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Corporate Governance and the Timeliness of Financial Reporting: A Comparative Study of Developing and Developed Economies

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ABSTRACT

Timeliness of financial reporting is one of the attributes of good corporate governance because shareholders and other stakeholders need information while it is still fresh and the more time that passes between yearend and disclosure, the more stale the information becomes and the less value it has. This study therefore is a Comparative study of developing and developed economies of corporate governance on timeliness of financial reporting of companies. Descriptive statistics show the sample size, range, median, mean, and p-value for both samples. Developing economy's companies took an average of 97.1 days after year-end to report financial results, while developed economy's companies took an average of 65.8 days after year-end to report financial results. The medians for developing and the developed economies were 82 and 53 days, respectively. Using the median data, it appears that the average developing company takes about 29 days longer to report financial results. A Wilcoxon test found the differences in time delay to be significant at the 1 percent level (p- <=2.077e–27). The study recommends that financial reporting quality should be a priority of the managers and policy makers to allow investors to make timely informed decisions on economic resources allocation. Corporate governance mechanisms to be put in place should be supportive of this endeavour. Awareness should also be created amongst the academia, practitioners and policymakers on the significance of timely financial reports.

Keywords: Developing economy, Developed economy. Financial Reporting

Introduction

Timeliness of financial reporting is one of the attributes of good corporate governance identified by the OECD and World Bank. Shareholders and other stakeholders need information while it is still fresh and the more time that passes between year-end and disclosure, the more stale the information becomes and the less value it has. This paper aims to examine the timeliness of financial reporting in the People's Republic of China and to compare it to timeliness in the USA and the European Union (EU). It is important to report financial information in a timely fashion. The longer a company waits to release its annual report and accompanying financial statements, the more stale the information is and the less useful it is. Various organizations have cited the importance of timely financial reporting. The Accounting Principles Board (1970) addressed the issue in one of its statements. The Organisation for Economic Co-operation and Development (OECD, 2004) lists it as an important principle of corporate governance. The World Bank has conducted more than 40 studies on corporate governance in various countries that have included a look at their financial reporting practices, including timeliness. This is one of the first empirical studies, to our knowledge, that has been conducted on the timeliness of financial reporting in an African country. Thus, there is a gap in the literature that needs to be filled. The purpose of the present study is therefore to partially fill that gap. Cadbury (1992) explain that sound corporate governance mechanisms help assure investors that they will get their capital back and receive an adequate return on their investment. Firms with good corporate governance provide transparent disclosures and are investor friendly therefore are able to access capital markets on better terms. A well-developed financial system provides a market for corporate control while a strong legal system protects investors' contractual rights by minimizing the risk of loss from managerial opportunism.

Corporate Governance

Corporate governance is the system of rules, practices, and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure. Governance refers specifically to the set of rules, controls, policies, and resolutions put in place to dictate corporate behavior. Proxy advisors and shareholders are important stakeholders who indirectly affect governance, but these are not examples of governance itself. The board of directors is pivotal in governance, and it can have major ramifications for equity valuation. Communicating a firm's corporate governance is a key component of community and investor relations. On Apple Inc.'s investor relations site, for example, the firm outlines its corporate leadership—its executive team, its board of directors—and its corporate governance, including its committee charters and governance documents, such as bylaws, stock ownership guidelines and articles of incorporation. Most companies strive to have a high level of corporate governance. For many shareholders, it is not enough for a company to merely be profitable; it also needs to demonstrate good corporate citizenship through environmental awareness, ethical behavior, and sound corporate governance practices. Good corporate governance creates a transparent set of rules and controls in which shareholders, directors, and officers have aligned incentives (Muhoro & McGee 2009).

