Financial Reporting in Emerging Capital Markets

Characteristics of Financial Reporting in ECMs:

1. Availability—means that financial and other information on publicly traded firms is adequate, timely and conveniently accessible. The adequacy of corporate information is linked inextricably to issues of disclosure.

A higher proportion of companies in ECMs disclose less financial and other information compared to companies in developed capital markets.

Convenient access to financial information is also a key feature of information availability. In the larger and relatively more sophisticated ECMs such as Malaysia and South Africa, real time information is made available through online systems connected to securities exchanges.
In other ECMs, the public dissemination of information is limited by several factors. One is the absence of an efficient securities exchange agency that coordinates the retrieval and dissemination of corporate information.

2. Reliability

Reliability encompasses two requirements. First, financial reports need to be prepared on the basis of sound accounting requirements. Second, adequate steps should be taken to ensure compliance with these accounting requirements.

Some ECMs have attempted to emulate financial requirements in more developed capital markets by adopting IFRS. Adoption of IFRS does not necessarily translate to perceived quality in accounting standards.

A principal source of weakness is the extent to which extant standards do not address specific areas of accounting such as accounting for business combinations,
investments, property and equipment, leases, foreign currency transactions and translations, and financial instruments.

Even where adequate financial accounting standards exist, enforcement is a potential problem in many ECMs. The accounting and auditing profession in some countries may be relatively weak owing to lack of government support or an inadequate degree of organization.

3. Comparability

In the context of financial reporting, it has at least two dimensions. The first dimension is in terms of the specific accounting policies used to prepare financial reports. Various international organizations such as the UN and OECD have asserted that uniform rules for measurement and disclosure are necessary to achieve comparability. The ultimate goal is to ensure a uniform set of minimum standards of disclosure and accounting.
A high degree of accounting diversity exists among ECMs. Countries such as Argentina, Brazil, Greece, and Mexico allow or even require financial statements to be prepared using a basis other than historical cost. Discretionary and hidden reserves are also tolerated in Greece, Nigeria, and Poland thus increasing the potential that reported results are biased towards greater conservatism.

The second dimension often overlooked is the need to understand the contextual significance of financial information. Even if accounting reports are prepared using the same policies, comparability does not exist if the underlying environmental factors which provide significance to the information differ between countries.
Financial Reporting Policy Issues and Options in ECMs

1. the choice between mandated and voluntary approaches to regulation

Proponents of a voluntary approach argue that competitive market pressures would ensure that the optimal level of disclosure is achieved as firms compete to reduce the costs of obtaining funds from the market.

Advocates of the mandatory regulatory approach argue that an adequate framework of disclosure regulation is necessary because of the potential for market failure in the supply of financial information.

An important reason for inadequate levels of disclosure in ECMs relates to cultural attitudes consistent with secrecy and lack of transparency over corporate affairs. Societies with strong collectivist orientation share a strong sense of restricting the access of corporate outsiders to corporate information. Factors creating a strong demand for adequate financial information
also tend to be weaker in ECMs such as the absence of a strong domestic investor base.

2. strengthening enforcement capability

Several factors account for differences in enforcement capability with respect to financial reporting regulations in ECMs. First, government attitude towards capital market development in general and financial reporting in particular varies across countries. Second, enforcement appears to be stronger if a designated government agency is responsible for regulating the securities market. Third, the size and quality of the accounting personnel significantly impacts the enforcement capability in a nation. Fourth, financial reporting is generally more sophisticated in countries that assign a greater role to the private sector particularly the accounting profession in shaping regulations.

3. harmonization of accounting standards
ECM policy makers must grapple with issues regarding the most appropriate financial reporting system for their country. The alternatives range from adopting aspects of regulation in economically advanced countries to formulating a system uniquely tailored to their particular circumstances.