INVESTMENT ANALYSTS' USAGE AND PERCEIVED USEFULNESS OF CORPORATE ANNUAL REPORTS

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Abstract

This paper reports a study of the perceptions and beliefs of external users (investment analysts) of corporate annual reports in one of major international financial centres – Hong Kong. It was found that analyst users (1) view annual reports as having high information value particularly in terms of relevancy, (2) have a relatively high usage of annual reports and read the income statement and balance sheet most often, (3) consider the most important voluntary disclosure items to be discussions of factors affecting future financial results, future prospects of the company, main product market share, acquisition and disposal activities, and China business review, and (4) feel annual reports are somewhat useful, but the amount of information disclosed remains inadequate. Only a small percentage of users felt that the current disclosure requirements are either effective or very effective in serving investors' needs and that much improvement is still needed. The implications of these findings for management, investors, regulatory bodies and researchers are discussed.

Keywords: corporate governance, corporate disclosure, financial reporting, annul reports, Hong Kong

1. Introduction

The economic turmoil in East Asia in the late 1990s has led to a wider recognition of the importance of corporate governance and disclosures. It is well recognized that the quality of corporate disclosure influences to a great extent the quality of investment and loan decisions. The corporate annual report is the primary output of a firm's financial reporting system, its purpose been to communicate information to corporate stockholders and other interested parties. For many years the accounting profession has promulgated that corporate annual reports must provide information useful to users in making rational investment and other decisions (AAA, 1966; AICPA, 1973, 1994; ICAS, 1988, 1999; FASB, 1978; AARF, 1990).

In its 1994 report, Improving Business Reporting - A Customer Focus (AICPA, 1994), the AICPA Special Committee on Financial Reporting suggested that the effective functioning of the capital markets depends critically on effective information-sharing among companies, securities analysts, and shareholders. Improvements in information sharing should increase management credibility, analysts' understanding of the firm, investors' patience and confidence, and potentially, share value (Eccles and Mavrinac, 1995). Some experts argue that market functioning consists of two dimensions: structure and process (see e.g. Eccles and Mavrinac, 1995). In this context, 'structure' refers to the various laws and regulations covering financial reporting, while 'process' refers to the information flows and communication processes between the firm and various stakeholders. These two dimensions complement each other in enhancing total market functioning. From a firm's perspective, the disclosure of additional information involves cost/benefit trade-offs. In order to achieve better marketing functioning, it is important to understand the beliefs about and practices and effectiveness of corporate disclosures from the perspective of both preparers and external users. Although many empirical studies have been carried out on the topic of financial disclosure, most of them have focused on the relationships between the extent of disclosure and specific economic/performance variables (see Marston and Shrives (1991 & 1996) and Ahmed and Courtis (1999) for a review of studies treating disclosure extent as a dependent variable). Other studies focus on the information content

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of specific disclosures mainly in term of changes in share price or other performance measures. However, there are relatively few empirical studies examining the information needs of users as well as their perception of the quality of the current financial disclosures. Currently, we still do not know precisely what information a firm should disclose and whether the current disclosures satisfy users' needs.

The focus on the objectives of external reporting two decades ago led to a number of survey studies being conducted across a number of countries including the U.K., U.S., Australia and New Zealand which mainly explored the views of firm executives and information users on the usefulness of annual reports and disclosures (e.g. Singhvi and Desai, 1971; Brenner, 1971; Baker and Halem, 1973; Buzby, 1974; Lee and Tweedie, 1975, 1981; Epstein, 1975; Chenhall and Juchau, 1976; Chandra and Greenball, 1977; Winfield, 1978; Firth, 1978; Wilson and Tabb, 1978; Anderson, 1979 & 1981; McNally, Eng and Hasseldin 1982; Hines, 1982; Courtis, 1982 & 1999; Mckinnon, 1984; Chang and Most, 1985; Hawkins and Hawkins, 1985; Gray, Radebaugh and Robert, 1990; Malone, Fries and Jones, 1993; Epstein and Pava, 1993; Bence, Hapeshi and Hussey, 1995; Abu-Nassar and Rutherford, 1995, 1996; Eccles and Marvinac, 1995; Coleman and Eccles, 1997; Eccles and Kahn, 1998; Bartlett and Chandler, 1997; Barker, 1998; Anderson and Epstein, 1998). However, many of these survey findings are somewhat dated, and the financial reporting and decision making environments have changed considerably in the intervening years. Over the same period of time concerns have been expressed about the quality of accounting information provided, and increased litigation actions against auditors have occurred.

