accountants. The mean scores comparison and analysis has shown that accountants believe more on TCPLA. Since the difference in their means are not large, the need to test for statistical significance. The t- test

statistic was employed to test the hypotheses as well as determine the probability of taking a wrong decision based on the 5% level of significance.

Discussion of Results

The standard deviation of both respondents can be said to be equal hence the variance was assumed equal. The result of the t – test conducted as shown in tables 4.3 – 4.7 respectively (see appendices below), showed that accountants understand the TCPLA and they perceived it to be relevant, reliable, important and clear as well as the investors.

- The test results have shown that, all the variables are statistically significant at P (diff 0> 0.0003< 0.05) for understanding. While, P (diff 0> 0.00001 < 0.05) for relevance, reliable, important and clarity.

- The result of our analysis showed differences of 2.9, 6.2, 5.9, 5.9 and 4.7 between accountants' perceptions and investors' perceptions. This simply means that for every ten investors that understand TCPLA, thirteen Accountants accept to understand it. Where ten investors perceived TCPLA to be clear, fifteen Accountants admit that TCPLA is clear. Sixteen Accountants perceived TCPLA to be relevant reliable and important for every ten investors who perceived TCPLA to be relevant, reliable and important.

- The t- test statistic reports that the H_o is true. Since, (t < tα/2,n-1) in every question item. This implies that, the Ha is not true, which states that the parameter for both groups are equal. This means that, both units analyzed are in support of TCPLA.

This result has shown that both investors and accountant understand TCPLA easily while, one less of the accountants think that TCPLA is not so clear as compared to their perception on Relevance, Reliability and Importance. These findings are consistent with PWC (2007) report clearly showed that investors are agitating for clarity in financial statement. They reported that "there's probably a growing need for something understandable and standardized by way of earnings concepts – to rescue earnings from oblivion; Australians attributed a successful reporting model to be that with the ability to communicate succinctly to a broad audience. Earnings numbers are an important building block of that communication". For preparers and users to both significantly agree that TCPLA is clear and relevant, makes this study consistent with the PWC (2007, P 11). In addition, the result of Edwards, (1975) who suggested that accounting income be partitioned into current operating income and holding gains supports the finding of this study.

CONCLUSION

This study "Accounting Clarity via TCPLA; Analysis of accountants and investors opinions" centred on ascertaining the RURIC-(Relevance, Understand-ability, Reliability, Importance, and Clarity) of the proposed TCPLA by surveying two hundred and ninety-four users and two hundred and twenty preparers of the income statement. The purpose of the study was to satisfy the test criteria of any accounting concept that is required to be generally accepted as a standard.

The result has shown that, no hypothetical error type has been committed. This is because; the findings are very true with expectations and observations. The results show that the perception mean of the accountants and those of investors are equal in absolute term.

Recommendations and Policy Implications

Based on the above findings, as well as other findings, which are consistent with this study, the following recommendations are suggested;

- There is the need for Standard Setting Bodies to analyze the proposed TCPLA or TCIS (Two Column Income Statement) in the light of rendering quality and transparent reports to users of accounting reports. They should incorporate the disclosure of credit transactions in the income statement. This will increase accounting information credibility.

- The TCPLA should be brought into the classrooms for academics and students benefits. This will enhance the frontiers of accounting theory.

- Tax authorities should adjust the accounting profits taking into cognisance the effects of credit transactions on such profits. This will enable the authorities compute the relevant and real tax of the entity. This definitely will result in the reduction of tax avoidance and evasion by taxpayers.

- Directors of various entities should use the TCPLA to ascertain the disposable profit before fixing dividend for distribution. This will also ensure that the payment of dividends is not from capital.

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APPENDICES

1.   An hypothetical sample of TCPLA is shown below;

XYZ Limited Statement of Comprehensive Income for the year ended 31st Dec…………

	Credit			Cash		Total
	₦	₦	₦	₦	₦	₦
Sales/ Turnover		50,000		100,000		150,000
Less: Cost of sale						
Opening Stock	-		20,000		20,000	
Purchase	1,000		20,000		30,000	
Closing Stock	(5,000)	(5000)	(10,000)	(30,000)	(15,000)	(35,000)
Gross Profit		45,000		70,000		115,000
Less: Distribution & Selling						
Admin expenses	-	-	10,000		10,000	
	-	-	20,000	30,000	20,000	30,000
Net Profit						
		45,000		40,000		85,000

2.   POPULATION TABLES

Table-3.1. NPC Population and Estimated Investors Population of the Study.

Locality	Population	Est. Investors Population
Owan	253,686	50,000
Etsako	510,814	102,163
Esan	521,258	104,252
Edo	1,686,041	500,000
Total	**2,971,799**	**716,415**

Source: Investors Population 2010 "National Population Commission (2006). Census Report *Federal Republic of* Nigeria

official Gazette, Abuja. The Federal Government Printer, Nigeria.