Timeliness of Financial Reporting

Timeliness principle in accounting refers to the need for accounting information to be presented to the users in time to fulfill their decision making needs. Timeliness of accounting information is highly desirable since information that is presented timely is generally more relevant to users while conversely, delay in provision of information tends to render it less relevant to the decision making needs of the users. Timeliness principle is therefore closely related to the relevance principle. Timeliness is important to protect the users of accounting information from basing their decisions on outdated information. Imagine the problem that could arise if a company was to issue its financial statements to the public after 12 months of the accounting period. The users of the financial statements, such as potential investors, would probably find it hard to assess whether the present financial circumstances of the company have changed drastically from those reflected in the financial statements. Foremost, timeliness is defined as the reporting lag from the end of the fiscal period covered by the report to the date of the report. In the second definition, timeliness of earnings reports is relative to their expected dates. A report is classified as early when it is released before the date it is expected and late if it is released after that date. Whereas timely presentation of accounting information is highly desirable, it may conflict with the objective to present reliable information. This is because producing reliable and accurate information may take more time but the delay in provision of accounting information may make it less relevant to users. Therefore, it is necessary that an appropriate balance is achieved between the timeliness and reliability of accounting information.

Corporate Governance and Timeliness of Financial Reporting

McGee and Yuan (2009) opine that one aspect of transparency in financial reporting is timeliness. Generally speaking, it is better to disclose information sooner rather than later. Transparency requirement in financial reporting is widespread and pervasive as companies are required to disclose anything that might influence the investment decision of an informed investor. In developing economy, timeliness of financial reporting is investigated and established to delay when compared to developed econmy companies and faster when compared to Chinese companies. In developed economies, Alford, Jones and Zmijewski (1994) indicate that delays in filing of financial reports affect returns for listed companies. Conover, Miller and Szakmary (2008) also show that poor firm performance and longer reporting lags are strongly linked in common law countries and greater capital market scrutiny and more timely filing are related. Ball, Robin and Sadka (2008) differentiate the role of debt and equity markets size in shaping financial reporting practice by illustrating that timely loss recognition, overall timeliness and conditional conservatism are associated with debt market and not equity market sizes.

McGee and Yuan (2008) explain that timeliness of financial reporting is one of the attributes of good corporate governance identified by the world bank and OECD because shareholders and other stakeholders need information while it is still fresh and the more time that passes between year end and disclosure, the more stale the information becomes and the less value it has. As corporate governance has always attracted significant attention in all times. Its presence is like a backbone for any corporate that emphasizes its role for survival and sustainable growth in the long run. In the present condition of globalization and liberalization, governance structures are constantly evolving, and driven by the local and the global factors. There is a debate on the issue of corporate governance, whether it should focus exclusively on protecting the interests of equity stakeholders or it should focus on non-equity stakeholders. One attribute of good corporate governance for company is maintaining transparent policies and reporting practices. In case of reporting, the foremost thing is to report the concerned information well in time, as it may be used by investors, stakeholders, regulatory authorities, decision makers, managers, professional bodies, financial analysts, and academicians. As audited financial statements in the annual report act as a reliable source of information available to the market, its publication should be made in time (Charumathi and Krishnan, 2011).

Determinants of Timeliness of Financial Reports

Literature alludes that Timeliness of financial reporting by companies is influenced by firm corporate governance practices and legal systems in the country of operation. Anderson, Mansi and Reeb (2004) explain that creditor reliance on accounting based covenants suggest that debtors are potentially concerned with board of director characteristics that influence financial accounting process. The study illustrates that cost of debt financing is inversely related to board independence and board size. The study also show that fully independent audit committees are associated with a significantly lower cost of debt financing and yield spreads are also negatively related to audit committee size and the number of audit committee meetings. These findings provide market-based evidence that boards and audit committees are important elements affecting the reliability of financial reports. Joos and Lang (1994) describe the Continental model, present in Germany, France, most of continental Europe and Japan where public reporting is not emphasized. The focus of the Continental model has traditionally been on debt holders, due in part to the large debt holdings of banks. In contrast, the Anglo-Saxon model, present in the U.K. and former colonies, focuses on equity holders and presenting a "true and fair view" of the firm's financial operations. Ball, Kothari and Robin (2000) group countries into those with common law systems, where a shareholder governance model prevails and accounting practices are determined primarily in the private sector, and those with code law systems. The latter generally have a stakeholder governance model whereby major groups contracting with the firm (such as banks, debt holders and labour unions) are represented on corporate boards, and national governments establish and enforce accounting standards. Ball, Kothari and Robin (2000) hypothesize that there is less demand for public disclosure in code law countries because there is greater monitoring of the firm's operations by banks and other stakeholders with close relationships with the firm.