In addition, many of these findings may not be applicable to an Asian context (see e.g. Perera, 1989). In recent years, there have been debates in which capital markets in Asia are effective and critically whether there is a need for market reform including increased financial reporting requirements. A special case is the Hong Kong Special Administrative Region (hereafter 'Hong Kong') which is a major business and financial centre with a very lax regulatory framework. Besides a few studies (e.g. Courtis, 1999; Ho and Wong, 1998), little is known about how listed companies in Hong Kong communicate with the capital markets and the current state of corporate disclosure in this emerging market. These different factors provided motivation for a study of how annual reports are used by in Hong Kong.

In Hong Kong, the accounting standards and mandatory disclosure requirements are similar to many Commonwealth countries adopting a common law system. Despite having a sophisticated capital market and being viewed one of the most transparent economies in East Asia (Gray 1988; Williams and Tower, 1998; HKICS, 1998), the scope of disclosure requirements in Hong Kong is much narrower and less specific than in the U.S. and U.K. (Eccles and Mavrinac, 1995; Gray and Vint, 1995). For instance, until very recently, there was no need for listed firms to disclose their balance sheets in interim reports and cost of goods sold was not available in income statements. Other rules governing related party transactions, directors' remuneration and minority shareholding protection are less stringent than in the U.S. and U.K. Since the accounting standards in Hong Kong have no legal backing (guidance status only) and are not comprehensive, Hong Kong companies have considerable flexibility in reporting and disclosure. Consequently, their disclosure choices are likely to reflect voluntary responses to market forces. In general, conformity with accounting standards by Hong Kong firms is very high (HKSA, 1995; SEHK 1996; Tai, Au Yeung, Kwok and Lau, 1990; Chan and Ho, 1996; HKSA, 1997). The only area that has a comparatively low standard of compliance is on the disclosure of connected transactions. In terms of the overall disclosure standard of annual reports, the Judges Report of the HKMA Best Annual Report Award 1998 (HKMA, 1999), notes that the quality of annual reports has been improving and variations in quality have been decreasing (South China Morning Post (SCMP), Nov 28, 1998a). Nevertheless, it stressed that firms in Hong Kong still have to provide more in-depth analysis of their business and performance (e.g. management analysis and discussion). However, especially after the financial crisis in late 1997, there have been a number of unexpected company failures and financial scandals, as well as negative publicity about excessive directors' benefits, which have undermined investors' confidence to some extent in the local capital market. Many investors and auditors in Hong Kong think that company disclosure practices on related party transactions and other dealings are inadequate. Some audit firm partners suggested that the Stock Exchange should increase its disclosure requirements, while others suggested that listed companies be advised to disclose more information voluntarily (SCMP, 1998b). However, the SEHK believes that the current disclosure requirements in Hong Kong are quite adequate, and to avoid over-regulations it hopes to encourage a culture of voluntary disclosure among listed companies. The ultimate incentive, SEHK believes, is that the quality of a company's disclosure record will be reflected in its stock price and its future ability to raise share capital (HKICS, 1998). Nevertheless, disclosure requirements in Hong Kong are still regularly reviewed and expanded..

The objective of this paper is to report findings of a study on the usage and perceived usefulness of corporate annual reports by one major type of external users (i.e. investment/financial analysts) in Hong Kong. Many professional and regulatory bodies argued that annual report disclosures should focus on the needs of current/potential investors whose information requirements are the most comprehensive (see e.g. ASSC, 1975; ICAEW & ICAS, 1991; AICPA, 1994; FASB, 1978; IASC, 1989). Investment analysts/brokers were chosen as a proxy group for annual report users in this study because they have similar information requirements as their client investors and they are considered to be more influential and knowledgeable users. Specifically, the current study sought to answer the following questions:

- How do analyst users view the relative importance of corporate annual reports?
- How do they use annual reports?
- Which sections of the annual report are read (and used) most?
- What is the perceived importance of various voluntary disclosure items?
- How do they view the effectiveness of current corporate disclosures in meeting investors' needs?

The findings should contribute to better understanding of the current corporate disclosure practice and effectiveness in Hong Kong and provide a better basis for policy makers to make further regulatory improvements.

