Conceptual Framework for Financial Reporting and Bridging Users Information Needs' Gap

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Abstract- *In the past decade the rise in the use of conceptual framework for financial reporting in many countries around the world has moved the wave towards developing countries considering how it can bridge users' information needs' gap and expectation gap. Factually, almost all investors presently use financial reporting across the globe. Out of this numerous users of financial report, almost all wants to know how can the conceptual framework for financial reporting help improve users of financial statement. However, it is quite surprising that investors still have issues in their profit oriented nature, because it is believed that the financial report should be able to help improve their profit, and foresee the future and sustainability of their business. However, to operate in the global financial markets, there is an urgent need for a uniform global financial reporting framework to bridge the users' information needs' gap.*

Key words: Financial reporting, Conceptual Framework, Users information Need Gap, Financial reporting disclosure.

1.0 Introduction

Financial reporting is the process in which financial information about a business entity is prepared in various formats and disseminated to users of such information. Financial reporting is the extent to which the financial statements provide true and fair information about the underlying performance and financial position (Gray and Manson, 2000). However, the accepted definition is provided by Arcas and Marti, (2016) who state that financial reporting is full and transparent financial information that is not designed to obfuscate or mislead users.

The annual report and accounts of a company is the most common format of formal financial reporting. The financial statements present a report on the financial performance of the company over the previous financial year and the financial position of the company as at the end of that year. Which include the balance sheet, and the income statement, the cash flow statement and the notes to the accounts. The directors' report and other statements produced in the annual report and accounts provide supporting information, much of it in narrative than in numerical form. Shareholders and other investors use the information in the annual report and accounts to assess the stewardship of the directors and the financial health of the company (He, 2015).

According to Olowokure et al., (2016) the issues relating to financial reporting could be traced back to 1975 with the start of what was then known as corporate report, in England. In Nigeria, following the increasing demand for financial information on companies, financial reporting has now assumed an appreciable position because it provides information that is useful to current and potential investors, creditors and other users in making rational investment, credit, and other financial decisions. It also enables users to assess the amount, timing, and uncertainty of prospective cash receipts about economic resources, the claims to those resources and the changes in them.

Financial reporting is a two party transaction in which the issuers of the financial reports provide the report to the users, who use the financial information with the expectation that the report will assist the users to enhance their financial decision making. The issue of quality in financial reports is of main concern to the whole society as it affects economic decisions which may have significant impact. The concept of financial reporting is therefore broad and includes financial information, disclosures and non-financial information useful for decision making.

The framework for financial reporting includes locally applicable accounting laws, rules, regulations and standards, that are determined by regulatory authorities such as the Nigerian Accounting Standard Board (NASB), which functions under a set of assumptions, constraints and principles. According to Adhikari, and Garseth-Nesbakk, (2016), accounting framework, can be describe as Generally Accepted Accounting Principles (GAAP), that should not be seen as a constitution but as ordinary guidelines to preparers of financial statements. Wojciech (2018) observed that process of financial reporting is closely associated with human beings' societal actions. According to him, a directive conceptual framework for financial reporting is authoritative not only to the business entities but also to the hypothesis and principles of accounting.

2.0 Conceptual Review

2.1 Financial Reporting

Financial reporting is a process of reporting financial activities of business on a formal way. It has been considered as a crucial resource for any market participant. Also, it reduces conflict in opinion between interested users such as managers, society, investors, regulatory agencies and stakeholders. Every one contributes in this process, even each operation related to this process should be submitted carefully, particularly the disclosure process, all transactions, the accounting policies and all judgments and opinions made by the staff involved in this process (Gaynor et al., 2016). Explaining variation in firm performance is the central focus of much of the strategy literature. A large part of literature and previous studies try to examine quality of financial reporting and its effects on the subsequent performance of a company.

