International Journal of Economics, Commerce and Management
United Kingdom Vol. II, Issue 12, Dec 2014
http://ijecm.co.uk/ ISSN 2348 0386

PROPOSING A MODULE FOR TRANSPARENCY IN ACCOUNTING DURING CRISES: AN EMPIRICAL STUDY

Khaled Jamal Jaarat
Department of accounting, Middle East University, Amman, Jordan
khaledjaarat@yahoo.com

Suleiman J. Mohammad
Department of accounting, Middle East University, Amman, Jordan
suleiman0516@gmail.com

Abdullah Al Daas
Department of accounting, Middle East University, Amman, Jordan
aldaasco@gmail.com

Abstract

Transparency plays an important role in the financial accounting disclosures, therefore, the lack of transparency in certain situations where the unplanned, or unanticipated gathering of risks may be a complete consequence of inadequate accounting principles that hide risk itself. An important example of the limitations of standard accounting principles in identifying and revealing large risk exposures is offered by companies financial disclosures. The researcher feels the needs to establish a module that should be included in the financial reporting, to minimize and detect the risk and hopefully avert a company failure. Researchers investigate the effect of financial liberalization on the probability of financial crises in economies with poor transparency. We used Jordan as an example in our study, as we chose 20 listed companies in Amman Stock Exchange as a sample for this study. We interviewed twenty individuals from different financial and experience level, and back grounds, and based on the result and the outcomes we constructed a model for transparency, and recommendations were made to improve transparency in financial reporting. The researchers find out after examining and analyzing the interviewees answers that there is a miss or lack of information to the importance of transparency in the financial disclosures and reporting.

Keywords: Financial liberalization, transparency, financial crisis, risk, financial disclosures

INTRODUCTION

The importance of transparency of economic activity and policy has sprung to the front of economic research following the recent financial and banking crises in the United States, Mexico, South East Asia and Russia. Evidence from other countries that have experienced long period of poor transparency and low growth rate suggest that poor transparency may have adverse affect on long term growth as well.

Transparency is a concept that has become quite an important topic of concerns lately, and it's being applied to a number of situations in business, government, international aid and more. It has traditional elements and new, fast-changing aspects (Campos, 1994). Its relevance in particular for boards, for senior executives, and it has roots in one of our most Muslims values-trust. Unfortunately, transparency is not universally accepted or interpreted the same way around the world. Transparency first started in the area of international aid and politics. Organizations such as the International Monetary Fund (IMF) and the World Bank wanted to be sure that the money they loan to underdeveloped countries was properly disbursed. Financially, these same bodies wanted to see an open accounting of how the money flowed to different projects, and indeed to the people of the country themselves, again without being diverted to personal bank accounts or fraudulent activities companies of those in power (Calvo,1999).

Crises may be considered exceptional situations that impose a specific procedures and treatments, that because misleading information resulted in inaccurate decisions which caused errors that led to losses, and sometimes to bankruptcy and destruction of many related entities shows that poor transparency may lead to “informational overshooting” in the stock market (Bushman, 2010). Financial crises can occur regardless of financial liberalization, but financial liberalization combined with poor transparency increases the probability of a crisis. This paper analyses how poor transparency combined with new and deregulated financial markets may lead to unsustainable investment, and large exposures and vulnerability of financial institutions (Ivanshina &. Scharfstein, 2009).

One of the reasons why crises cause an extraordinary situations are information disclosed by the entities, that sometimes include manipulations, deceive and irritability, irrelevantly and the like (Landsman, 2007).

Accounting give high importance to characteristics of high quality information, through its standard setters like the International Financial Reporting Standard (IASB), The American Financial Accounting Standard Board (FASB), and the British Accounting Standard Board (ASB), These characteristics as they mentioned in associated conceptual frame work of financial reporting between the aforementioned ISB and FASB as followed. Fundamental characteristics; representations of faithfulness and relevance; enhancement characteristics,

timeliness, understandability, comparability and verifiability (Jaarat, 2012). These characteristics does not include an important related characteristics as some studies indicate, like transparency which occupied high attention during later financial crisis2007-2008, However despite the fair presentation of financial statements and the attached disclosures, the facts are these disclosures and statements are insufficient to match the real need of information. The lack referred to ethics, self-control, conducts, morals, and others that rule over the human behavior and practices that make the information more transparent for making decisions purposes.

