

RETROSPECTIVE OF FINANCIAL REPORTING ON CAPITAL MARKET

Diana Mureşan¹

ABSTRACT: The purpose of this paper is to develop a conceptual framework for the evolution of financial reporting on capital market. Due to the worldwide changes, the role of financial reporting in capital market is constantly growing. Financial reporting analyzed through market perspective is strongly correlated with issues like: capital allocation, financial statements, international accounting standards and informational valences. Capital market research emphasizes the need for qualitative and transparent financial reporting which require an increased level of information accuracy. Thus, financial statements are measured in terms of comparability and disclosure. This paper presents a qualitative research through a content analysis of several articles related to financial reporting on capital market.

Key words: financial reporting, capital market, international accounting standards, financial information, disclosure.

JEL Codes: G15, M41

Introduction

World changes have determined major implications on global capital markets. The most important changes were technological ones which have facilitated the access on capital markets (Sutton M.H., 1997). It was proved that institutional improvements and changes in financial technologies have provided a major impetus for the expansion of global capital markets (Kai Li, 2007).

Capital markets are one of the two main pillar of the financial system together with banking system (Pálosi-Németh B., 2007). The efficiency of capital market depends on a defined set of standards and principles according to the Chairman of SEC (Securities and Exchange Commission) Wallman S. (1996), along with information accuracy and strong listing requirements.

The aim of this paper is to develop a conceptual framework for the evolution of financial reporting on capital market that will contribute to capital market research. This type of research has raised the interest of many researchers, following its evolution and development, due to the influence that capital market has on economic growth (Singh A. and Weisse B.A., 1998). Still, just the existence of a capital market doesn't support a growth in economy (Durnev A. et al., 2004).

Global capital market recognizes as a benchmark of the qualitative and transparent financial reporting, U.S. capital market (Sutton M.H., 1997). U.S. financial reporting system is considered an ideal one and their success is based on a full disclosure. Also, strict requirements raise up the superiority of both U.S. and United Kingdom capital markets (Saudagaran, S.M. and Diga, J.G., 1997).

Analysis of literature

For a real presentation of the status of literature in this field, we have examined the main articles related to this theme from 1994 to present. It has been noted an increase of research of financial reporting on capital market after 2005 (see Appendix 1). Most of the articles that approach this theme make a clear distinction between emerging and developed markets due to the different level of development, different requirements of stock exchanges and various interpretations and

¹ Babeş-Bolyai University, Cluj-Napoca, e-mail: diana.muresan@econ.ubbcluj.ro

manifestations of capital market fluctuations. Investigated studies have given a significant importance to accuracy and asymmetry of information dividing the articles in these categories.

Research methodology

Research methodology used for developing this theme is related to capital market research, with a positive research current. The content analysis of selected articles was made in order to bring to forefront the main subjects related to this topic. Articles used are from international database and their analysis include: a content analyses, research methods, year of publication, name of publishing journal, emerging and developed markets classification, accuracy or asymmetry information ranking. The content analyses allowed us to make a classification of the factors with great impact on capital market. Research methods used are both qualitative and quantitative (see Appendix 1).

The main issues related to financial reporting on capital market

In order to emphasize the trend that our theme is following we have split the studied literature in several subthemes strict related to financial reporting on capital market. Our research design is described in Figure 1 presented below:

