

## Decision Usefulness and Financial Reporting: The General Public Perspective

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**Abstract** *The study examines how the quality of financial reports aid accounting information users (the general public) to make informed decisions. To achieve this objective, the current Staff and Higher National Diploma Students of Accountancy Department, Rufus Giwa Polytechnic Owo, Ondo State, Nigeria was used as our respondents. Data were gathered using the questionnaire. A total of 75 sets of a questionnaire were administered to the respondents with 57 of them retrieved, thus, representing a 76% response rate. The Ordinary Least Square (OLS) regression technique was employed to analyze the data gathered. From the empirical results, reliability, understandability, comparability, timeliness and verifiability of financial reports with t-statistic values of (1.309), (-0.792), (-0.357) and (-0.681) respectively were found to be insignificant for decision making by the general public. While relevance and faithful representation with t-statistic values of (2.398) and (2.004) respectively were found to be positive and statically significant for decision making by the general public. The paper therefore concludes that most of the respondents do not rely on the financial reports provided by companies as a result of not providing their information needs as stakeholders. Therefore, it was recommended that for financial reports to be more meaningful and of immense benefit to the general public there is need to make information in financial reports more reliable, understandable, comparable, timely and verifiable.*

**Key words** Financial reporting, reliability, understandability, comparability, timeliness, verifiability, relevance, faithful representation

DOI: 10.6007/IJARAFMS/v7-i4/3470

URL: <http://dx.doi.org/10.6007/IJARAFMS/v7-i4/3470>

### 1. Introduction

The principal objective of financial reporting is to provide high-quality financial reporting information vis-à-vis economic entities, primarily financial in nature, useful for economic decision making (IASB, 2008). Providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit and similar resource allocation decisions enhancing overall market efficiency. According to Beest *et al.* (2009), financial reporting quality is a broader concept that not only refers to financial information, but also to disclosures, and other non-financial information useful for decision making included in the report. Therefore, in the Exposure Draft (ED)- 'An improved Conceptual Framework for Financial Reporting' of the FASB and IAS, both the FASB and the IASB (2008) explicitly express their desirability of constructing a comprehensive measurement tool to assess the quality of financial reporting considering all dimensions of decision usefulness. Hence, this measurement tool considers all the qualitative characteristics because these characteristics determine the decision usefulness of financial reporting information.

IASB (2008) defines financial reporting quality in terms of the fundamental and enhancing qualitative characteristics underlying decision usefulness as defined in the ED. The fundamental qualitative characteristics (i.e. relevance and faithful representation) are most important and determine the content of

financial reporting information. The enhancing qualitative characteristics (i.e. understandability, comparability, variability and timeliness) can improve decision usefulness when the fundamental qualitative characteristics are established.

However, Akmai *et al.* (2012) argued that the two prominent accounting standard setting bodies, the IASB and FAS, have skewed and accorded undue relevance to the concept of decision usefulness to creditors and shareholders; thus, attributing less importance to other users of accounting information. It is on this premise that this study tends to ascertain how the quality of financial reporting aids accounting information users (the general public) to make informed decisions. For this reason we operationalize the financial reporting quality in terms of the fundamental characteristics (i.e. relevance and faithful representation) and the enhancing qualitative characteristics (i.e. understandability, comparability, reliability, verifiability and timeliness) as defined in the ED (IASB, 2008). The specific objective of this paper is to examine whether the financial reports of companies in Nigeria (based on the qualities of financial statement as identified by IASB) adequately make disclosure on specific information needed by the members of the general public taking the entire Post graduate students (2014-2015 Academic Session) of Accounting Department of University of Benin, Benin City with a view to making informed and useful decisions capable of bringing assistance to the environment within which businesses operate. To achieve this objective, a research question was raised thus; are the information reported in financial statement qualitative enough to make an informed and useful decision by members of the general public? And a hypothesis was formulated in null form to guide the study i.e. information disclosed in financial reports are not qualitative enough for members of the general public to make informed decisions. The study will hopefully contribute towards existing academic literatures on how the qualitative characteristics of financial reports aid users in making informed decisions.