Importance and Purposes of the Study

Importance of the study derived from the importance of the transparency as qualitative characteristic of financial information that means information should reflect the real position of entity whether its financial, cash , or performance , far from manipulation in accounting alternatives specially those related to recognition and measurement. Thus, the purposes of the study are the followings:

- Discussing the exceptional situation during the financial crisis
- Discussing the accounting responsibility toward fair presentation of financial statements and disclosures
- Studying qualitative characteristics as its mentioned in associated conceptual frame work of financial reporting and its criticism
- Discussing the importance of ethics, morals, religions rules, self-control, conducts in accounting to rule over the practices besides standards and other generally accepted accounting concepts.
- Focusing on transparency as a main requirement for financial reporting during crisis.
- Building a module of transparency can be applied in companies, and presented within the annual report.

Problem and Elements of the Study

No doubt that the availability of information is not considered the main issue in financial reporting, since the users focus on the usefulness of these information in making decisions, so the focus on the characteristics of information not the availability of information itself, these characteristics are identified in the conceptual frameworks that issued by IASB and FASB, but none of these setters includes transparency as a qualitative characteristic, in spite of its importance during the latest financial crisis 2007-2008, all of entities that suffered of bankruptcy during this crisis published financial statements accompanied by disclosures within the annual reports, but all of the presented information did not reflect the actual position of the entities,

however , intended practices done by the entities hided much information affecting both financial position and financial performance, that resulted in unfair presentation of financial statements, reasoned by understating the importance of transparency (Plantin et al, 2008). Depending on that, the problem of the study may be questioned as follow "to what extent, transparency considered as main limitation to useful information especially in crises"?

The elements of the study can be questioned by the followings:

1- Will the adoption of transparency in the financial disclosure minimize the effect of the financial crisis
2- What is the relationship between transparency in the financial reporting and the limitation of financial information

LIMITATIONS OF TRANSPARENCY IN FINANCIAL REPORTING

1. Comparative information that presented in financial statements for one comparative year are insufficient to benefit in comparison between accounting periods, at the same time it is not acceptable to personal information for you because time series analyses is misleading if it is less than 5 years. The relationship to cross management is trend analysis can be adopted by analyzing information for two years, current comparative especially in financial forecasting using historical data wide range.

2. The core problem in accounting information is how this information expressed in terms of numbers that is known in accounting countries as measurement concept (Laux & Leuz, 2010). Measurement has many criticism, it contributed effectively in overstating and ensuring itself in crisis as dominant factor, studies emphasize the following criticism to accounting measured through latest financial crisis:

A. Using different measured basis in accounting, make the proposed financial statements, include mixed figures, these basis like: Historical Cost (H.C) Fair Value, F.V, Net Present Value (NPV), current value (C.V) ….etc. after that all these figures sums in one figure as total assets, the questions arises are these figures meaningful while it is a total for mixed figures, using different measurement basis (Penman, 2007).

B. These measurement basis are not at the same degree of precise for example: H.C is the only generally accepted concept which other like —now days resolution in measured by way F.V because at the end it is estimated value that—according to deferred assumptions, but F.V is an outcome to get rid of measured basis problem in deleting related problems, or vice versa ensuring the problem.

C. The market related measurement basis that depend on market transaction in valuation technique, use deferral duplicate like : activity market, best and lower use, similar and identical assets, and non level 1,2 and 3, approach in determining F.V cost, income, and market …, etc. Those duplicated assumption resulted in duplicated values.

What reduces risk of measurement is transport information to avoid ambiguity and mis-understandability, and at the same time enhance the presentations faithfulness.

3. Financial statements prepared using accounting standard whether international financial reporting or American accounting standard, it assumed that using these standards will result in fair presentation and achieve transparency .but at the same time, there are limitations and critics to the standards minimize the benefit of applying it. (Shaffer, 2010) such as: using treatment alternatives included in the standards, continuous amendments to the standards because of the rapid change of the economic environment, but the conceptual frame work include an exception, that is: the impediments of applying IFRS if the applicants resulted in reliable information. Instead management has to use its judgments that lead to reliable information this exception considered to be important and risky, and might be used in a wrong way to achieve intended interest. This can make transparency difficult concept to be achieved because of manipulations.