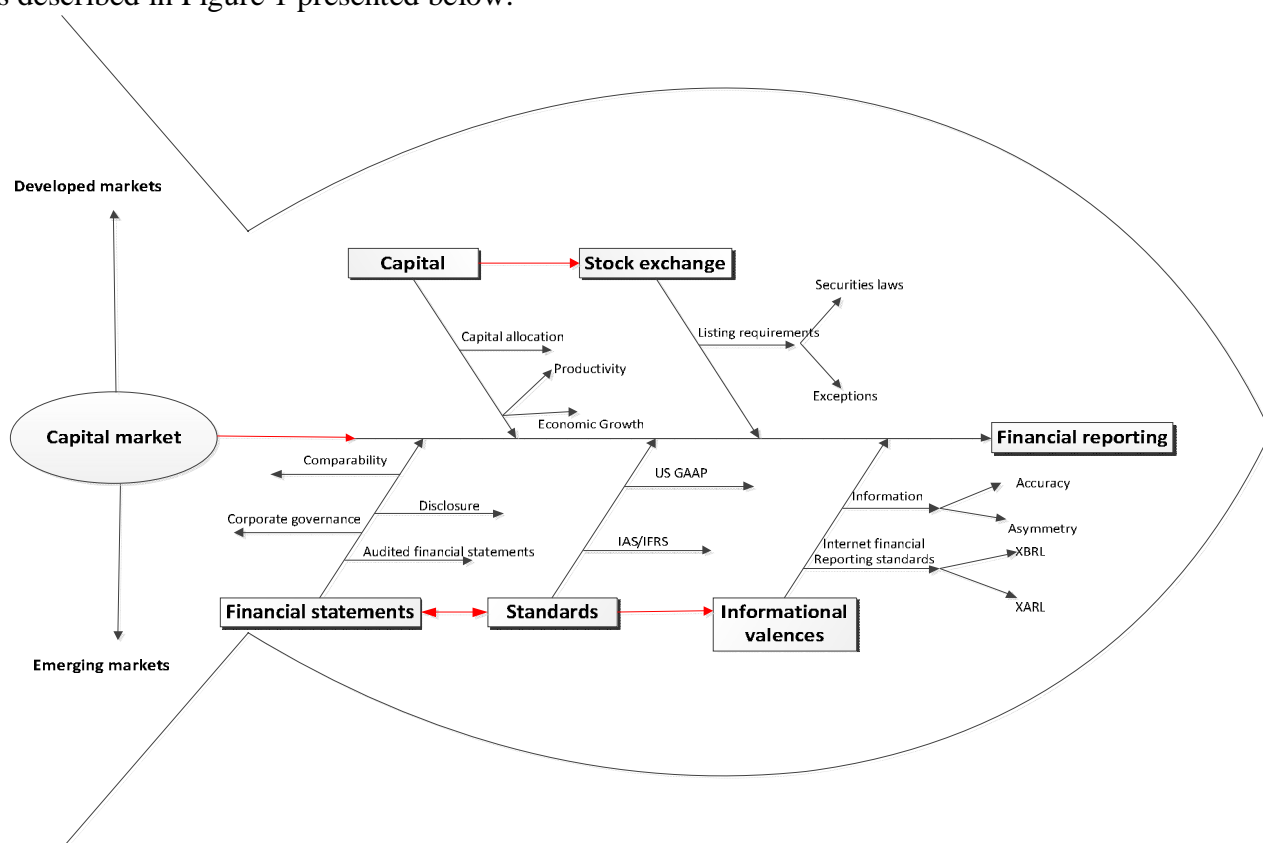


Figure no. 1.- Financial reporting on capital market

Source: accomplished by author

1. Capital allocation

Capital is located in the center of capital market and its allocation must be efficient and reliable. In order the capital allocation contribute to the development of capital market, the researchers have took into account its impact on economy and investors decision.

An efficient allocation leads to increased productivity and economic growth (Durnev A. et al., 2004), but are preferred markets which are more developed, more liquid, with a higher degree of market efficiency and smaller cost of transaction (Thapa C. and Poshakwale S., 2012). Han Kim, (1998) shows that capital market openness to foreign investors is benefic for the majority of emergent economies although investments in emerging markets are more volatile (Saudagaran S.M.

and Diga J.G., 1997) and subject to higher risk premiums (Hearn B. et al., 2010). Financial markets globalization will allow the access to portfolio investment opportunities worldwide (Saudagaran S.M. and Diga J.G., 1997).