2. Survey Design and Data Collection

The construction and validation of the questionnaire for this research was partly based on a review of the literature and surveys conducted in other countries (see e.g. McNally, Eng and Hasseldine, 1982; Gray, Radebaugh and Roberts, 1990; Abu-Nassar and Rutherford, 1995, 1996; Eccles and Mavrinac, 1995). In addition, the list of 43 voluntary disclosure items were identified by reviewing previous empirical voluntary disclosure studies (e.g. Chow & Wong-Boren, 1987; Lau, 1992) and adjusted by checking against a mandatory disclosure checklist prepared by a Big-6 accounting firm in Hong Kong. Items mandated to be disclosed by Hong Kong listed companies were eliminated and the remaining 35 items were listed in the questionnaire. The structure of the questionnaire basically followed the order of the main research questions listed earlier. Subjects were also requested to give any comments and suggestions on the topics in the free space provided. The piloted-tested survey questionnaire was sent to 535 buy-side investment analysts/borkers of all investment/brokerage firms in Hong Kong to seek their views on the research questions. Two mailings took place and a total of 42 completed questionnaires were returned within two weeks of the first mailing. The researchers sent follow-up letters to those firms which did not respond to the first mailing, along with an additional copy of the questionnaire and a reply envelope. The follow-up reminder emphasized the practical importance of the research and the confidentiality of the responses. In addition, it requested respondents to give reasons if they decided not to complete the questionnaire, by returning the reply slip in the bottom. A further 50 completed questionnaires were received within two weeks of the second mailing. Data collection was thus completed about ten weeks after the initial distribution of the questionnaires.

The survey resulted in usable responses from 92 financial analysts, providing an actual response rate of 17.2%. Since many Hong Kong firms are very conservative and generally unwilling to allow studies by outsiders, this response can be considered acceptable (Redding and Pugh, 1986). In order to establish the reliability and validity of the data obtained, the responses to five randomly selected Likert-scale questions from the last 20 questionnaires received were compared with the results of the first 20 questionnaires in order to check for any possible non-response bias. This split-half technique, introduced by Oppenheim (1966) (see also Wallace and Cooke, 1990), which assumes that the later respondents provide similar replies to the non-respondents, indicated no significant difference (alpha = 0.05) between early and late responding firms. Furthermore, the returned reply slips from 45 users who declined to return the questionnaire indicated that over 97% of the non-respondents did not complete the questionnaires due to 'company policy' or 'lack of time'. These findings imply that those who failed to respond would not necessarily have had different perceptions from the subjects who did respond. It was believed that no important biases have been introduced and that the sample results can be generalized to the population of interest.

3. Survey Findings

The findings are reported under the following four major headings: Perceived Importance of Different Information Sources, Perceived information attributes of annual reports, Usage pattern of annual reports, Perceived importance of various voluntary disclosure items, Perceived effectiveness of current corporate disclosure practice.

3.1. Major Sources of Corporate Information

Firms communicate with external users through different media. Analysts also have to rely on using information from a variety of sources in order to provide valid investment advice to their clients. Investment analysts/brokers were asked to rate the perceived importance of 13 different sources of corporate information. Table 1 indicates that while analyst users considered financial statements in annual reports (mean=4.47) as the most important source of information, the second most important information source as perceived by them was visits to companies and communication with management (mean=4.28). The third most important sources was other information in annual reports (mean=3.71). Analysts obviously believe that a direct meeting with officers of the company they follow is very useful to complement the information contained in annual reports.

Table 1. Perceived Importance of Corporate Annual Reports by Comparison with Other Sources of Information

	Mean	S.D.
They contain more relevant information	3.86	0.8287
They give up-to-date information	3.52	0.9334
They are more understandable	3.32	1.0000
They are prepared by a neutral party	3.24	0.9800
They contain new information	3.11	1.0100
They serve as a cross reference	3.08	0.9500

(1= Not important at all; 5 = Mostly important)