4. Financial instruments and related transactions in financial market may be considered as very solid obstacle faced transparency because of many reasons:

- Different classifications resulting in different measurement bases, depending on intended use upon the initial recognition to the same instrument and permission of reclassification from one category to another increasing and assure these difficulties and obstacles
- The absence of actual trade of these instruments for determining their prices besides the lack of expectations, because of the factors and criteria of determining active from non-active market, while the bidding accurate prices supposed to be determined in active market but there are constraints make the market mostly to be classified as non active market like percentage of outstanding instrument in the market, related party transactions, and absence of fair disclosures about all transactions use in determining the prices of the instruments.
- Manipulations and other nominal transactions that lead to increasing prices. Like re-purchasing the shares by the issuer which were called treasury shares and deceiving others by classify it as investment which lead to overstating of owners equity, and assets that resulted in higher share prices.
- Transactions with related parties, like: associates, and subsidiaries, parents, and joint ventures which resulted in un-recognized gains.

5. Issuing IFRS for SME's as consistent as standards to be applied by entities classified as small and medium entities, this standards include many exemptions, exceptions, and limited alternatives. The problem is in distinction between entities considered to be within this cope of this standard and other entities out of it (Jaarat, 2014). Depending, on standards of classification. for example, if the standards of classifications number of employees and suppose that the entity that have fifteen employees maximum classified as medium entity so entity that has sixteen employees out of the scope of the standard despite of the difference between two entities is one employee.

6. Whatever mentioned about transparency, it is a concept not easy to be achieved because it is qualitative characteristics that include qualitative dimension make it not easy to be conceptualized.

METHODOLOGY

In order to induct this study, researchers conducted experimental method through structural interviews, as a data collection method to specialist in financial reporting in entities

All listed companies in Amman Stock Exchange considered being the population of the study; number of it (237) company, and the researchers chose 20 companies as a sample.

ANALYSIS

Researchers analyzed collected data as:

I. Related to part one of the interview , demographic information of the interviewees are as follows:

- Positions of the interviewees as it included in the following table :

Table 1: Positions of the interviewees

Position	**CFO**	**FM**	**OG Assistant**	**Total**
Numbers	8	9	3	20
Percentage	40	45	15	10

High graded positions of interviewees assist in consulting. Precise results help in building a proposed module for transparency.

-Experience Period:

Table 2: Experience level

	Less than ten year	10-20	More than 20	Total
Experience Period	2	14	4	20
Percentage	10%	70%	20%	100%

Information included in the above table shows that 90% of the interviewees had an experience period 10 years and more, which also assist in presence of knowledge background that could be contributed in giving a high qualified opinions in building proposed module of transparency, because they were present during financial crisis.

- Scientific levels:

Table 3: Scientific levels

Level	**BS**	**Master**	**Phd**	**Total**
Numbers	6	13	1	20
Percentage	30%	65%	5%	100%

Information included in the table above shows that all of the respondents (Interviewees) are scientific qualified and know facts about transparency, and the challenges faced companies during financial crisis.

Regarding question 1 of part 2 related to the fact of financial crisis during 2007- 2008, and how can it be called, answers include the followings:

Fact of the financial crisis:

17 of the interviewees support the fact of the financial crisis, during 2007-2008, and it is very obvious through the bankruptcies and shortage in liquidity especially in USA and Europe , but they called it as follows:

A. Liquidity crisis depending on shortage of liquidity in banks, financial institutions and other entities
B. Credit crisis depending on mortgage loans.

C. Liquidation of credit crisis depending on the problem that faced banks, when borrowers failed to pay matured loans, and banks found it to be very difficult to liquidate the mortgages and other guarantees pledged customer loans.

- 3 of the interviewees denied the fact that where was a financial crisis during 2007-2008, they called it a theft trick aimed to steal money and to achieve other purposes, justified their answers by the following:
- Initial area of crisis is USA, and crisis must affect the economic environment in USA especially the currency US dollars but vice versa, the exchange rate of the US dollar raised because of the demand on dollar, it was un-acceptable fact.
- Sudden disappearance of liquidity also is un-acceptable fact, while transferring of liquidity in the entire world could be justified the centralizing of liquidity in some area over the world, but the liquidity disappeared from the entire world, that is unjustifiable?

Regarding to question 2 of part 2 if the latest financial crisis affected their company analyzing the answers revealed the followings:

- 14 answers are yes because there are related items affected by the crisis
- 6 answers are no, because there are no item in the financial statements affected.

Regarding to question 3 of part 2 about the affected items in the financial statements analysis revealed the followings:

A. 14 answers mentioned investment in financial instrument in multi-national companies, including American and Europe companies.

B. The other 6 answers revealed that there are no effects on financial statements , hence, they don't believe in investment in financial instrument for many reasons:

- Trading of financial instrument in financial markets is not actual trading since there no real inventory

- Prices of the instruments determined in non-active market because in reality there are no active markets while criteria and terms of the active market are very difficult to be achieved.

