CORPORATE FINANCIAL REPORTING PRACTICES IN EMERGING CAPITAL MARKETS

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ABSTRACT

Financial reporting is done by every business and organization to assess its financial performance. It is an indicator of how well or poor a company has performed in a particular financial year. Financial reporting involves preparation of financial reports or financial statements and then studying the overall performance of a company. Financial reporting may be defined as communication of published financial statements & related information from a business enterprise to third parties (external users) including shareholders, creditors, customers' governmental authorities & the public. It is the reporting of the accounting information of an entity (individual, firm, company, government enterprise) to a user or group of users. A sound corporate financial reporting system is the cornerstone of a well-functioning market economy and the bedrock of a healthy financial system. The Asia-Pacific capital markets have experienced rapid growth over the last decade, with many of the emerging markets as key players in the global economy. The issue of corporate reporting for greater transparency has come up in the wake of such scandals and due to the process of globalization. The inability to understand and deal with financial data is a severe handicap in the corporate world.

Keywords: *Corporate financial reporting, capital market, globalization, stakeholders*

INTRODUCTION

Financial reporting is done by every business and organization to assess its financial performance. It is an indicator of how well or poor a company has performed in a particular financial year. Financial reporting involves preparation of financial reports or financial statements and then studying the overall performance of a company. These financial statements give a summary of a firm's long and short-term profitability." It involves income statement, balance sheet and cash flow statement. "Balance Sheet is one of the most important financial statement containing the assets, liabilities and net equity of a company at a given point of time. Income Statement is also known as Profit or loss statement. This financial statement reports company's results of operations over a period of time. Cash Flow Statement reports company's cash flow activities, including its operating, investing and financing activities" (www.abacusoutsourcing.com, 2012).

In financial reporting, transparency is one of the most significant feature or characteristic.

"Companies must disclose something that might influence the investment decision of an informed investor. Nothing of consequence may be hidden. This rule is widespread and pervasive. Stock exchanges and Government agencies require it. Various accounting rulemaking bodies require it, including the Financial Accounting Standards Board in the United States and the International Accounting Standards Board. One aspect of transparency is timeliness. Generally speaking it is better to disclose information sooner rather than later, although there is some trade-offs. For example, companies that issue their annual reports on January 1 are extremely timely but there is a certain probability that some of the information in that report is not as complete or accurate as would be the case if the company had spent more time preparing the statements and had issued them a few weeks or months later. There is an inverse relationship between the quality of financial information and the timeliness with which it is reported. Accounting information becomes less relevant with the passage of time."

Conceptual Framework of Corporate Financial Reporting

A conceptual framework is an arrangement of concepts and principle that underpin the preparation and presentation of financial statements. These concepts and principles should be consistent with one another. Financial reporting is the process of preparing and distributing financial information to users of such information in various forms. Financial statements are the most common format of formal financial reporting. These statements are prepared according to the rigorously applied standards defined by professional accounting bodies developed according to the legal and professional framework of a specific locale (Wikipedia, 2010). "The main expected role of the financial reporting is to meet the external users' varying needs. Users of financial reports in general and particularly investors require useful information for their decision making."

Objectives of Corporate Financial Reporting

The objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers. Capital providers are the primary users of financial reporting. To accomplish the objective, financial reports should communicate information about an entity's economic resources, claims to those resources, and the transactions and other events and circumstances that change them. The degree to which that financial information is useful will depend on its qualitative characteristics.

Value Relevance of Corporate Financial Reporting

Researches on value relevance of financial reporting are motivated by the fact that listed companies use financial statements as one of the major medium of communication with their equity shareholders and public at large. Further, lot of hard work is done by stock market regulators and accounting standard setters in improving the quality of financial reporting and increasing the transparency level in financial reporting.

Qualitative Characteristics of Corporate Financial Reporting

The qualitative characteristics can be termed as those qualities that financial information must have in order to satisfy the objective of financial reporting. The presence of these qualities makes financial information valuable. It also plays an indispensable role in enhancing the worth of financial reporting information. The way these characteristics affect the utility of financial information, decides whether they are fundamental or enhancing. Materiality and cost are two pervasive constraints which bounds the utility of financial information.

Emerging Capital Markets

Globalization has opened up many investment opportunities for investors in some of the most obscure countries in the world. However, the main goal of every investor is to maximize returns on investments. To maximize returns, the investor's strategy is to invest in a market where he can diversify his portfolios and succeed in gaining returns commensurate to the level of risk assumed. The investor will not be willing to put out investment capital if visibility for potential return on investment is obscures. With such objectives in the investor's mind, the investor will prefer to invest in only emerging capital markets. The terminology "emerging markets" was derived from the expression "newly industrializing countries". The expression "newly industrializing countries" was coined by IMF in the 1980"s and used to describe the few fast-growing economies in developing countries in, Asian and Latin American countries. In the 1990s, the number of liberalized economies increased, and as a result, the IMF replaced the term "newly industrializing countries with the expression "emerging markets". These emerging markets now include

Africa, Asia, Latin America and Russia. Emerging markets have some fundamentally applied characteristics that distinguish them from the developed markets. Emerging markets are countries with new and small stock markets that are experiencing rapid economic growth, and are located in countries with below- average income.