The mean score given by analyst users to newspapers was 3.19 (ranked no. 7) and therefore believe it is not an important source of information. Perhaps newspaper information has lower value for analysts due to their fragmented nature (i.e. reporting only the incremental news piece by piece). Lastly, computer databases (mean=2.79) were considered to be of very minor importance to the subjects and were ranked almost last. It is somewhat surprising that investment analysts did not use information technology as widely as one might expect. This may be because of the computer data are too brief and do not allow interactive dialogue. As the Internet technology becomes more popular, it is expected that the Web-based environment may change the nature and use of corporate information disclosed. In general, the findings are quite consistent with findings in the U.K. in the 1970s and Jordan in the 1990s (see Lee and Tweedie, 1975; Abu-Nassar and Rutherford, 1995), in which corporate annual reports were regarded as the most important information source for users. Lee and Tweedie (1975) in U.K. also found that financial newspaper reports were considered the next most important information source. In Australia, the survey findings are mixed. Annual reports were found to be the most important information sources by Chenhall and Juchau (1976) and Winfield (1978), whilst Anderson (1981) and Courtis (1982) found investor they surveyed ranked stockbrokers as the most important information source for investment decisions. In New Zealand, Chang and Most (1985) found that newspapers and magazines were ranked by investors as the most important information soruce ahead of stockbrokers and corporate annual reports. Anderson and Epstein (1998) in a 3-country study found that investors in Australia and New Zealand ranked the advice of their stockholders as the most important source, followed by financial newspapers and annual reports.

However, compared with findings in U.S., differences are visible. Epstein (1975) found that only 15% of American shareholders surveyed relied on the annual report as the primary basis for investment decisions, whereas 48.8% relied on the advice of stockbrokers. This finding led Epstein to conclude that corporate annual reports were not useful for investment decision making. Epstein and Pava (1993) found in a replication and expansion of Epstein's earlier work that increased importance was attached to the annual report as a source of information. Further, according to Eccle and Mavrinac (1995), there was perfect agreement across all three subject groups (corporate managers, financial analysts and portfolio managers) in U.S. which ranked individual meetings the highest. The second most important medium was press releases, and the third was annual reports. It can be seen that U.S. market players consider both oral and written communications as important, but annual reports is generally regarded as less useful in U.S. In a more recent study by Anderson and Epstein (1998), investors in U.S. ranked the annual report the most important source of information, followed by newspapers and magazines and advice of investment brokers. This reflects a shift in the information source used by U.S. investors from stockbrokers to the annual report.

Overall it is evident that investors in each country attach different importance to the information sources available. It is also a bit surprising to find that the rating of annual reports in Hong Kong is so much higher than its counterpart in U.S. A common finding was that investors in different countries ranked advice of friends as the least important source.

3.2. Perceived Information Attributes of Annual Reports

Although the literature (e.g. Abu-Nassar and Rutherford, 1995; Eccles and Mavrinac, 1995) indicated that annual reports were the most important source of information for investors and analysts, their usefulness to users is subject to certain limitations. Annual reports are prepared only once a year and the information contained may not be understood by persons without sufficient accounting background. Furthermore, much information in annual reports is mostly historical in nature and only the financial statement sections are required to be audited in some countries.

In the questionnaire, analyst users were further asked to indicate the importance of corporate annual reports in term of six information attributes by comparison with other information sources that they were familiar with (1=not important at all, 5=very important, see Table 2). The primary importance of annual reports was that they contain more relevant information than other sources (mean=3.86). The second most important attribute was that annual reports provide more up-to-date information (mean=3.52). This was surprising as most researchers think that corporate annual reports tend to give more historical information (less relevant) to the users. This may be due to the inefficiency and/or lower information value of other public/private information sources. These findings confirm that corporate annual reports were useful to investment analysts for making investment recommendations.

Table 2. Perceived Importance of Information Attributes of Annual Reports

	Mean	S.D.
They contain more relevant information	3.86	0.8287
They give more up-to-date information	3.52	0.9334
They are more understandable	3.32	1.0000
They are prepared by a neutral party	3.24	0.9800
They contain newer information	3.11	1.0100
They serve as a cross reference	3.08	0.9500

(1= Not important at all; 5 = Very important)

3.3. Usage Pattern of Annual Reports

Regarding analyst users' usage of annual reports, the analysts were asked to indicate the number of reports read and the average length of time spent reading each report. Table 3 indicates that most analysts had a relatively high usage of annual reports when compared with the findings in Jordan (Abu-Nassar and Rutherford, 1996). Approximately 50% of the analysts in Hong Kong read more than 30 annual reports per year. Analysts in the current study also appeared to spend more time reading each annual report (Table 4) when compared with those in other similar studies. For example, approximately 45% and 11% of analysts in Hong Kong and Jordan respectively spent more than one hour reading each annual report. There have been no similar studies on the extent of usage of annual reports in U.S. and U.K. for comparison. Nevertheless, the extent of usage reflects that annual reports have high information values to analysts in Hong Kong or that other sources of information are less readily available.