- Hidden transactions that are not disclosed such as transactions with related parties, transactions inside the entity like treasury shares

- The effects on the items included in the financial statements ,the 20 respondents believed in manipulations measurement of these items, especially financial instrument that measured at fair value since value is very difficult to be measured bear in mind the hypnosis that (Fair Value) F.V measurement depend it on.

Regarding question 4 of part 2 about the reasons behind causing financial crisis: The answers assured the following reasons:

A. misinformation and insufficient disclosures
B. manipulations and deceiving
C. Achieving special interest in spite of the ways followed to do that
D. Ethical and morals issues

Regarding question 5 of part 2 that relates to the necessary reporting requirements that make financial statements more transparent , the interviewees assured the following requirements

A. Enlarge and increase disclosures , including the annual reports with comparative disclosures
B. Increasing comparative information that required by IAS 1: presentation of financial statements to 4 years instead of one year, since the one year comparative information are not sufficient to analyze the trend of times series based information.
C. Using different basics of measurement at the same time to reflect the current value of items as an additional disclosures to those information reflected the original or benchmarked measurement
D. Restating of financial statements, to reflect the change in earning power in monetary units, in order to reach to currency units that have the same earning power, because of effects of inflation.
E. Encourage setters of accounting standards to find a permanent solutions to recognition and measurement concepts, as those concepts are dominant factors affect items included in financial statements,
F. The importance of ethics and morals in accounting environment especially in crisis, since improvements and modernization mostly spread over in accelerated rates, spread over at the same time corruption and bad values, also increased in accelerated rates, because of the absence of control factors, such as ethics, religion regulation, morals, good values and laws (Zeira, 1999).
G. Absence of active markets and its assumptions since those markets are the only areas in which prices of financial instruments are determined , so the outstanding of financial instrument is an impossible concepts to be achieved, despite of the facts, values of investments in the instruments determined in these non active markets
H. Latest procedures adopted by setters of accounting standards in financial crisis that minimize the benefit of financial reporting, resulted in reduction of transparency, for example: reclassifications of investments between four categories make the

measurement concept subject to manipulations, since every category has a measurement basis differs from other bases.

Proposed Transparency Module

Depending on aforementioned facts and analysis, researchers proposed the following module to transparency:

1. Comparative Information: since required comparative information by IAS 1 just for one year, in the opinion of the researchers that is not sufficient to compare current period with comparative period, in one hand, on the other hand, comparative period includes only the presented financial statement without any other disclosures. Researchers suggest enlarging and increasing comparative information to include the followings :

A. Increasing comparative financial statement to be presented as additional disclosures in the annual report to four periods.

B. Increasing comparative disclosures to four year periods also, but selecting the material and important disclosures.

2. Restatement of Financial Statements: Because one of the facts related to figures included in the financial statements that, it represents a different earning powers, as a result it is not logical to sum figures together, researchers suggest to restate the financial statements to reflect an equal earning power by modify figures using special index.

3. Risk analysis report: Risks surround businesses all the time and in all sides, Basil agreements emphasize that fact in the banking sector, but banks are one sector plays in the economic environment , researchers suggest the followings:

- Establishing a risk analysis unit in every business
- Assure the independency of those units
- Preparation of a periodic risk analysis report covers all fields in the business
- May be risk analysis department can be established at the level of every sector, and at a level of economic environment in every country

4. Budgeting and expected future change: One of the uses of the historical data and information is using it to generate accounting and financial predictive values throughout budgeting and standardizing. Researchers suggest in this area the followings:

- Focusing on discretionary predictive values to include it in budgets

• Assuring the preparation of budgets not to the upcoming year only, but to maximum periods such as 10 years , of course with taking in consideration the levels of budgeted figures (researchers meant detailed budgeting)

• Issuing a continuity report including all matters relates to continuity or discontinuity of business on quarterly basis at minimum in this report; this report can be prepared and issued by independent agency in the country.

5. External Audit: Assure the role of external auditor in achieving transparency, researchers suggest the followings:

• Consider the professional care in auditing financial statements and all other part of accounting system, especially that relate to the scientific qualification and focuses on electronic system

• Declaring a temporary reports by all observations and notes that affect negatively on transparency

• Consider the external auditor as the eye of the stakeholder in the business.

6. Ethics and Morals: Everything in the world found to serve people, so they (people) can use these things in a bad or a good manner, centralizing the importance of ethics, and morals. Researchers suggest the followings:

• Assure the perfect application of ethics and morals as a control factor to behaviors of all those treat with financial information

• Focus on religion regulations as a directive to ethics, morals, behaviors, values, manners, by - laws and laws, since the best dominate factor-to self-control is religion.

