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Financial Reporting and Corporate Governance in Developing Countries: A literature Review

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Abstract

Transparency is one of those terms that have many facets. It is used in different ways. It can refer to the openness of governmental functions. It can also refer to a country's economy. Or it can refer to various aspects of corporate governance and financial reporting. The Organisation for Economic Co-operation and Development (OECD, 1998) lists transparency as one element of good corporate governance. Kulzick (2004) and others (Blanchet, 2002; Prickett, 2002) view transparency from a user perspective. According to their view, transparency includes the following eight concepts: accuracy, consistency, appropriateness, completeness, clarity, time- liness, convenience, and governance and enforcement. This paper focuses on just one aspect of transparency – timeliness.

Keywords: Financial Reporting,Corporate Governance, APB.

The International Accounting Standards Board considers timeliness to be an essential aspect of financial reporting. In Accounting Principles Board (APB) State- ment No. 4, the APB (1970) in the USA listed timeliness as one of the qualitative objectives of financial reporting disclosure. APB Statement No. 4 was later super- seded but the Financial Accounting Standards Board continued to recognize the importance of timeliness in its *Statement of Financial Accounting Concepts No. 2* (1980). The U.S. Securities and Exchange Commission also recognizes the impor- tance of timeliness and requires that listed companies file their annual 10-K reports by a certain deadline. The OECD (2004) lists timeliness as a principle of good corporate governance.

The issue of timeliness has several facets. There is an inverse relationship between the quality of financial information and the timeliness with which it is reported (Kenley & Staubus, 1974). Accounting information becomes less relevant with the passage of time (Atiase, Bamber, & Tse, 1989; Hendriksen & van Breda, 1992; Lawrence & Glover, 1998).

There is some evidence to suggest that it takes more time to report bad news than good news (Bates, 1968; Beaver, 1968), both because companies hesitate to report bad news and because companies take more time to mas- sage the numbers or resort to creative accounting techniques when they have to report bad news (Givoli & Palmon, 1982; Chai & Tung, 2002; Trueman, 1990). Stated differently, there seems to be a tendency to rush good news to press, such as better-than-expected earnings, and delay the reporting of bad news or less-than-expected earnings (Chambers & Penman, 1984; Kross & Schroeder, 1984). Dwyer and Wilson (1989) found this relationship to hold true for municipalities. Haw, Qi, and Wu (2000) found it to be the case with

Chinese companies. Leventis and Weetman (2004) found it to be the case for Greek firms.

However, Annaert, DeCeuster, Polfliet, and Campenhout (2002) found that this was not the case for Belgian companies, and Han and Wang (1998) found that this was not the case for petroleum refining companies, which delayed reporting extraordinarily high profits during the Gulf crisis of the 1990s, perhaps because political repercussions outweighed what would otherwise have been a good market reaction. Rees and Giner (2001) found that companies in France, Germany, and the UK tended to report bad news sooner than good news.

A study by Basu (1997) found that companies tend to report bad news quicker than good news, presumably because of conservatism. Gigler and Hemmer (2001) discuss this point in their study, which finds that firms with more conservative accounting systems are less likely to make timely voluntary disclosures than are firms with less conservative accounting systems.

Building upon the Basu study (1997), Pope and Walker (1999) found that there were cross-jurisdictional effects when extraordinary items were either included or excluded, using US and UK firms for comparison. Han and Wild (1997) examined the potential relationship between earnings timeliness and the share price reactions of competing firms. But Jindrichovska and Mcleay (2005) found that there was no evidence of conservatism in the Czech accounting system when it came to report- ing bad news earlier than good news, presumably because the Czech tax system offers little incentive to do so. Ball, Kothari, and Robin (2000) found that com- panies in jurisdictions that have a strong shareholder orientation tend to disclose earnings information sooner than companies in countries operating under a legal code system.

There is also a relationship between the speed with which financial results are announced and the effect the announcement has on stock prices. If information is released sooner, the effect on stock prices is more pronounced. The longer the time lapse between year-end and the release of the financial information, the less effect there is on stock price, all other things being equal (Ball & Brown, 1968; Brown & Kennelly, 1972). This phenomenon can be explained by the fact that financial infor- mation seems to seep into the stock price over time, so the more time that elapses between year-end and the release of the financial reports, the more such information is already included in the stock price.

Some countries report financial results faster than other countries (Mc Gee & Preobragenskaya, 1005; 2006). DeCeuster and Trappers (1993) found that Belgian companies take longer to report their financial results than do Anglo-Saxon coun- tries. Annaert et al. (2002) found this to be the case for interim information as well. Companies can report financial results faster on the internet and the information can be more widely disbursed but posting 2-year-old annual reports does nothing to improve timeliness (Ashbaugh, Johnstone, & Warfield, 1999).

Atiase et al. (1989) found that large companies report earnings faster than small companies and that the reporting of earnings has a more significant market reac- tion for small firms than for large firms. In a study of Australian firms, Davies and Whittred (1980) found that small firms and large firms made significantly more timely reports than medium-size firms and that profitability was not a significant variable.

Whittred (1980) found that the release of financial information for Australian companies is delayed the first time an audit firm issues a qualified report and that the extent of the delay is longer in cases where the qualification is more serious. Keller (1986) replicated that study for US companies and found the same thing to be true. Whittred and Zimmer (1984) found that it took Australian firms in financial distress a significantly longer time to publish their financial information. A study of more than 5,000 annual reports of French companies found that it took longer to release audit reports where there had been a qualified opinion, and that the more serious the qualification, the greater the delay in releasing the report (Soltani, 2002; also see Ashton, Graul & Newton, 1989).

Krishnan (2005) found that the audit firm's degree of expertise has an effect on the timeliness of the publication of bad earnings news. Audit firms that specialize in the industry in which the company operates are timelier in reporting bad financial news than are audit firms that have less industry expertise.

The OECD (2004) lists timeliness as a principle of good corporate governance. The World Bank conducted more than 40 studies of various aspects of corporate governance in various countries. More than 20 of those studies examined corporate governance practices in developing economies. One item looked at the timeliness and accuracy of financial disclosure. It ranked timeliness and accuracy into the fol- lowing five categories:

O = Observed
LO = Largely Observed
PO = Partially Observed
MNO = Materially Not Observed
NO = Not Observed

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