2. *Listing on stock exchange*

Listing on stock exchanges implies the fulfilling of requirements both financial and non-financial. Stulz R. (2009) observed that if companies have the possibility to choose to what kind of securities laws they are subject to, when they go public, their options will be different, some will choose stronger securities laws than their national laws and some will do the contrary. SEC regulations present some exceptions for foreign issuers which have become the subject of research for many authors. Gotti G. and Mastrolia S. (2012) examine the quality of financial reporting of foreign issuers which are exempt from filing reports under SEC Rule 12g3-2b (exemption requirements are total assets less than \$10 million, more than 500 shareholders and less than 300 U.S. shareholders). The results show that the quality of financial reporting under SEC is higher than excepted reporting. Another exception is study by Yongtae K. (2012) who analyze capital market consequences of elimination by SEC of the US GAAP reconciliation requirements for listed foreign companies, if financial statements are in accordance with IFRS. This elimination is due to the convergence process between IFRS and GAAP. The results show that the removal doesn't affect stock market and that firms do not change their voluntary frequency.

3. *Financial statements*

Financial statements are an essential component of the financial reporting system that is necessary for the proper functioning of capital markets according to a statement made by Paul Behets, the President of the Belgian Institute of Registered Auditors, in a congress of the European Accounting Association in 2000 (Baker R. and Wallagey P., 2000). Currently accepted model of financial reporting might be replaced by electronic information systems (Elliott, 1994). This could provide other financial information and companies data, besides *audited financial statements* which could be available on Internet. Audited financial reporting is considered to offer value to capital market (Bottom E., 1998).

Due to the continuous developing of market, investors will seek to compare investments opportunities, and there will be an increasing request of common financial statements and disclosure (Sutton M.H., 1997). Although, Choi and Levick (1990) claim that investors are willing to cope with diversity and not perceive accounting differences as barriers. For achieving comparability must be used the same methods and real representation of events (Gordon I., 2012) albeit some authors (Saudagaran, S.M. and Diga, J.G., 1997) support that even if are used the same policies, accounting reports won't be comparable if the environmental factors differ between countries.

Financial reports are an important component of *corporate governance* even if the form of financial reports can be changed (Elliott, 1994). An effective system of corporate governance requires an effective financial reporting system, and an effective financial reporting system requires a well-ordered system of financial accounting (Baker R. and Wallagey P., 2000).

Based on the fact that US capital markets success is based on full *disclosure*, the importance of disclosure standards has been raised by many authors (Saudagaran S.M. and Diga J.G., 1997, La Porta et al., 2006, Porter B. et al., 1995). Saudagaran S.M. and Diga J.G. (1997) show that emerging capital markets disclose less information than developed markets in his study about the characteristic of financial reporting. He doesn't recommend a voluntary approach in emerging markets because of cultural attitudes and weakness in institution to require appropriate information. The voluntary and obligatory disclosure are considered complementary and offsetting. La Porta et al. (2006) sustains that disclosure standards responsibility is important for capital market development and Porter B. et al. (1995) provides further proof that financial markets reward disclosure of information.

4. *IAS vs US GAAP*

In terms of fundamental accounting disclosures exist a significant degree of variability among emerging capital markets (Saudagaran S.M. and Diga J.G., 1997). This variability is illustrated by the diversity in disclosure requirements in 12 selected emerging capital markets. Authors show that 19 from 30 emerging markets have adopted IAS completely or have used IAS for formulating their accounting standards. This demonstrate that IAS represent only a support for emerging markets, albeit the quality is not given just of IAS adoption. This leads to the conclusion that standards transplanted from a country to other without modifications is useless (Francis, Khurana and Pererira, 2003). IAS standards have to fulfill 3 elements in order to be accepted by SEC (see Sutton M.H., 1997): a basic set of standards, comparability and transparency – “full disclosure”, rigorous interpretation and application.

In many studies have been compared IAS with US GAAP (Leuz, C. 2003, Bartov E. et al. 2005). Previous studies regarding the comparability of financial statements quality based on IAS and US GAAP have presented mixed results. Still, Leuz (2003) show that there are no indices that US GAAP financial reports are more qualitative than IAS. Also, Bartov et al. (2005) haven't discovered any difference in value relevance between IFRS and US GAAP numbers on Germany companies, suggesting this are even comparable. But, Bartov et al. (2005) finds that numbers provided by US firms which utilize GAAP are more relevant in his study about the level of comparability of accounting information between non US companies and US companies that apply GAAP. Leuz C. and Verrecchia R. (2000) studied German firms voluntarily reporting under U.S. GAAP or IFRS and records show that these companies provide important additional information for the market to those provided by the German GAAP. Also were observed few differences between the information provided by U.S. GAAP and those provided by IFRS. Results support either US GAAP adoption either IFRS convergence.