Objectives

Researcher aimed at developing an accurate model for corporate financial reporting practices. Therefore, the study is carried out by keeping in mind the following objectives in the context of Emerging Capital Markets of Asia - Pacific region:

1. To study the legal environment of corporate financial reporting,
2. To measure the quality of corporate financial reporting in selected companies,
3. To compare corporate financial reporting with International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS) in selected countries,
4. To assess the role of Extensible Business Reporting Language (XBRL),
5. To examine the stakeholder's perception towards corporate financial reporting in selected countries, and
6. To design a format of corporate financial reporting in emerging capital markets.

Research Design

This section describes the design and methodological highlights of the study including the sample description, data collection and analysis. Research design tracked by the researcher can be described in the following sub-heads.

Research Assumption

With aims at corporate financial reporting practices the study hypothesized that there is no significant relationship between quality of the corporate financial reporting and its modern

techniques such as application of IFRS and XBRL in corporate world.

Data Collection

The data for the study were collected mainly from the primary as well as secondary sources. Primary sources include e-questionnaire and secondary sources include Websites, journals, books, articles, and annual reports of selected companies of Stock Exchanges of Asia-Pacific region. The secondary source is sample survey through the structured questionnaire which was developed during the course of study.

Sample Description and
Selection Secondary Data

Emerging Capital Markets are financial markets that reside in the low or middle income economies or where the ratio of investable market capitalization to GNP is low. The emerging capital market nations have a large population size but a very low share of the World GNP. According to the statistics of the Bank for International Settlements the emerging capital markets have grown by 3% to 5% of the World Market. It has been observed that about 60% of the emerging capital markets resided in Asia, 21% in Latin America and 19% in Eastern Europe, Middle East and Africa. Although the size of the emerging equity market is very small, more number of domestic companies participates in these markets as compared to the equity markets of the developed countries.

Asia-Pacific region includes eight Stock Exchanges and at least 10% to 25% of companies of each stock exchange were selected for study from Asia-Pacific region randomly.

Table 1- showing the selection of Companies

Region	Stock exchange	No. of benchmark companies	No. of companies selected
Asia-pacific	Australian Securities Exchange	101	22
Asia-pacific	Bombay Stock Exchange	200	20
Asia-pacific	Hong Kong Stock Exchange	70	14
Asia-pacific	Korea Exchange	55	12
Asia-pacific	National Stock Exchange of India	50	10
Asia-pacific	Shanghai Stock Exchange	111	22
Asia-pacific	Shenzhen Stock Exchange	48	10
Asia-pacific	Tokyo Stock Exchange	100	20
	Total	565	132

Primary Data: Sample size was 100 respondents in each country to examine the stake holder's perception towards financial reporting practices in the concerned country. For the selection of stakeholders, convenient sampling technique will be used by considering only

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those stakeholders who were available on "Net". Sample size to measure the benefits and challenges in XBRL adoption, was 49 in first stage and 400 in next stage.

Data Description: It is rightly said that data selection must be performed judiciously to avoid the "garbage-in, garbage-out" syndrome often associated with computers. Performance of an analytical study is highly dependent on the quality and appropriateness of its input data. If relevant data inputs are not included, the results suffer needlessly. Keeping this in mind, the researcher had planned to use the following data.

Dependent Variable: The Quality of Corporate Financial Reporting has been taken as the dependent variable.

Independent Variables: Seventeen different parameters have been taken as the independent variable. The description of the variables selected and their source is tabulated below in the table

Table 1.2 Data Description

S. no	Variables	Symbol	Data Source
Dependent variable			
1	Quality of corporate financial Reporting	QCFR	------------
Independent Variables			
2.	Net Profit	NP	Concerned Company's website
3.	Return On Average Net Worth	ROANW	Concerned Company's website
4.	Issued Capital	ICAP	Concerned Company's website
5.	Market Capitalization	MCAP	Concerned Company's website
6.	Monthly Returns	MRET	Concerned Company's website
7.	Contents	C	Concerned Company's website
8.	Timeliness	T	Concerned Company's website
9.	Economic Value Added	EVA	Concerned Company's website
10.	Corporate Social Responsibility	CSR	Concerned Company's website
11.	Corporate Governance Report	CGR	Concerned Company's website
12.	Consolidated Financial Statements	CFS	Concerned Company's website
13.	Human Resource Accounting	HRA	Concerned Company's website
14.	Environmental Disclosures	ENVDIS	Concerned Company's website
15.	Related Party Disclosures	RPD	Concerned Company's website
16.	Segment Reporting	SEGREP	Concerned Company's website
17.	Risk Management	RMGMT	Concerned Company's website
18.	Employee Stock Option Scheme	ESOP	Concerned Company's website

Tools for Analysis

For the purpose of study, researcher made use of following tools.