Theoretical Literature Review

This study was guided by the propositions of various theories including Stewardship theory and Resource dependency theory that are discussed below.

Stewardship Theory

Stewardship Theory as explained by Donaldson and Davis (1991) looks at directors and managers as stewards of the Firm. As stewards, they are essentially presumed to be trustworthy individuals and therefore good stewards of the resources entrusted to them, which makes monitoring redundant. The theory holds that there is no inherent, general problem of executive motivation. Given the absence of an inner motivational problem among executives, there is the question of how far executives can achieve the good corporate performance to which they aspire. Thus, stewardship theory holds that performance variations arise from whether the structural situation in which the executive is located facilitates effective action by the executive. Structures will be facilitative of this goal to the extent that they provide clear, consistent role expectations and authorize and empower senior management. In light of this, Cornforth (2002) explain that the main function of the board is not to ensure managerial compliance or conformance but to work with management to improve organizational performance.

Resource Dependency Theory

This theory is based on the premise that an organization depends on its environment for its resources and as such it must establish good relations to ensure constant flow of the resources and information. Davis and Cobb (2009) mentioned three core ideas of the theory: social context matters; organizations have strategies to enhance their autonomy and pursue interests; and power (not just rationality or efficiency) is important for understanding internal and external actions of organizations. Their main emphasis was on power and they stated that if dependence of resources comes from relying on a sole supplier, then the solution is to find and maintain alternatives.

Another solution is in the selection of the board members. Board members are selected for the important external links and knowledge they can bring to the organization and to try to co-opt potential external threat (Cornforth, 2002). The theory suggests that an organization can manage uncertainty by inviting a representative of the source of constraint onto its governing board thus trading sovereignty for support (Davis and Cobb, 2009).

Empirical Review

In the US, where public domestic corporations are required to file financial statements within 90 days of their fiscal year end, Alford, Jones and Zmijewski (1994) examine the timeliness of accounting disclosures and report that firms who file beyond the filing

requirement have poorer performance by both accounting measures and stock returns. The late filers have lower returns on equity, smaller growth in earnings per share, higher financial leverage, and lower internal liquidity for the fiscal year in which they file late.

Market-adjusted stock returns are also lower during the fiscal year in which the firm files ate. Additionally, Alford, Jones and Zmijewski (1994) establish that market adjusted stock returns for late filers are lower in the post 90 day period, past the time when an investor would already be aware that a late filing firm was potentially facing financial difficulty. These returns are also lower the later a firm files past the regulatory requirement. Conover, Miller and Szakmary (2008) examine financial reporting lags, incidence of late filing and the relationship between reporting lags, firm performance and the degree of capital market scrutiny. The study analyzes 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 US firms, the study establishes 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. Further, greater capital market scrutiny and more timely filing are related but there is less support for a relationship between the level of debt financing and timely filing in code law countries.

Broedel Lopes and Walker (2008) investigate the role of a broad set of firm's attributes on three financial reporting features namely; conservatism, timeliness and value relevance. The study establishes that interactions between corporate governance attributes and earnings as well as change in earnings are both positive and significant. Thus, better governed firms, present more timely earnings. Further, cross listing and corporate governance arrangements act as complements to increase timeliness of earnings. McGee and Yuan (2008) examines the timeliness of financial reporting in the people's republic of China and compare the findings with those of non – chinese companies in developed market economies so as to determine whether there is a significant difference. Timeliness of financial reporting measured as number of days elapsed between year end and date of independent auditirs report is established to vary amongs the companies. The study

observes that chinese companies take significantly longer to isue their financial statements than do non – Chinese companies and since timeliness is an attribute of good corporate governance, corporate governance in Chinese companies is not yet on the same level with that of companies in developed economies. Ball, Robin and Sadka (2008) investigate the role of debt and equity markets in shaping

financial reporting practice. Reckoning that timely financial reporting is a costly activity and the quantity of it observed in practice should depend on demand, the study regresses individual country measures of gain and loss recognition timeliness, and overall timeliness, on the sizes of the country's debt and equity markets. The measure of demand is the market size. The study establishes that the gain and loss recognition timeliness as well as the overall reporting timeliness is not associated with equity market size. However, timely loss recognition, overall timeliness and conditional conservatism are associated with debt market size.