International comparability of financial statements is used as an argument for convergence of local accounting standards with IFRS (Gordon I., 2012). Mylonidis N. and Kollias C. assess the dynamic process of convergence among four major European stock markets: Germany, France, Spain, Italy and results suggest that although some convergence has been taking place over time, it is still in the process of being achieved.

Informational valences

Information provision in financial markets will know an improvement if market performance is regulated according to Bennouri M. et al. (2010).

For the comparability and valuation of financial reporting, information must meet the following criteria: availability, reliability and comparability (see Saudagaran S.M. and Diga J.G., 1997). In the presence of new information, increased liquidity enhances market efficiency as it was demonstrated by Chung D. Hrazdil K. (2010a,b). Regarding security of internet financial reporting, this was treated by Boritz J.E. and Won G. No (2005), Blankespoor E. et al (2011), etc. Boritz J.E. and Won G. No (2005) study the security on internet of financial reporting using XARL and XBRL. XBRL and XARL are mechanisms based on XML to overcome actual limits of information transmission. These provide access to financial information of companies for different users, especially investors and provide a higher confidence in information integrity. Users are assured that accessed information are real and are not altered, ensuring confidentiality. This area has some limitation due to frequent threats on the Internet. Blankespoor E. et al (2011) investigate the impact of SEC's adoption of reporting using XBRL. SEC decided in 2008 to replace the old system EDGAR (Electronic Data Gathering, Analysis and Retrieval) based on static electronic data with XBRL (eXtensible Business Reporting Language). Implementation should be done in 3 phases, between 2009 and 2011. And this study investigates the effects of the first phase of implementation of XBRL on the following aspects of market behavior: trading volume, bid-ask spread and market depth. The results show that those who have adopted XBRL recorded a trading volume smaller, relative to the sample of those who have not adopted. SEC sustains that this new approach will reduce information barriers and will improve market efficiency. Regarding the impact of financial

reporting information to the capital market, in studied articles, this is divided in 2 categories: information accuracy (Bennouri M. et al (2010), Bottom E. (1998), Durnev et al. (2004), Boritz J.E. & Won G. No (2005), Blankespoor E. et al. (2011)) and information asymmetry (Thapa C. & Poshakwale S. (2012), Yongtae K. (2012), Blankespoor E. et al (2011)).

Conclusions

This article bring to forefront the fact that the chosen theme can be divided in several subsections with impact on capital markets, like: capital allocation, listing on stock exchange, financial statements, disclosure, corporate governance, international accounting standards, information etc. Capital allocation must be efficient and reliable in order to increase market performance. The listing on stock exchange supports several exceptions regulated by SEC, for foreign issuers which emphasize contradictory results. Financial statements are an important component of financial reporting system necessary for the proper functioning of capital markets (Paul Behets) and their auditing offers value to capital market (Bottom E. 1998). Even if it is desirable to have a comparable or a unique model for reporting, this is still in process of achieving, due to the national characteristics, cultural influences and submission to different standards. International comparability is used as an argument for convergence of local accounting standards with IFRS (Gordon I., 2012). For achieving qualitative and transparent financial reporting on capital market is required a higher degree of disclosure or even a full disclosure and exigent requirements. Though, should be considered a benchmark, US system which is regarded as an ideal one, even results of IAS and US GAAP comparison present mixed results and made an overview over XBRL adoption which is considered to improve market efficiency and reduce information barriers (Blankespoor E. et al. 2011).