## **2. Literature review**

### **2.1. Financial Reporting**

Financial reporting is the process of communicating financial information useful for making investment, credit, and other business decisions (Chiappetta *et al.*, 2009). It is about communicating both financial and non-financial information to the users of accounting information (Badloe, 2011). According to Sterling (1970), financial reporting is positioned to one of two ways: towards decision makers (the users who require the information contained in financial statements for particular decisions) or towards the decision models being used to make those decisions, for which that information constitutes the input. Users of financial reports might be able to make direct use of the information contained therein to take various informed decision or they might have to employ the services of some experts to guide them in appreciating the message contained therein and how to exploit it in taking informed decision. In any case, the beauty of financial report is its decision usefulness and, as such, it is ethical for a reporting entity to try and make it very useful to identified users, even where some adjustments to the theoretical financial statement becomes necessary (Dandago and Hassan, 2013). They assert further that the purpose of financial reporting is to provide financial information through the publishing of financial statements about the reporting entity that is useful to present and potential equity investor, lenders and other creditors in making decisions. According to the Companies and Allied Matters Act 1990 (CAMA), financial statements consist of the basic statement of account used to convey the quantitative information of financial nature about a business to shareholders, creditors and other interested in the reporting company's financial condition, result of operation uses and sources of funds. On his part, Ilaboya (2008) described financial statements as the end product of accounting transaction or economic events aimed at providing qualitative and quantitative financial information to evaluate and predict the performance of the organization to permit informed judgement and decision making. Ekwe (2013) defines financial statement as a statement that conveys to management and to interested outsiders a concise picture of the profitability and financial position of a business. The primary purpose of the financial statements is to provide information about a company in order to make better decisions for users particularly the investors (ASBJ, 2006). It should also increase the knowledge of the users and give a decision maker the capacity to predict future actions (Oyerinde, 2009). According to ASBJ (2006), the most fundamental characteristics required for accounting information in achieving this primary objectives is "decision usefulness". The usefulness of accounting

information is made of up many important rudiments. These are timeliness, reliability, relevancy, and materiality of the accounting information. Bees *et al.* (2003) pinpointed good attributes of financial statement which include among others: relevance, reliability, timeliness, comparability, comprehensiveness, understandability and verifiability. Ana (2012) classified relevance and reliability as fundamental qualities of good accounting information which could lead to effective decision making by the users.

## **2.2. Decision usefulness**

According to the Exposure Draft (ED)- 'An improved Conceptual Framework for Financial Reporting' of the FASB and IASB, providing decision-useful information is the fundamental objective of financial reporting. Decision-useful information is defined as information about the reporting entity that is useful to existing and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers (IASB, 2008). In the same vein, the FASB's Conceptual Framework states that the purpose of financial reporting is to provide information that is useful for business decisions (Concepts Statement No.1, FASB 1980, para. 34), and it considers decision usefulness the overriding criterion for judging accounting choices (Concepts Statement No.2, FASB 1980, para. 30 and 32). According to Wang (2012), decision usefulness is defined in term of relevance, reliability, comparability, and understandability. In OB2 of the IASB's conceptual framework (CF) for financial reporting of 2010, the objective of financial reporting is defined as:

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. Decisions about selling or holding such instruments are assumed to depend on the return these primary users expect from investing in them (CF OB3 &OB5). Consequently, users need information to help them assess the prospects for future net cash inflows to an entity (CF OB3). Moreover, information about a reporting entity's financial performance is judged useful in assessing the entity's future ability to generate net cash inflows by IASB (CF OB18).

Thus, financial statements provide information that should be useful in estimating the value of the reporting entity (CFOB7). However, IASB stresses (OB6) that: General purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

## **2.3. Relevance and Financial Reporting**

Relevance refers to the ability of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations (FASB, 1980). Relevance considers the fact that the information is necessary to the users in order to sustain the economic decisions (Dima, 2013). On its part, IASB (2010) regarded relevance as the capability of accounting information to making a difference in the decisions made by users in their capacity as capital providers. It asserts further that, that financial information is capable of making a difference in the decisions if it has predictive value, confirmatory value, or both. Predictive value explicitly refers to information on the firm's ability to generate future cash flows. According to IASB (2010), information about an economic phenomenon has predictive value if it has value as an input to predictive processes used by capital providers to form their own expectations about the future. On the other hand, confirmatory value contributes to the relevance of financial reporting information. Information has confirmatory value if it confirms or alters past (or present) expectations based on previous estimations.

