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# AN ANALYSIS ON EMERGING CAPITAL MARKETS AND GLOBALIZATION: CORPORATE FINANCIAL REPORTING PRACTICES

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# An Analysis on Emerging Capital Markets and Globalization: Corporate Financial Reporting Practices

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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.***

***Financial reports are intended to meet the needs of decision makers. Accordingly, timeliness is identified as one of the characteristics of information in financial reporting. To accomplish this objective, financial reports must be available on time to inform decision making. Therefore, financial reports should be published as soon as possible after the end of the accounting period.***

***This study reveals that the establishment of the Indian Stock Exchange and the introduction of new accounting regulations in India did not alter significantly the accounting measurement methods used by the companies. While mandatory disclosure declined, overall disclosure, voluntary disclosure and, in a large measure, the disclosure of categories of information increased over the ten years. Firm size and listing status were found to be significantly positively associated with overall disclosure and voluntary disclosure. Accounting regulation was significantly positively associated with overall disclosure, but not mandatory disclosure.***

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## INTRODUCTION

Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions.

Financial statements also show the results of the management's stewardship of the resources entrusted to it (IAS 1). With the increasing complexity of business operations and the growth of the investment community, investors are making greater demands for more relevant and more timely information.

The conceptual framework of financial reporting of accounting standard setters worldwide (e.g. the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB)) recognizes timeliness as one of the characteristics which determines the relevance of accounting information. Users need timely information to enable them make apromptly review to decide whether tocommit or continue to commit their capital in a company. Delays in disclosing timely information on the preparers' part would result in greater market inefficiency. (Ismail & Chandler, 2004) Regulatory agencies around the world have set statutory maximum time limits within which public companies are required to issue audited financial statements to shareholders and other external users and file them with concerned regulatory bodies. The purpose of this Communiqué is to determine the rules, procedures, and principles regarding the financial reports to be drawn up by enterprises in order to ensure that sufficient and accurate information are disclosed to the public on a timely basis as well as prepared and submitted to the relevant authorities. According to this Communiqué, companies shall submit their annual financial reports and the related independent audit reports to the Board and the stock exchange,

a) Within ten weeks following the end of the accounting period where there is no obligation to prepare consolidated financial statements.

b) Within fourteen weeks following the end of the accounting period where there is an obligation to prepare consolidated financial statements.

The main trends in emerging markets corporate finance include an increase in corporate bond issuance and stagnation or a decline in bank lending and equity issuance. As a result, in part, of a series of policy measures, corporate bonds have become a relevant source of funding in some Asian countries. In contrast, bank lending to the corporate sector and equity issuance have been on the decline, except for a recent timid recovery. Cyclical factors, including expansionary monetary policies, are underpinning this recovery, but it remains unclear to what extent structural factors may continue to constrain some of these sources of funding. In particular, some emerging markets may be starting to experience the process of bank disintermediation that several mature economies have gone through in the 1980s and 1990s, while recent efforts to improve access to equity capital may prove insufficient.

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. “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.”

“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”.

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."

“The system of financial reporting is a function of the economic, legal and political institutions in a country. The changes taking place in the commercial world due to globalization have resulted in accountancy profession critically reviewing its role and relevance of its curriculum. In early times accounting was merely concerned with ascertainment of results of business enterprises. But, financial reporting has a new orientation these days owing to the increased needs of users accounting information. New accounting principles are constantly evolving and are influenced by changes in social, legal and economic environment and professional bodies like ICAI, the AICPA, IASB and the needs of users" financial information.”

Creating a financial report is obviously one of the most important jobs for an accountant during the course of a fiscal year. It is essential to keep investors and stakeholders apprised of a company's financial situation to maintain good business relationships and fulfill investor contracts. “When the international business environment is undergoing rapid transformation and new linkages are sought to be enforced through multilateral trade negotiations, there is a need for restructuring the industry, agriculture and other sectors of economy to meet new challenges in the changing global business scenario. As a result, corporate reporting has also undergone a sea change, presenting newer challenges and further opportunities.” Although some investors prefer the traditional "numbers on a page" approach to financial reporting, but time is changing. New technologies have shifted the paradigm financial reporting.