Table 3. Number of Annual Reports Read per Year

	No. of cases	Percentage
5 or below	3	3.5
6-10	18	21.2
11-20	15	17.6
21-30	11	13.0
31-40	11	13.0
41-50	10	11.7
51-60	4	4.7
More than 60	5	5.9
	85	100.0

Table 4. Average Time Spent Reading an Annual Report

	No. of cases	Percentage
10 minutes or below	3	3.4
11 – 20 minutes	10	11.2
21 – 30 minutes	12	13.4
31 – 60 minutes	23	25.8
1 – 2 hour	29	32.6
2 – 4 hours	10	11.2
More than 4 hours	2	2.2
	89	100.0

Given the importance of annual reports, analysts were further asked to indicate the extent to which they read different sections of the annual report (1=not at all, 5=always). It was found that analysts were most interested in the income statement (mean=4.38) and balance sheet (mean=4.33) (see Table 5). Cash flow statements and notes to the accounts were ranked third (mean = 4.09) and forth (mean = 4.01) respectively. This is somewhat different from previous studies in the U.S. where the income statement and cash flow statement were the most widely read (Eccles and Mavrinac, 1995), although the use of the balance sheet had increased while the income statement had declined in perceived usefulness (Epstein and Pava, 1993). This showed that U.S. investors read the cash flow statement somewhat thoroughly and more so than investors in Hong Kong, Australia and New Zealand. This may reflect the difference in investors' ability to understand cash flow statements.

Lee and Tweedie (1975) in U.K. found that the most widely read item was the Chairman's address, although the profit and loss account was found to be most influential item for investment decision making. However, the current finding is consistent with the more recent findings in Australia, New Zealand and the U.K. (see Anderson, 1981; Courtis, 1982; Wilton and Tabbs, 1978; Lee and Tweedie, 1981; Chang and Most, 1985) in that the income statement and balance sheet were the most widely read sections. Furthermore, the directors' report and the auditor's report were ranked fifth and sixth in the current study by analysts. In contrast, the auditor's report was the least read section by analysts in U.K and U.S (Mckinnon, 1984; Firth, 1978).

For other information in the annual report, analyst users in Hong Kong expressed very little interest. The readership of the chairman's address (or CEO message) and the essay and pictorial section is greater in Australia and New Zealand than it is for the equivalent items by Hong Kong and U.S. investors (Anderson and Epstein, 1998). The low readership level on non-financial items found in the current study may be a reflection of lack of corporate credibility. Further studies on such usage behavior should be encouraged and fruitful.

Table 5. Extent of Usage of Different Types of Information in Annual Reports

	Mean	S.D.
Income statement	4.38	0.77
Balance sheet	4.33	0.85
Cash flow statement	4.09	0.89
Notes to the accounts	4.01	0.89
Director report	3.93	0.12
Auditor report	3.79	1.02
Financial review	3.76	0.89
5-years statistical / financial summary	3.75	0.84
Chairman statement	3.65	1.12
CEO message	3.60	0.83
Directors and senior management profile	3.45	0.90
Accounting policies	3.39	1.07

(1=not at all; 5=very much)

3.4. Perceived Importance of Various Voluntary Disclosures Items

In the current study, users were asked to indicate the perceived importance of each voluntary disclosure item in annual reports on a scale of 1 (very low) to 5 (very high).

Table 6 indicates analysts' perceived importance of the 35 different types of voluntary disclosures items. The top five were discussions of factors affecting future financial results, future prospects of the company, main product market share, acquisition and disposal activities, and China business review. The lowest five items were financial statements in other currencies, value of backlog orders, expenditure on staff training & development, advertising expenses, and contributions to the community & corporate citizenship. In general, predictive types of disclosure items tended to perceive as much important. These items were future prospects of the company (mean=4.04), discussion of factors affecting future financial results (mean=4.08), cash flow forecast (mean=3.82) and capital commitments for future years (mean=3.88).

On the other hand, historical or other descriptive type of information tended to receive `moderate' scores. Examples of such items are financial summary for more than 5 years (mean = 3.56), sale and marketing network (mean = 3.64), cost of goods sold (mean = 3.65).