## **2.4. Faithful Representation and Financial Reporting**

Financial reports represent economic phenomena in words and numbers. To be useful for decision making, financial information must not only represent relevant phenomena but must faithfully represent the phenomena that it purport to represent (IASB, 2010). However, to be a faithful representation,

information must be complete, neutral and free from error. To be complete, financial reports must include all information necessary for a user to understanding the phenomenon being depicted, including all necessary descriptions and explanations. To be neutral, financial reports must be without bias in the selection or presentation of financial information. This implies that financial information must not be manipulated in anyway so as to influence the decisions of users. And to be free from errors, financial reports must have no errors in the description of a phenomenon and in the process by which the financial information was produced. Therefore, financial information must be both relevant and faithfully represented if it is to be useful. Neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users make good decisions.

### **2.5. Reliability and Financial Reporting**

Reliability is defined as the quality of information that assures information is reasonably free from error and bias and faithfully represents what it purports to represent (FASB, 1980; Ashford, 2011). Since financial statements that are made public are usually been exposed to scrutiny by an independent external person who guarantees and validates the contents, it is expected that such financial statement can reasonably be relied upon (El-Maude *et al.*, 2015).

### **2.6. Understandability and Financial Reporting**

Understandability refers to the attribute that users of financial reports will perceive the significance of a reported item to their decisions (FASB, 1980). According to Beest *et al.* (2009), understandability, will increase when information is classified, characterized, and presented clearly and concisely. Understandability is referred to, when the quality of information enables users to comprehend their exact meaning (IASB, 2008). Classified and characterized information refers to how well-organized it is easier to comprehend where to search for specific information (Jonas & Blanchet, 2000).also, disclosure information, and in particular the notes to the statement of financial position and statement of profit or loss and other comprehensive income, may be appreciated in terms of explaining and providing more insight into earnings figures (Beretta and Bozzolan, 2004). Narrative explanations help to increase the understandability of information (Iu and Clowes, 2004). However, if technical jargon is inevitable, for instance industry related jargon; an explanation in a glossary may increase the understandability of the information.

### **2.7. Comparability and Financial Reporting**

Comparability refers to the quality of accounting information that enables users to identify similarities and differences between two sets of economic phenomena (IASB, 2010). Thus, similar situations should be presented the same, while different situations should be presented differently. Comparability also incorporates the quality of consistency. Hence, consistency refers to the use of the same accounting policies and procedures, either from period to period within an entity or in a particular period across entities (IASB, 2010). Comparability not only refers to the consistency of the use of accounting procedures by a single company, it also refers to comparability between different companies (IASB, 2010). When assessing the comparability of annual reports of different companies, the accounting policies used, the structure of the annual report, and the explanation of transactions and other events are of exceptional importance (Jonas & Blanchet, 2000). For accounting information to be comparable, the same accounting treatment should be applied when the substance is the same, that is, the amount, timing, and uncertainty of future cash flows of the entity is considered to be same from the viewpoint of investors' decision making, and different treatment should be applied when the substance is different (ASBJ, 2006). However, comparability does not require uniform treatment based solely on formalities nor does it deny the use of different accounting procedures depending on the situation. To prepare accounting information which is useful to decision making, the substance of the business activities and transactions (business activities) should be taken into consideration (ASBJ, 2006). A good financial statement is one that permits comparability of performance within the organization for years as well as with other similar institution from other sectors. Riley (2012), stated that it is important to provide an avenue when users can compare similar companies in the same industry and compare their performance overtime SEC (2000) observed that it is only through comparability that the confidence of investor is truly nurtured.

### **2.8. Timeliness and Financial Reporting**

Time is one important resource that should be judiciously utilized; hence, a good financial statement is one that is presented at the closest period immediately after the end of a given financial year (El-Maude et al., 2015). Timeliness connotes having information available to decision makers before it loses its capacity to influence users' decisions (IASB, 2010). It refers to the time it takes to reveal the information and is related to decision usefulness in general (IASB, 2010). According to Dima (2013), timeliness refers to the fact that if there is undue delay in reporting the information, it may lose its relevance and the management may need to choose between the relative value of the reporting at a certain time and providing reliable information.

### **2.9. Verifiability and Financial Reporting**

Verifiability helps to guarantee users that the accounting information provided accurately represent the economic phenomena they intend to describe (Dima, 2013). According to ASBJ (2006), in measuring profits, estimates may vary significantly based on the person who makes the estimates. Such profit information inevitably contains some "noise", and it is difficult for investors to fully rely on information based exclusively on estimates. In order to avoid such situation, financial reporting should be based on facts unaffected by subjective judgment of the person who makes the measurement.