• Building a code of conducts and assuring the punishment and penalties to those who contrivers those conducts.

• Interim financial reporting: big changes taken place during the financial period that mostly is one year, there is a mass need for interim reporting , researchers suggest the followings:

A. Minimize the interim period to monthly reporting

B. Maximize the business's prepared interim reporting to includes all types and sizes of companies

C. Insure the considerations of all matters inside and outside the business environment that effect its financial positions, financial performance and cash position.

Transparency as a qualitative characteristic

Although, transparency considered as an important characteristic of financial information, but till now not included in the conceptual framework of financial reporting that issued by IASB, researchers suggest including transparency, as a qualitative characteristics, through two alternatives, the first: as enhancement characteristics, second : as a main content of representational faithfulness.

Recognition and Measurement:

Recognition relates to include in specific item on the financial statements with a special criteria required include the probability flow of the economic benefits, and the reliability of measurement to these benefits. Measurement relates to grant value to the recognized item, so the measurement considered as a main term in the recognition concept. Recognition and measurement are two difficult concepts to be achieved, which create a big gap between reality and clarity, affected negatively on transparency. Researchers suggested the followings:

A. Disclosing the facts relate to un-recognized items that absent from financial statements like : internally generated intangible assets including good well, contingent assets and liabilities

B. Disclosing the facts of fair value of the of the owner equity, and entity calculated as follow:

Fair value of owners equity = Fair value of entity - Fair value of Liabilities

Fair value of owner equity may be indicated by market price of share:

F.V of ordinary capital = Issued capital (shares) * Market value of shares.

F.V of owner equity= F.V of ordinary capital *(Book value of ordinary capital *total owner equity)

F.V of entity = F.V of OE * (OE/ Total assets)

F.V of entity = fair value of all assets

Or F.V of entity = fair value of entity as cash generating unit (CGU)

Brief Comparative Financial Analysis

Financial analyses relate to find relationships between figures included in the financial statements, which indicate to different situations in entity.

Researchers suggest preparing a brief comparative financial report for five years include the current year: consists of main ten ratios and a summary explanations about the ratios no more than one page

CONCLUSIONS AND RECOMMENDATIONS:

Final conclusive remarks:

A. There is a misinformation leading to decrease level of transparency

B. The importance of transparency as a qualitative characteristic of financial information

C. The ability of building a model to transparency in business

Depending on the aforementioned conclusions, researchers recommend the followings:

A. Adopting the model for transparency proposed by the researchers.

B. Assured the importance of transparency, and support on effort of management toward achieving that.

REFERENCES

Bushman, R. and W.R. Landsman, 2010, The pros and cons of regulating corporate reporting: a critical review of the arguments, Accounting and Business Research, forthcoming.

Calvo, G., 1999, “Contagion in Emerging Markets: When Wall Street Is a Carrier,” University of Maryland

Campos, Ed, Root, Hilton L, 1994. “Information Aggregation and Economic Development: The Case of East Asia” University of Western Ontario, Papers in Political Economy: 50 December 1994, pp. 53

Ivanshina, V., and D.S. Scharfstein, 2009. Bank lending during the financial crisis of 2008. NBER working paper.

Jaarat, Khaled Jamal, 2012. Proposed a new model for qualitative characteristics , Journal of Baghdad for economics and trade,

Jaarat, Khaled Jamal, 2014. International financial Reporting Standards.

Landsman, W.R., 2007, Is fair value accounting information relevant and reliable? Evidence from capital market research, Accounting Business & Research Special Issue: International Accounting Policy Forum, 19-30.

Laux, C., and Leuz, C., 2010, Did Fair-Value Accounting Contribute to the Financial Crisis?,Journal of Economic Perspectives, forthcoming

Penman, S.H., 2007. Financial reporting quality: is fair value a plus or a minus? Accounting Business & Research Special Issue: International Accounting Policy Forum, 33-44.

Plantin, G., H. Sapra, and H. S. Shin. 2008a. Fair value accounting and financial stability. Financial Stability Review 12, Banque de France, Paris

Shaffer, S., 2010, Fair value accounting: villain or innocent victim – exploring the links between fair value accounting, bank regulatory capital and the recent financial crisis, Working paper, (Federal Reserve Bank of Boston Quantitative Analysis Unit).

Zeira, Joseph, 1999. “Informational overshooting, booms, and crashes.”Journal of Monetary Economics, v43 1999, PP 237–257.