## LITERATURE REVIEW

The conceptual framework of corporate financial reporting is, by now, well-documented in the literature. A significant research has been done to investigate the framework of corporate financial reporting across a number of different capital markets over a range of different time horizon. Some of these researches are described here as follows.

Oyelere, Laswad and Fisher (2000) examined the extent and determinants of voluntary corporate Internet financial reporting (IFR) in two hundred and twenty-nine (229) companies listed on the New Zealand Stock Exchange (NZSE) as at the end of 1998 by applying univariate and multivariate analytical approaches. The results indicated that some determinants of traditional financial reporting such as firm size and spread of shareholding are influential determinants of IFR. However, other characteristics such as liquidity do not significantly explain the choice to use Internet as a medium for corporate financial reporting.

Financial Accounting Standards Board (2008) described ―the objective of financial reporting, the primary user group to which financial reporting is directed, the types of decisions made by that group, and the financial information useful to that group in making those decisions and the qualitative characteristics that make financial information useful.

Vishnani and Shah (2008) aimed ―at determining the value relevance of financial reporting. They explained likely impact of financial reporting by listed companies on the market prices of their shares by applying regression analysis and revealed that value relevance of published financial statements, per se, is negligible. However, ratios based on these financial statements show significant association with stock market indicators.‖.

Conover, Miller, & Szakmary (2008) examine financial reporting lags, the incidence of late filing, and the relationship between reporting lags, firm performance and the degree of capital market scrutiny. They use a large sample of firms spanning 22 countries over a eleven-year period. A focal point of our analysis is whether the incidence of late filing, and the relations between reporting days and other variables differ systematically between common and code law countries. Relative to U.S. firms, they report that the time taken and allowed for filing is usually longer in other countries and that the statutory requirement is more frequently violated. Timely filing is found to be less frequent in code law countries. Poor firm performance and longer reporting lags are more strongly linked in common law countries. They also find that whereas greater capital market scrutiny and more timely filing are related, there is less support for a relationship between the level of debt financing and timely filing in code law countries.

Said (2009) examined ―the Final report of the Advisory Report of the Advisory Committee on Improvements to Financial Reporting that offers a number of recommendations to progressively redress accounting standards in major areas for which the existing complex systems of standards, rules, and regulations that fail to provide relevant and transparent financial information. He concentrates on the sources that create substantive complexity and provides an analytical insight of the recommendations also provides implications for accounting educators as well as practicing professionals.‖

Dai (2011) focused the changes of economic environment, the accounting profession of China urges to build a conceptual framework of Chinese financial accounting. Starting from the connotations and effects of conceptual framework of financial accounting, the researcher analyzed the previous researches on conceptual framework of Chinese financial accounting, presenting suggestions for constructing the conceptual framework of Chinese financial accounting from four aspects: basic principles, basic relationships, levels and contents, construction institute and the name.

McGee & Yuan (2011) compare the timeliness of financial reporting in Republic of China, United States and European Union (EU). Their study also compares timeliness data on the basis of audit firm to determine whether companies audited by one of the Big-4 firms are more timely in their financial reporting. Results indicate that Chinese companies took significantly longer time to report financial results than either the EU or US companies.

EU companies took significantly longer time to report financial results than US companies. Companies that are not timely in their financial reporting practices find it more difficult to attract capital. Their corporate governance practices are also seen less than ideal, which has a negative effect on a company's reputation within the financial community. Thus, Chinese companies that are slow in reporting their financial results may suffer negative consequences in terms of reputation and ability to raise capital.

Lin (2012) contributed to the literature by providing preliminary evidence on the extent to which reporting incentives play an important role in IFRS compliance and the economic benefit of IFRS compliance in a developing country where enforcement is weak.

Srivastava and Bhutani (2012) made an attempt to find out up to what extent IFRS has been adopted by the organizations, what challenges and opportunities companies facing regarding IFRS, and what the measures that can be taken to make the process smooth and flawless. Authors surveyed the awareness and adoption of IFRS in India in 2011 by questionnaire analysis which was given to 150 respondents (academicians, finance professional, auditors and accountants) but only 100 answered the questions. The collected data were analyzed and interpreted through graphical presentation and tabular method. They found that the employees of the accounting department were aware of the standards to be implemented, yet they were not fully clear about the content.