Table 6. Perceptions of the Importance of Different Voluntary Disclosures Items

	Mean	S.D.
Discussion of factors affecting future financial results	4.08	0.84
Future prospects of the company	4.04	0.94
Main product market share	4.01	0.78
Acquisition and disposal activities	3.97	0.87
China business review	3.93	0.96
Bank loans, mortgages and their uses	3.92	0.95
Financial position & contribution of subsidiaries & associated companies	3.92	0.96
Capital expenditure commitments for future years	3.88	0.73
Cash flow forecast	3.82	0.86
Product contribution margin	3.80	0.89
Corporate strategy and impact	3.74	0.76
Description of company's product and service	3.70	0.81
Aging of debtors' balance	3.67	0.94
Details of investments in China & overseas	3.66	0.81
Details of operating expenses	3.65	0.91
Cost of goods sold	3.65	0.89
Sales and marketing network	3.64	0.91
Stock price information and analysis	3.63	0.95
A large variety of financial ratios	3.59	0.93
Financial summary for more than 5 years	3.56	0.93
Market capitalization	3.50	0.86
Research and development activities	3.49	0.84
Shareholders' analysis	3.43	0.93
Productivity indicators	3.43	0.85
Organizational chart or structure	3.37	0.77
General corporate information	3.36	0.99
Responsibilities of directors/senior management	3.36	0.94
Segmental information	3.24	1.25
Effect of inflation on results	3.21	1.03
Improvement to facilities	3.16	0.86
Financial statement in other currency	3.09	1.03
Value of backlog orders	3.09	0.90
Expenditure on staff training and development	2.98	0.96
Advertising expenses	2.89	1.01
Contributions to community/corporate citizenship	2.38	0.99

(1=Not important at all; 5=Very important)

3.5. Perceived Effectiveness of Current Corporate Disclosure Practice

3.5.1. Fairness of Share Values and Existence of a Communication Gap

One indicator of market efficiency and capital allocation effectiveness is the accuracy of share valuation (Eccles and Mavrinac, 1995). Subjects were asked for their estimation of share valuation of the typical firm they follow. The results indicate that 46% of investment analysts believed that the shares of the typical companies they follow were fairly valued. While about 36% of analysts perceived that their companies' shares were undervalued and only 16.3% 'slightly overvalued', only 1.1% of analysts reported that these companies' stocks were significantly valued. Since the market functions are affected by its participants' perceptions and attitude, these findings may to a large extent reflect the market functioning. As mentioned in earlier sections, it was generally viewed by the regulatory and professional bodies that the current disclosure requirements are by-and-large adequate (HKICS, 1998). To test this, the respondents were asked to what extent they believe a communication gap exists between the companies they follow and its shareholders. The mean score for analysts' perception was 3.39 (1=not at all, 5=very much) and 60.5% of analysts believed that there was 'much' or 'very much' a communication gap or information asymmetry. 7.6% and 31.8% believe there was 'somewhat' and 'moderate' existence of such a communication gap respectively.

Some analysts expressed the view that corporate managers were uncooperative and difficult to talk to.

3.5.2. Perceived Quality of Current Financial Reporting and Disclosures

Table 7 indicates analysts' perceptions of the qualitative characteristics of financial reporting and corporate disclosures in Hong Kong. Analysts ranked the following qualitative characteristics of financial reporting as the highest: ease in understanding (mean=3.83), reliability (mean=3.14), comparability within the same company over time (mean=3.18), information reflecting short-term profit performance (mean=3.13), and materiality (mean=3.05). However, they did not perceive that accounting information reflects long-term economic value (mean=2.91), that this information is timely for making decisions (mean=2.87), and that there is low comparability of companies within the same industry (mean=2.73).