References

1. Baker R., Wallagey P., 2000. *The Future of Financial Reporting in Europe: Its Role in Corporate Governance*, The International Journal of Accounting, vol. 35, no. 2, pp. 173-187
2. Bartov E., Goldberg S., Kim M., 2005. *Comparative value relevance among German, U.S., and international accounting standards: a German stock market perspective*, Journal of Accounting Auditing and Finance, no. 20, p. 95–119
3. Bennouri M., Clark C.R., Robert J., 2010. *Information provision in financial markets*, Research article, Ann Finance, no. 6, pp. 55–286
4. Blankespoor E., Miller B.P., White H.D., 2011. *Capital market effect of financial reporting regulation requiring nontrivial investor involvement: Evidence from the XBRL Mandate*, Sept.
5. Boritz J.E., Won G. No., 2005. *Security in XML. Based financial reporting services on the Internet*, Journal of Accounting and Public Policy, no. 24, pp. 11-35.
6. Bottom E., 1998. *Is accounting a value adding function. Examining financial reporting and auditing with respect to capital markets*, Journal of Accounting Education, vol. 5, no. 1, pp. 262-279
7. Choi F.D., Levich R.M., 1990. *The Capital Market Effects of International Accounting Diversity*, Chicago, IL, Dow Jones-Irwin
8. Chung D., Hrazdil K., 2010a. *Liquidity and market efficiency: A large sample study*, Journal of Banking&Finance, no. 34, pp. 2346-2357
9. Chung D., Hrazdil K., 2010b. *Liquidity and market efficiency: Analysis of NASDAQ firms*, Global Finance Journal, no. 21, pp. 262–274
10. Durnev A., Li K., Mørck R., Yeung B., 2004. *Capital markets and capital allocation: Implications for economies in transition*, Economics of Transition, vol. 12(4), pp. 593–634
11. Elliott R., 1994. *Confronting the Future: Choices for the Attest Function*, Accounting Horizons, no. 8, pp.106-124

12. Francis J., Khurana I. K., Pereira R., 2003. *The role of accounting and auditing in corporate governance and the development of financial markets around the world*, Asia-Pacific Journal of Accounting & Economics, no. 10, pp.1–30
13. Gordon I., Gallery N., 2012. *Assessing financial reporting comparability across institutional settings. The case of pension accounting*, The British Accounting Review, no. 44, pp. 11-20
14. Gotti G., Mastrolia S., 2012. *The Effect on financial reporting quality of an exemption from the SEC reporting requirements for foreign private issuers*, The International Journal of Accounting, vol. XX
15. Han Kim E.H., 1998. *Globalization of Capital Markets and the Asian Financial Crisis*, Journal of Applied Corporate Finance, vol. 11.3, pp. 30-40
16. Hearn B., Piesse J., Strange R., 2010. *Market liquidity and stock size premia in emerging financial markets: The implication for foreign investment*, International Business Review, no. 19, pp. 489-501
17. Kai Li, 2007. *The growth in equity market size and trading activity: An international study*, Journal of Empirical Finance, no.14, pp. 59–90.
18. La Porta R., Lopez-de-Silanes F., Shleifer A., 2006. *What works in securities laws?*, Journal of Finance, no. 61, pp.1–32.
19. Leuz C., 2003. *IAS versus U.S. GAAP: Information asymmetry-bases evidence from Germany's New Market*, Journal of Accounting Research, no 41(June)(3), pp. 445–473
20. Leuz C., Verrechia R., 2000. *The economic consequences of increased disclosure*, Journal of Accounting Research, vol. 38 supplement, pp. 91-124
21. Mylonidis N., Kollias C., 2010. *Dynamic European stock market convergence: Evidence from rolling cointegration analysis in the first euro-decade*, Journal of Banking & Finance, no. 34, pp. 2056–2064.
22. Pálosi-Németh B., 2007. *Emerging capital markets in financial globalization*, Tiger Working Paper no. 100, pp. 1-49.
23. Porter B., Sivakumar K., Waymire G., 1995. *Disclosure policies and shareholder wealth in the early twentieth century, The case of the American Sugar Refining company*, Journal of Accounting&Finance, pp. 121-145.
24. Saudagaran S.M., Diga J.G., 1997. *Financial reporting in emerging capital markets: characteristics and policy issues*, American Accounting Association, Accounting Horizons, vol. 11, no. 2, pp. 41-64
25. Stulz R., 2009. *Securities Laws, Disclosure, and National Capital Markets in the Age of Financial Globalization*, Journal of Accounting Research, vol. 47, no. 2, pp. 349-390
26. Sutton M.H., 1997. *Financial reporting in US CM: international dimensions*, American Accounting Association, Accounting Horizons, vol.11, no. 2, pp. 96-102
27. Thapa C., Poshakwale S., 2012. *Country-specific equity market characteristics and foreign equity portfolio allocation*, Journal of International Money and Finance, no 31, pp. 189–211
28. Wallman S., 1996. *The future of accounting and financial reporting part II: The colorized approach*, Accounting Horizons, June, pp. 138-148
29. Yongtae K., Haindan Li, Siqu Li, 2012. *Does eliminating the Form 20 F reconciliations from IFRS to US GAAP have capital market consequences?*, Journal of Accounting and Economics, no. 53, pp. 249-270