Sharma and Sharma (2013) modeled Confirmatory factor analysis was carried out on the responses of public and private sector employees working in various sectors of service industries of Jammu region (India) using AMOS 16 Software package against the various dimensions of DUWAS. The current study contributed to the existing literature by examining the psychometric properties of Dutch Work Addiction Scale (DUWAS). The results provided support for the first-order a priori 3-factor, 20-item DUWAS scale which collectively comprised second order factor called workaholism.

## CORPORATE FINANCIAL REPORTING

At the core of the corporate reporting model is the financial reporting model, consisting of financial statements and accompanying notes that comply with generally accepted accounting principles (GAAP). Financial reporting is the communication of financial information of an enterprise to the external world. Currently, the legal framework within which companies operate is governed extensively by financial reporting standards or accounting standards. The overview of the legal and regulatory requirements for corporate financial reporting considers laws and accounting standards.

The corporate and financial reporting regulation enshrined in the corporate and securities law is designed to make directors (formerly and generally entrepreneurs) accountable to shareholders and investors by requiring them to make disclosure of the utilization of the funds provided. Corporate accountability is now increasingly extended to a wider group of stakeholders. The current review of the law is to support this view in a move to recognize a broader range of concerns in the corporate environment.

“India is a federal state with unitary bias. This is perhaps why, unlike in the USA, there is no separate company law for any state in India. Apart from professional regulation, corporate financial reporting in India is governed primarily by one central Act i.e., the Companies Act, 1956. Another body that has a major influence in reshaping Indian financial reporting is the Securities and Exchange Board of India (SEBI). The Companies Act, 1956 prescribes the financial reporting requirements for all the companies registered under it. The reporting requirements that are imposed by the SEBI through its Guidelines and through the Listing Agreement are in addition to those prescribed under the Companies Act. SEBI requirements are to be followed by the companies listed in the Indian stock exchanges. The Companies Act and the SEBI requirements together provide the legal framework of corporate reporting in India.”. Before elaborating the legal requirements, it may be interesting to discuss the role of the SEBI as it is pioneer to introduce certain changes (e.g., cash flow statement) in the area of corporate financial reporting. Following sections sequentially discuss the role of the SEBI, the Companies Act and SEBI reporting requirements.

Indian Accounting Standards, (Indian AS) are a set of thirty two accounting standards notified by the Ministry of Corporate Affairs which are converged with IFRS. These accounting standards are formulated by Accounting Standards Board of ICAI. Now India will have two sets of accounting standards viz. existing accounting standards under Companies (Accounting Standard) Rules, 2006 and IFRS converged Indian Accounting Standards (Ind AS). The Ind AS are named and numbered in the same way as the corresponding IFRS.

## 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.” (www.ghanaweb.com, 2011).

“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.”

## QUALITY OF FINANCIAL REPORTING IN CAPITAL MARKETS

Capital markets in developing countries, which constitute a significant part of what has become known as the emerging capital markets (ECMs), are an integral segment of the global capital market and cannot, therefore, be viewed in isolation. ECMs compete for investment funds and investment opportunities with the developed capital markets. It is necessary, therefore, that ECMs become well positioned if they are to compete favourably with the developed capital markets. This requires that measures appropriate to their growth are promoted. One such measure is high quality financial reporting, at which this study is directed. A high level of accountability and transparency in corporate dealings, among others, increases the confidence that investors have in capital markets (Sutton, 1997).

The financial reporting process produces information which is used by investors to monitor the behaviour and actions of management and for making investment decisions. The separation of ownership and management inherent in the modern corporate structure makes it necessary for investors to monitor the actions and performance of management in order that their interests may be protected. This monitoring process feeds on information. Investment decision making involves an assessment of the probability distribution of future returns and the selection of securities which offer investors the best returns for their risk preferences.

This process is hindered by uncertainty. The availability of financial and other information reduces uncertainty. The monitoring of the actions and performance of management and investment decision making are aided by high quality corporate information generated by the financial reporting process.