Table 7. Perceived Quality of Current Financial Reporting and Disclosures

Quality Attributes	Mean	S.D.
Ease of understanding	3.83	0.78
Reliability	3.14	0.78
Comparability within the company overtime	3.18	0.89
Accounting information reflects short term profit performance	3.13	0.81
Materiality	3.05	0.78
Relevance	3.02	0.67
Consistency in accounting methods by the companies within a single industry	2.97	0.87
Completeness / adequacy	2.93	0.87
Neutrality	2.92	0.77
Accounting information reflects long term economic value	2.91	0.88
Timeliness	2.87	0.73
Comparability between different companies within a single industry	2.73	0.91

(1=Very low; 5=Very high)

3.5.3. Perceived Effectiveness of Current Corporate Disclosures and Need of More Regulations

The analysts were further asked to express their perceptions about the effectiveness of current disclosure in annual reports in serving users' information needs. On a 5-point scale where 1=very ineffective and 5=very effective, the results are shown in Table 8. A total of 41% of analysts are somewhat ambivalent on the effectiveness of Hong Kong's current disclosures in serving investors' needs (mean=2.75). Only 17% of the respondents perceived that current disclosures served investors' needs effectively or very effectively. These findings support the crticis' argument that the capital market's information flows are somewhat flawed and improvements in market structure and corporate communication process are needed.

Table 8. The Effectiveness of Current Disclosure Requirements in Serving Investors' Need

	No. of cases	Percentage
Very effective	6	6.6
Ineffective	28	30.7
Somewhat in between	41	45.1
Effective	14	15.3
Very Effective	2	2.2
	91	100.0

Mean = 2.75 S.D. = 0.8736
(1=Very ineffective; 5=Very effective)

One solution to the communication gap and the inefficient information flows is to change the financial reporting and disclosure regulations. Investment analysts were asked to indicate the extent that there should be more financial reporting and disclosure requirements in Hong Kong. On a 5-point scale where 1= not at all, 2=somewhat, 3=moderate, 4=much and 5=very much, analysts agreed that there should be more reporting and disclosure requirements (mean=3.527). Almost 54% of analyst users agreed 'much' or 'very much' with increasing disclosure requirements, while only 45% believed that there were only 'somewhat'or 'moderate' need of such additions. Overall, although users felt that annual reports are somewhat useful, they thought that the amount of information disclosed remains inadequate. These findings support the argument that much improvement in the corporate communication process is still needed. Although adding more regulations are useful, some respondents mentioned that no matter how clearly these new regulations are defined and how strictly they are monitored by auditors, firms always have means to manipulate them or 'manage' earnings if they wish to do so. Therefore, there are real concerns about the usefulness of structural changes in financial reporting in the direction of more regulation.

The respondents recommended that certain voluntary measures should be adopted by corporate managers to reduce the communication gap. Besides additional disclosures of useful information voluntarily, managers should focus on the corporate disclosure process by means such as formulating an open proactive disclosure strategy, having more direct meetings between analysts/investors and corporate executives, conducting regular surveys on users' needs, and upgrading investor relationship staff. The objective is to develop a supporting context to ensure effective capital allocation between insiders and outsiders of the firm.

4. Summary and Conclusions

The objective of this study was to provide descriptive evidence of current use and perceived effectiveness of corporate annual reports of listed companies by analyst users in Hong Kong, giving the increasing public scrutiny and litigation faced by the accounting profession, the continued evidence of an expectation gap and the questioning of managerial credibility by investors.

In general, the findings confirm the importance of corporate annual reports as a major source of information, and support the view that continued improvement in the quantity and quality of financial disclosures in annual reports is necessary if Hong Kong and other East Asian countries are to remain competitive in international financial markets.

It was found that analysts (1) view annual reports as having high information value, particularly in terms of relevancy, (2) have a relatively high usage of annual reports and read the income statement and balance sheet most often, (3) view the most important voluntary disclosure items to be discussions of factors affecting future financial results, future prospects of the company, main product market share, acquisition and disposal activities, and China business review, and (4) feel that annual reports are somewhat useful, but the amount of information disclosed remains inadequate. Only a small percentage of users felt that the current disclosure requirements are either effective or very effective in serving investors' needs. While tightening or upgrading disclosure regulations to an international level is necessary, there is still a communication gap among the market participants and respondents recommended that certain voluntary measures (e.g. more voluntary disclosures and enhanced relationship between preparers and investors) should be adopted by corporate managers to reduce this gap. The findings should be useful for corporate report preparers, users and regulators to understand the problems of corporate disclosures in Hong Kong and make necessary improvements.

The recent Asian financial crisis has raised a number of research opportunities. As there are very few studies on the corporate disclosure of listed firms in East Asia, more studies should be conducted to determine to what extent different institutional and corporate governance factors influence the corporate disclosure practice in the region. These findings should provide useful inputs for accounting policy makers or other regulatory bodies in the region to review and improve existing disclosure requirements and corporate governance policies.

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