The important characteristics for effective financial management include- access to relevant information; use of that information to enhance management standards; and assurance that the information is accurate, relevant and secure (Bracci, Humphrey, Moll, and Steccolini, 2015). Accounting information systems maintain and produce the data (e.g. financial statements containing information about accounts and their balances) used by organizations to plan, evaluate and diagnose operations and financial position (Peters and Hlla, 2015), therefore, the aim of the regulators should be to make a system (accounting) that offers maximal benefits at lowest possible costs.

Other benefits of having high-quality information from financial reporting are mentioned in Lambert et al. (2007). He clarifies that the high-quality information guarantees the reduction of information risk and liquidity. Other opinions are mentioned in Chatterjee, et al. (2017): It reduces the mangers authority and power in making decisions for their own interests and guides them to make appropriate and efficient investment decisions. Rajgopal and Cohen, and Karatzimas, (2017) add that the high-quality financial reporting reduces the lack of equivalence and the asymmetric information that arises from conflicting agency. It also helps market agents to get full understanding about all company operations and activities by reducing the ambiguity that surround some events (Chatterjee, et al. (2017).

2.2 The Financial Reporting Framework

There are significant number of different assumptions, principles and methods available to a reporting entity in the preparation and presentation of its financial statements. For example, there are various ways of calculating depreciation such as reducing balance, sum of years digit, straight-line, and inventory valuation could be done through FIFO, LIFO, and averages. It is therefore worthy to note that the assumption, principle and method adopted by a reporting entity significantly affects its outcomes of operations, financial position and change thereof. To lessen such differences in financial reporting, the General Accepted Accounting Principles (GAAP) was adopted, which is described as the framework of financial reporting.

Ojeka (2015) confirms that the provisions of GAAP differ slightly from the international financial reporting standards. The scope of the present financial reporting framework deals with the objectives of financial statements; recognition of the elements of financial statements; qualitative characteristics of financial statements; elements of financial statements; and capital maintenance (Dabbicco, and D'Amore, 2016).

2.3 Accounting Information and Financial Reporting Qualities

According to Jaballah, et al., (2014). accounting is an information system that measures, processes, and communicates financial information about an identifiable economic entity. Also, this information is designed to make it easier for individuals with an interest in an organization to make better decisions about that specific entity. Accounting relates to the provision of information to people about what they have got, what they used to have, and the changes in what they have got and what they may get in future (Gaynor, et al., 2016).

Accounting is often looked at as performing the stewardship role, and a steward would have to account to those who have put him in charge of their estate by way of reporting to them. Accounting information also refers to information on the economic activities of a business organization which is identified, measured and communicated to users to enable them make an informed judgment about the business enterprise (Daw, 2015). The identification and recording of financial or economic information is done by way of accounting system known as double entry book keeping. Measurement of accounting information involves making judgment about the value of assets and liabilities of a business. It also measures the profit or loss of an organization during a period.

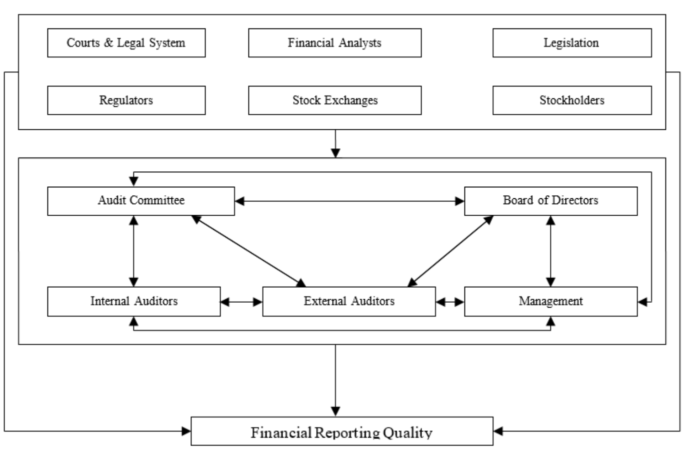
For accounting information to be useful, it has to be communicated to users of such information. The communication is proficient through the preparation of and reporting performance in financial statements, which shows the financial position of the business organization during a particular period. The main objective of financial reporting is to provide high-quality accounting information about organizations which are financial in nature that is useful for making economic decisions (Abdallah, et al., 2015). Financial reporting quality therefore, relates to the accuracy with which reported financials of a firm reflects its operating performance and how useful they are in forecasting future cash flows (Chan-Jane, et al.,2015).