Accounting standards, whether developed for domestic or international application, aim at ensuring comparability and adequacy, among others, of financial reports. Such has been the aim of International Accounting Standards (IASs) developed by the International Accounting Standards Committee (IASC). The observance of IASC standards by companies should foster comparability and adequacy of financial reports. Similarly, domestic accounting regulation should, all things being equal, lead to comparable and adequate financial reports.

The accounting infrastructure is, without doubt, an important factor in the development and growth of ECMs because it is a major source of corporate information. However, it is generally the case that the quality of financial reporting leaves much to be desired. Not only are regulations inadequate, non-compliance with regulations is widespread. Apart from low disclosure levels, diversity in accounting methods used by companies in ECMs is prevalent (Nicholls and Ahmed, 1995; Saudagaran and Diga, 1997b). The perceived low quality of financial reporting also raises doubts about the observance of IASC standards in ECMs. It is generally contended that the perceived low quality of financial reporting in ECMs is an inhibition to their growth as it tends to erode the confidence of investors.

## GLOBALIZATION OF CAPITAL MARKETS

As mentioned above, the recent developments in domestic capital markets, as well as their prospects, would be difficult to understand without considering the trends in global capital markets. Studying how international capital markets have evolved helps not only for setting a benchmark to assess the performance of domestic markets, but also for understanding the degree to which local developments are the result of changes in international capital markets. This section first outlines the main developments in international capital markets and then describes how Latin American countries have responded to these worldwide developments.

An important message from this section is that financial globalization has expanded to a degree that it has become difficult to ignore. Moreover, many new developments have taken place in the last three decades, bringing about significant changes to capital markets in both developed and developing nations. However, despite the perception of widespread financial globalization, the international financial system is far from being perfectly integrated, and there is evidence of persistent capital market segmentation both across and within countries.

Capital markets in developed countries have grown substantially over the past three decades, experiencing a large boom in the 1990s. As part of this process, companies raised more capital in bond and equity markets, while both retail and institutional investors increased their participation in those markets. Financial markets experienced such a robust expansion that by 2004 the combined credit to the private sector by financial institutions, stock market capitalization, and private bonds outstanding reached an average of over 260 percent of GDP for G-7 countries, compared with about 100 percent in 1975.

The development of capital markets in rich countries has been accompanied by an increasing financial integration across nations. This globalization is not new. International capital flows have existed for a long time.

In fact, according to some measures, the extent of global capital mobility and capital flows a hundred years ago—especially during the gold standard era (roughly from 1880 to 1914)—is comparable to today's level. At that time, however, few countries and sectors participated in financial globalization. Although globalization at the beginning of the 20th century mainly entailed flows from rich countries to emerging economies, most of the action in the more recent globalization phase has taken place among developed economies. In this phase, capital flows across developed countries have increased sharply.

Although most of the capital market development and globalization portrayed above have taken place in financial centers and in developed economies, developing countries have also been affected by the same underlying trends and were able to participate to some extent in these processes. The global trends affected developing countries in at least two ways. First, new capital became available in international financial markets, with developing countries trying to attract it to their domestic markets. Second, developing countries tried to emulate the increasing use of capital markets that characterized developed economies by reforming their local markets.

## CONCLUSION

A sound corporate financial reporting practices are the cornerstone of a well-functioning market economy and the bedrock of a healthy financial system. Corporate Reporting is the process of communicating information (both financial and non-financial) about the resources and performance of the reporting entity. It is the process of communicating both financial & non-financial information relating to the resources & performance of a company because reporting of both type of information is play an important role of stakeholder's decision making as well as in company's performance.

Financial reporting is performed by every organization as well as business in order to evaluate its financial performance. It also indicates that how well or poor a company has performed during a particular financial year. It consists of preparing of financial reports or financial statements and then analyzing the performance of a company on an overall basis.

It is not only necessary that users have financial information which is relevant to their predictions and decisions; the information should also be current in nature rather than relating only to prior periods. The information used by investors and creditors should be current at the time of making the predictions and decisions. The accumulation and summarization of accounting information and its publication should be as rapid as possible to assure the availability of current information to the users.

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