### **2.10. General Purpose of Financial Statements and the Position of Secondary Users**

Members of the general public might probably not find accounting information that much interesting because from the onset, the point of reference was made to protect the investors and the creditors who are the primary users of the financial statements. Akmal *et al.* (2012) argued that the two prominent accounting standard setting bodies, the IASB and FASB, have skewed and accorded undue relevance to the concept of decision usefulness to creditors and shareholders. The general purpose financial reports are more or less skewed to investors and creditor perhaps because Statement of Financial Accounting Concepts (SFAC) No. 1 describes the objective of financial reporting. According to SFAC 1, financial reporting has the following major objectives:

Firstly, financial reporting should provide information that is useful to *present and potential investors and creditors and other users* in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sales, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.

Lastly, financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

### **2.11. Theoretical Framework**

#### *Single-Person Decision Usefulness Theory*

Single-person decision theory, which is based on the viewpoint of an individual who must make a decision under conditions of uncertainty, is the underpinning theory to this study. The theory sets out a procedure for allowing additional information to be obtained from reporting entities to revise a decision-maker's subjective assessment of the probabilities of what might have happened after a decision is made. According to El-Maud *et al.* (2015), the philosophy behind the single-person decision usefulness theory is to tilt financial reporting to a particular class for users with a view to optimally utilize all the available information capable of making informed decision. Single-person decision usefulness theory takes the view that "if we can't prepare theoretically correct financial statements, at least we can try to make financial statements more useful" (Dandago and Hassan, 2013). However, it should be appreciated that tailoring financial reports to the needs of each of the users could be easier than struggling to satisfy the needs of all the users concurrently (El-Maude *et al.*, 2015). This theory has been used by Scholars like Ijiri (1983), Cartney, (2004) etc.

### 3. Methodology of research

#### 3.1. Population and Sample

The population of the study is the entire staff and higher national diploma students of Accountancy Department Rufus Giwa polytechnic Owo, 2015/2016 Academic Session, with a total number of 92. Thus, staff 19, student 73. However, the sample size of the study was determined using Yaro Yamane (1967) formula given thus:

$$n = \frac{n}{1+N(e)^2} \quad (1)$$

Where:

n= sample size, N=population size, e= level of significance.

$$n=92/1 +92(0.05)^2$$

$$n= 92/1.23 = 74.8$$

$$n=75.$$

#### 3.2. Data and Data Source

Data were gathered using the questionnaire. And a total of 75 sets of a questionnaire were administered to the respondents and 57 (representing 76%) were retrieved.

#### 3.3. Model Specification

The model for this study is a modification of the model of EL-Maude et al (2014) who conducted a research on “The general public perception of decision usefulness approach to financial reporting: A replication from Accountancy department, MAUTECH, Yola, Nigeria”, using the model:

$$FR = \beta_0 + \beta_1UN + \beta_2CMP + \beta_3DCL + \beta_4REL + \beta_5TML + \beta_6FFL + \beta_7RVA + \mu \quad (2)$$

Where UND represents understandability of financial statement, CMP represent comparability, DCL represent social and environmental disclosure, REL represents reliability, TML represents timeliness, and RVA represents relevance, FPR represents faithful representations, REL represents reliability and  $\mu$  stands for error term.

Therefore, for the purpose of this study, the above model is model is modified thus:

$$FR = a_0 + a_1RLV + a_2FFR + a_3REL + a_4UND + a_5CMP + a_6TML + a_7VRF + \epsilon \quad (3)$$

Where: FR represent financial Reporting, RLV represents relevance, FFR represents faithful representation, REL represents reliability, UND represent understandability, CMP represent comparability, TML represents timeliness, VRF represents verifiability,  $\epsilon$  stands for error term,  $a_0$  stands for intercept and  $a_1$ - $a_7$  represent coefficients.

#### 3.4. Data Estimation Technique

The study employed the Ordinary Least Square (OLS) to analyze the data gathered.