2.4 Financial Reporting and Corporate Governance

Corporate governance plays an important role in ensuring the quality of the financial reporting process (Cohen, and Karatzimas, 2017). Cohen, and Karatzimas, 2017 noted that, "the link between a company's directors and its financial reporting system has never been more crucial". Many of the recent corporate failures, have been attributed to poor governance, which manifested in fraudulent financial reporting and earnings mismanagement (Honu et al., 2014). Beasley et.al 2000, provide evidence about the link between weaknesses in corporate governance and poor financial reporting quality, earnings manipulation, financial statement fraud and weaker internal controls. These findings have led to corporate governance reforms across the globe to bring about improvements in the financial reporting process and to make directors and management more accountable for ensuring the integrity of financial reports (Dabbicco, and D'Amore, 2016).

The model below shows the actors in the governance process, highlights their potential interactions, and suggests that the governance process impacts the quality of financial reporting.

Corporate Governance Mosaic and Financial Reporting Quality



Source: Cohen et.al. (2004

2. 5 Financial Reporting and Expectations Gap

According to Koh and Hoo, (1998), the expectations gap has a long and persistent history, recent clearly indicate that the expectations gap is still a relevant issue to investigate, but from a "financial statements" point of view. It is increasingly being considered that the role of the financial statements is not simply confined to giving a true and fair view of an entity's state of affairs. It seems that much more is being expected in relation to the financial health of the entities (Scicluna, 2010). Such an expectation brings into question a wide array of issues - matters such as the sustainability of business models, the analysis of business risk and forward-looking business plans and financial outlooks. Such matters fall clearly outside the realm of the financial statements preparation presently governed by accounting frameworks and their subsequent audit under the applicable auditing framework.

Nevertheless such literature on expectations gap, it is clear that there is still a knowledge gap on this subject. Higson (2003) argued that it is useless to only tackle the expectations gap. This is because he feared that there is a bigger expectations gap relating to the financial statements themselves. Higson (2003) therefore contended that there are two separate and distinct elements making up the "financial reporting expectations gap", and these are illustrated in diagram below:

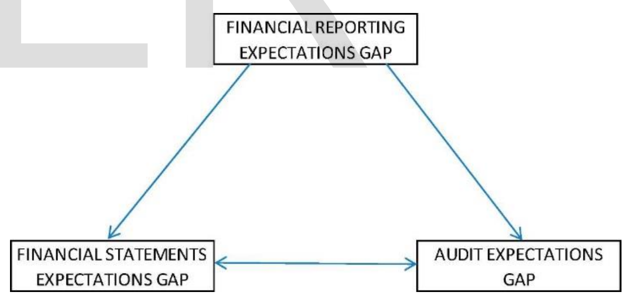


Figure 1.1 The financial reporting expectations gap (Higson, 2003, p.13)

The diagram above draws a distinction between the "financial statements expectations gap" and the "audit expectations gap", which together comprise the "financial reporting expectations gap". Higson (2003) suggested that the possible components of the financial statements expectations gap included the emphasis on decision-usefulness, the prediction of future cash flows, the imprecision of the word "stewardship", and connotations that the balance sheet represents wealth. Higson (2003) also argued that the limitations of financial reporting are not communicated well enough to enable their proper understanding, thereby contributing further to the financial statements expectations gap. In addition, another contributing factor was the pre-occupation and importance afforded by standard-setters to satisfying various user needs with the same set of financial statements.