Logit Model

Joseph Berkson in 1944 introduced logit model. The model was borrowed by analogy from the very similar probit model developed in 1934 by Chester Ittner Bliss. G. A. Barnard in 1949 coined the commonly used term log-odds; the log-odds of an event is the logit of the probability of the event. Both the models can be applied in qualitative studies on dichotomous (dummy) variables with a domain between 0 and 1. The only difference is that probit model is applicable when only independent variables are dummy coded while logit model is applicable when both dependent and independent variables are dummy coded. For the purpose of modeling the quality of corporate financial reporting, software such as MATLAB 7.0, STATA 12.0 and SPSS 19 were used.

Factor Analysis

This technique was invented by Charles Spearman in the context of psychology. Factor analysis in psychology is most often associated with intelligence research. Raymond Cattell expanded on Spearman's idea of a two-factor theory of intelligence after performing his own tests and factor analysis in the study of personality. However, it also had been used to find factors in a broad range of domains such as personality, attitudes, beliefs, etc. it can assess the validity of an instrument by finding if the instrument indeed measures the postulated factors. It can reduce the number of variables, by combining two or more variables into a single factor and identify groups of inter-related variables, to see how they are related to each other.

Today, it is used in behavioral sciences, social sciences, marketing, product management, operations research, and other applied sciences that deal with large quantities of data. There are basically two very closely related types of factor analysis:

Exploratory factor analysis (EFA): It is used to identify complex interrelationships among items and group items that are part of unified concepts and thereby identify the underlying factor model.

Confirmatory factor analysis (CFA): It aims to confirm theoretical predictions, tests the hypothesis whether a specified set of constructs is influencing responses in a predicted way. It uses structural equation modeling to test a measurement model whereby loading on the factors allows for evaluation of relationships between observed variables and unobserved variables. For the purpose of modeling the measures of XBRL adoption, software such as SPSS 19 and Amos 19 were used.

Principal Component Analysis (PCA): Principal Component Analysis was developed in 1901 by Karl Pearson, as an analogue of the principal axes theorem in mechanics. Later,

Harold Hotelling in the 1930s independently developed and named it. It studies an overview of the relationships between a set of variables and evaluate individuals with respect to those variables. PCA is often used in this manner for dimensionality reduction. In addition, this technique is used in conjunction with other techniques, such as regression analysis, z-test etc. For the purpose to study the stakeholders‟ perceptions towards corporate financial reporting, PCA was applied on questionnaire with the use of STATA 12.0.

Limitations

The limitations to the study justify the need to develop new research, to correct the limitations now announced. It is necessary to undertake a new study covering the period in which the new guidelines are of mandatory application. Another area of research is to investigate the quality of corporate financial reporting practices and its emerging trends, which previously were not in the public domain. This new source of information will enable a more detailed research on the corporate financial reporting subject.

- The sample size of the respondents is very limited due to the lack of respond problem. Due to the lack of responses, the results obtained are limited to India, not to Asia Pacific region in primary study.
- It was a common practice among the respondents; those who were aware of; were not willing to respond to the questionnaire.
- Some of the conclusions are based on the estimates, assumptions, observations and informal interviews.
- It is very difficult to contact the higher authorities within the companies due to the companies not allowing the researcher to contact authorities.
- The companies had certain facts which are kept confidential, hence not shared with the researcher.
- The respondents hold the key to an effective research. When the respondent is biased, ignorant and moody or influenced by any external or internal factor, then the response tends to be incorrect.
- Sample size remains medium and the margin of error associated with it could creep into influence the inferences drawn in this study.
- Long- run success of XBRL in reporting practices can be analysed by taking a longer time period, say post adoption years. For this, one would have to wait for few years to get the relevant data.

Conclusion

Present chapter is aimed at a conceptual framework of corporate financial reporting in general. Further, researcher have focused on motivation for research work, objectives developed on its basis and discussed the methodology to achieve these objectives in the light of research assumption, sample selection and description, data collection, data description, study period and analytical tools and techniques which are applied on arranged data in the present research work. In the last section, researcher have discussed about the limitation of the study which can be overcome in further studies.

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