### 4. Data Presentation and Discussion of Results

Table 1. Model Summary<sup>b</sup>

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.556 <sup>a</sup>	.310	.211	1.88518	2.002

a. Predictors: (Constant), VRF, RLV, TML, FFR, CMP, REL, UND

b. Dependent variable: FR

Table 2. ANOVA<sup>a</sup>

Model	Sum of Square	Df	Mean Square	F	Sig.
Regression	78.104	7	11.158	3.140	.00b <sup>b</sup>
1 Residual	174.141	49	3.554		
2 Total	252.246	56			

- a. Dependent variable: FR
- b. Predictors: (Constant), VRF, RLV, TML, FFR, CMP, REL, UND

Table 3. Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error			
(constant)	5.231	1.766		2.962	.005
RLV	.259	.108	.314	2.398	.020
FFR	.230	.115	.298	2.004	.051
REL	.146	.111	.194	1.309	.197
1 UND	-.120	.152	-.146	-.792	.432
CMP	-.044	.124	-.054	-.357	.723
TML	.241	.128	.266	1.889	.065
VRF	-.084	.123	-.104	-.681	.499

- a. Dependent variable: FR
- b.

R<sup>2</sup>=0.310; Adjusted R<sup>2</sup>=0.211; F-stat= 3.140; F-stat (Prob) =0.008; D-W stat =2.002

The model estimate is thus presented below:

$$FR = 5.231 + 0.259RLV^* + 0.230FFR^* + 0.120UND - 0.044CMP + 0.241TML - 0.084VRF$$

(2.962)(2.398)                      (2.004)      (1.309)      (-0.792)      (0.357)      (1.889)      (-0.681)

\*--- variables significant at 5% level of significance

The results above show that Relevance (RLV); a fundamental characteristic of financial reports is significant at 5% level of significance with a t-statistic value of (2.398). This implies that financial reports present information that is relevant for making informed decision. The effect of Faithful representation (FFR) on the usefulness of financial statement for decision making was also found to be positive and significant with a t-statistic value of (2.004), thus, showing that users viewed faithful representation as an important characteristic of financial reports towards making decisions.

However, the impact of Reliability (REL) with a t-statistic value of (1.309) is not significant to the usefulness of financial reports for decision making. This implies that, to the users of accounting information, Reliability is not an important characteristic for usage of financial reports for making decisions. In addition, the influence of understandability (UND) with a t-statistic value of (-0.792) is not significant reflecting that understandability of the financial reports is not useful for decision making. It also appeared to have a negative and adverse effect on usefulness of financial statement for decision making. Furthermore, the results also showed that comparability (CMP) with a t-statistic value of (-0.357) has a negative impact on the usefulness of financial reports for decision making. Its influence is also not significant, showing that based on the users' perception, comparability is not a useful characteristic for decision making. The effect of Timelines (TML) with a t-statistic value of (1.889) on the usefulness of financial report for decision making is also not significant, implying that the users do not view timeliness as an important characteristic for decision making. Lastly, verifiability (VRF), from the results (t-statistic value of -0.681) has a negative impact on the usefulness of financial reports for decision making. However, its influence was not significant.

The diagnostics from the results show that D-W Statistics, which is a test for auto-correlation is 2.002 and from the rule of thumb, which states that when D-W Statistics is between 1.5 and 2.00, there is the absence of auto-correlation. Thus, the model is free from auto-correlation. Also, the R-Squared which shows how much of the variation in the dependent variable is explained by variations in the independent variables has a value of 31%. The low R-Squared value is an indication of the number of the independent variables that have a significant impact on the dependent variable which from the results is 2 (i.e. RLV and FFR). There is also an indication of the absence of multi-collinearity in the model. The F-Statistics has a value of 3.140 which shows that the model is generally significant, following the rule of thumb which states that if the value of F-Stat is greater or greater or equal 2, then the model is significant.

## 5. Conclusion and Policy Implication

The study examined Decision usefulness and financial reporting; the general public perspective. Taking cognizance of the current staff and students of accountancy department, Rufus Giwa polytechnic Owo, Ondo state, Nigeria as our population. The study therefore revealed that reliability, understandability, comparability, timeliness, and verifiability for the purpose of making informed decisions are insignificant. For instance, the study revealed that most of the respondents do not rely on the financial reports provided by companies as a result of not providing their information needs as stakeholders. This is as represented by a t-stat value of 1.309 for reliability. Meanwhile, relevance and faithful representation were significant for decision making by users (the general public) of accounting information.

In conclusion, the paper recommends that for financial reports to be more meaningful and immense benefit to the general public there is need to make information in financial reports more reliable, understandable, comparable, timely and verifiable.

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