Bonsón-Ponte, Escobar-Rodríguez and Borrero-Domínguez (2008) analyze the factors that determine delays in signing of audit reports. The study measures the delay as the number of days that elapse from the closure of the accounting period until the date when the audit report is signed. The study finds that the two factors that characterize the companies that present less audit delay are classified to sectors that are subject to regulatory pressure, such as the financial and energy sectors and the size of the company relative to its sector. Charumathi and Krishnan (2011) analyse the compliance status of timeliness attribute in financial reporting by listed Indian companies understood as stable with good corporate

governance practices. The study concludes that timely publication of results and following the best practices in corporate governance issues alone can help them to attract foreign investments and there by, they can able to assist the country's growth than ever before.

Charumathi and Krishnan (2012) examine timeliness of financial reporting by indian public sector companies that constitute the public sector undetaking index (PSUI) of Bombay stock exchange and compare their reporting patterns for the year 2006 to 2010.

The study establishes that there is a significant difference among the PSUs in their financial reporting pattern. Considering that non compliance appear in all the years, the study suggests that timely publication of financial results and following best practices in

corporate governance issues can help PSUs to improve themselves and assist the country's growth.

Sugut (2014) analyzes the effect of computerized accounting systems on quality of financial reports of NGOs in Nairobi county and concludes that computerized accounting systems factoring their speed, timeliness, accuracy and the possibility of producing quality data affects the quality of financial reports of the NGOs. The drivers for leadership are established to include the board and management independence, effectiveness of both the board and NGO management and the technical knowhow of the staff which enhances the quality of financial reports.

Methodology

Timeliness was determined by counting the number of days that elapsed between yearend and the date of the auditor's report. Data for developing economy was gathered from the financial statements of 46 companies that are listed on the Stock Exchange. Data for the developed economy was collected from the websites of large companies. Such a methodology is less than perfect. The date on the audit report might not be the same as the date the information was released to the general public. However, there is no way to obtain the date the information was released to the general public, so the date on the audit report acted as a surrogate for the actual release date.

Findings

Table 1.1 shows the sample size, range, median, mean, and *p*-value for both samples. Developing economy's companies took an average of 97.1 days after year-end to report financial results, while developed economy's companies took an average of 65.8 days after year-end to report financial results. The medians for developing and the developed were 82 and 53 days, respectively. Using the median data, it appears that the average developing company takes about 29 days longer to report financial results. A Wilcoxon test found the differences in time delay to be significant at the 1 percent level (p^{-} <=2.077e–27).

The chart below shows the median days delay for developing economy and developed economy companies.

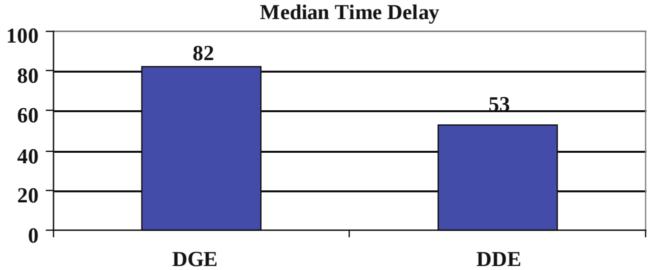

Table 1.1 Full sample data

	Sample size (years)	Mean (days)	Median (days)	Range (days)	*p*- value
DGE companies	556	97.1	82.0	16–357	2.077 e–27*
DDE companies	107	65.8	53.0	8–100	

*Significant at 1%

Table 1.2 A Comparative Study of Financial Reporting in Developing and the Developing Economies

Concluding Comments

The present study compared the time it takes DGE companies to report financial information with the time it takes companies in the DDE. The study found it takes DGE companies about a month longer to report. The difference was found to be significant at the 1 percent level. Companies that are not timely in their financial reporting practices find it more difficult to attract capital. Their corporate governance practices are also seen as 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, all other things being equal.

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