Table-3.2.   Accountants Population of the Study

Locality	Population
Benin & district society	258
Auchi & district society	82
Total	**340**

Source: Accountants population 2010

Table-3.3. Sample of Investors and Accountants Studied

Locality	Total investors surveyed	Total accountants
Owan	26	24
Etsako	54	48
Esan	56	49
Edo (Benin)	264	219
Total	**400**	**340**

Source: Sample Size of the Study 2010

Table-3.4. Measurement Scale

Evaluation	Rating
Yes	2
No	1
Strongly agree	1
Agree	2
Indifferent	3
Disagree	4
Strongly Agree	5

HYPOTHESES TEST RESULTS

Table-4.1. Response Rates of investors and accountants

	Investors		Accountant	
	Administered	Received/ qualified	Administered	Received/ qualified
Owan	26	3	24	14
Etsako	54	47	48	36
Edo (Benin)	254	208	219	136
Total	400	294	340	220
Percentage %	100	74	100	65

Source: Field work, 2011

Table-4.2. Tabulation of Mean and Standard Deviation of Respondents' Responses to Variables.

Variable	Investors		Accountants	
	$\bar{X}_2$	$S\bar{O}_2$	$\bar{X}_1$	$S\bar{O}_1$
Understand	0.6598639	0.9419797	0.952381	1.000569
Relevant	0.8095238	0.9833656	1.428571	0.9050484
Reliable	0.7755102	0.976138	1.360544	0.9343325
Important	0.7755102	0.976138	1.360544	0.9343325
Clarity	0.7755102	0.976138	1.22449	0.976138

Source: Descriptive analysis 2011

Table-4.3a. Summary of T-test results between the mean of investors and accountants' perceptions of the relevance of TCPLA.

Variable	Obs	Mean	Std. Error	Std. Dev.
Investors Relevance	294	0.8095238	0.057351	0.9833656
Accountants Relevance	220	1.428571	0.0527835	0.9050484
Combined	514	1.119048	0.0409809	0.9937339
Diff		- 0.6190476	0.0409809	

H_o ; diff $= 0$ t = -7.1490   df = 512

$H_a = diff < 0$ diff! =0   diff > 0

Prob (T<t) = 0.0000 |T| > |t| = 0.0000   Prob (T > t) = 1.0000

Table-4.3b. Summary of T-test result between the mean of investors and accountants' perceptions of the understanding of TCPLA.

Variable	Obs	Mean	Std. Error	Std. Dev.
Investors understand	294	0.6598639	0.054937	0.9419796
Accountants understand	220	0.952381	0.0583543	1.000569
Combined	514	0.8061224	0.0404913	0.981861
Diff		- 0.292517	0.0801458	

H_o ; diff $= 0$ t = -3.3776   df = 512

$H_a = diff < 0$ diff! =0   diff > 0

Prob (T<t) = 0.0001 |T| > |t| = 0.0003   Prob (T > t) = 0.9999

Table-4.3c. Summary of T-test result of investors and accountants' perceptions mean of the reliability of TCPLA.

Variable	Obs	Mean	Std. Error	Std. Dev.
Investors Reliability	294	0.7755102	0.0569295	0.976138
Accountants Reliability	220	1.360544	0.0544914	0.9343325
Combined	514	1.068027	0.0411788	0.9985329
Diff		- 0.585034	0.0788053	

H_o; diff $= 0$ t = -6.8501   df = 512

$H_a = diff < 0$ diff! =0   diff > 0

Prob (T<t) = 0.0000 |T| > |t| = 0.0000   Prob (T > t) = 1.0000

Table-4.3d. Summary of T-test results between the mean of investors and accountants' perceptions of the importance of TCPLA.

Variable	Obs	Mean	Std. Error	Std. Dev.
Investors importance	294	0.755102	0.0566416	0.971202
Accountants importance	220	1.428571	0.0544914	0.9343325
Combined	514	1.119048	0.0412054	0.9991768
Diff		-0.605442	0.0785976	

H_o; diff $= 0$ $\qquad$ t = -6.8501 $\qquad$ df = 512

$H_a = diff < 0$ $\qquad$ diff! =0 $\qquad$ diff > 0

Prob (T<t) = 0.0000 $\qquad$ |T| > |t| = 0.0000 $\qquad$ Prob (T > t) = 1.0000

Table-4.3e. Summary of T-test results between the mean of investors and accountants' perceptions of the clarity of TCPLA.

Variable	Obs	Mean	Std. Error	Std. Dev.
Investors clarity	294	0.7755102	0.0569295	0.976138
Accountants clarity	220	1.22449	0.0569295	0.976136
Combined	514	1	0.0412744	1.000851
Diff		- 0.4489796	0.08051505	

H_o ; diff $= 0$ $\qquad$ t = -5.4203 $\qquad$ df = 512

$H_a = diff < 0$ $\qquad$ diff! =0 $\qquad$ diff > 0

Prob (T<t) = 0.0000 $\qquad$ |T| > |t| = 0.0000 $\qquad$ Prob (T > t) = 1.0000