Appendix 1

Analyzed articles related on financial reporting on capital market ordered by years

Journal	Author	Year	Subject	Method Quantitative	Method Qualitative	Emerging Markets	Developed Markets	General	Inf. asymmetry	Inf. accuracy
Accounting Horizons	Elliott, R.	1994	Informational valences		x			x	x	
Journal of Accounting&Finance	Porter, B., Sivakumar, K.,Waymire, G.	1995	Financial statements-disclosure	x			x			x
Accounting Horizons	Saudagaran, S.M., Diga, J.G. (1997)	1997	Financial statements	x		x				
Accounting Horizons	Sutton M.H.	1997	Financial statements-disclosure	x			x			x
Journal of Applied Corporate Finance	Han Kim, E.H.	1998	Capital allocation		x	x			x	
Journal of Accounting Education	Bottom E.	1998	Financial statements		x		x			x
The international Journal of Accounting	Baker, R., Wallagey, P.	2000	Financial statements-Corporate governance		x			x		x
Asia-Pacific Journal of Accounting & Economics	Francis, J., Khurana, I. K., Pereira, R.	2003	IAS vs GAAP	x		x	x			x
Journal of Accounting Research	Leuz, C.	2003	IAS vs GAAP	x				x		x
Economics of Transition	Durnev, A., Li, K., Mørck, R., Yeung, B.	2004	Capital allocation	x		x	x			x
Journal of Accounting, Auditing and Finance	Bartov,E.,Goldberg,S.,Kim,M.	2005	IAS vs GAAP		x		x		x	x
Advances in International Accounting	Prather-Kinsley, J., Shelton, S.W.	2005	IAS vs GAAP	x		x	x			
Journal of Accounting and Public Policy	Boritz, J.E., Won G. No.	2005	Informational valences	x				x		
Journal of Finance	La Porta, R., Lopez-de-Silanes, F., Shleifer, A.	2006	Financial statements-disclosure		x			x		
Journal of accounting research	Stulz R.M.	2009	Listing on stock exchange		x			x		

Internation Business Review, 19,2010, 489-501	Hearn, B., Piesse, J., Strange, R.	2010	Capital allocation	x		x				
Journal of Banking & Finance	Mylonidis, N., Kollias, C.	2010	IAS vs GAAP	x			x			
Journal of Accounting and Economic	Armstrong, C., Guay W., Weber J.	2010	Informational valences		x			x	x	
Ann Finance	Bennouri, M., Clark, C.R., Robert, J.	2010	Informational valences	x				x		
Journal of Banking&Finance	Chung, D., Hrazdil, K.	2010	Informational valences	x			x			
Global Finance Journal	Chung, D., Hrazdil, K.	2010	Informational valences	x			x			
Working Paper	Blankespoor, E., Miller, B.P., White, H.D.	2011	Informational valences	x				x		
Journal of international monetary and finance	Thapa, C., Poshakwale, S.	2012	Capital allocation	x		x	x			
The British Accounting Review	Gordon, I., Gallery, N.	2012	Financial statements-disclosure		x		x		x	
The International Journal of Accounting	Gotti, G., Mastroli, S.	2012	Listing on stock exchange	x				x		
Journal of Accounting and Economics	Yongtae K. (2012)	2012	Listing on stock exchange	x		x			x	x

Source: accomplished by author