2.6 Differences between International Accounting Standard (IAS) 1 and International Accounting Standards Board (IASB) Conceptual Framework

The significant gap between IAS 1 and IASB Conceptual Framework creates from the fact that financial statements are intended to satisfy needs of a wide range of users. This is fundamentally different from IASB Conceptual Framework which prioritizes investors, creditors and lenders. Being accountable to the whole general public entails that financial statement preparers are accountable to none as they would have inadequate resources to address to the needs of all users. IAS 1 is significantly flawed as human rationality demands prioritization of objectives. This observation is reliable with International Standard on Auditing (ISA) 200 - Objectives of Auditor which is very accurate that auditors are only accountable to the shareholders.

The current scope and direction of the Revised IAS 1 in trying to accomplish multidimensional approach as previously propagated by Stakeholder Analysis Model by Freeman (1984) is deceptive and its present application can cause important problems for directors who could be bombarded with demands from various stakeholders with little financial interests in the reporting entities. Some important influences are presented below:-

1. Competitors are more concerned in copying the competitive benefit of another firm since that is where the value is created.
2. Customers are more concerned with obtaining value for their money and will switch to competitor if not satisfied. Customers will only be inquisitive of firm's profitability if it operates in a monopoly or oligopoly industry where customers have no bargaining power or little powers to choose substitute products.
3. Government should not been seen to be interfering with firm's legitimate business affairs. Tax agencies and other regulatory bodies should only make decisions based on audited accounts submitted by any particular firm.
4. Pressure groups and civil societies usually have limited capacity to understand the financial concepts and are more particularly interested with ethical and equality issues.

2.7 Challenges in International Financial Reporting Standards

The International Financial Reporting Standards (IFRS) is regarded as a global GAAP and a set of principles-based and globally accepted standards published by the International Accounting Standards Board (IASB) to assist those involved in the preparation of financial statements all over the world to prepare and present high quality, transparent and comparable financial statements. The major strength of IFRS is that it offers a lot of assistances to corporate and public entities in terms of cost; improved access to global financial capital markets; easy consolidation of financial statements; better management control of internal consistencies of reporting; ability of international investors to make meaningful comparisons of investment portfolios in different countries and promotion of trade within regional economic groups.

However, there are some inherent problems with aligning with international accounting standards. Kobayashi, et al (2016) pointed out that international accounting clearly has a language problem. The German language has no reasonable single-word counterpart for the term fair. Since accounting itself is not readily translatable into Dutch, people in Holland simply use the English word "accounting" as part of their native language. Accounting words are far from universally comprehensible. More so, government policy may not be in support of international standards. Moretti, (2016) claimed that where an accounting standard conflicts with government policy, the standard is revised. For instance, LIFO is not allowable for tax purpose in stock valuation. Another problem inherent with the adoption of IFRS is the universal tendency to resist change. Too often, co-operation comes only from compromise and sometimes to the detriment of quality (NASB 2010).

2.8 Empirical Review

2.8.1 Corporate Governance and Financial Reporting

Many scholars have studied the relation between board independence and financial reporting and the results were mixed. For example, Htay *et al.* (2013), Soheilyfar *et al.* (2014) and Monday and Nancy (2016) found a noteworthy positive relation between board independence and financial reporting. The finding recommended that keep tracking of corporate boards by independent directors will support them to become more sensitive to investors, and will boost the company's loyalty with the disclosure requirements, which successively will improve the extent and quality of information disclosures. Contrariwise, Chakroun and Hussainey (2014) show that board independence affects negatively financial reporting. This relationship might be clarified by the fact that firms would not enhance both financial reporting and board independence simultaneously; however, they would selected strategically to enhance one with the sacrifice of the other (Chakroun and Hussainey, 2014).

However, Haji and Ghazali (2013), Fathi (2013), Asegdew (2016) and Al-Asiry (2017) found an insignificant relation between board independence and financial reporting. This indicates that that board independence does not lead to high quality financial reporting.

2.8.2 Firm Characteristics and Financial Reporting Quality

Company's profitability showed mixed evidence on its association with financial reporting. For example, Takhtaei *et al.* (2014) and Al-Asiry (2017) found a significant positive relation between profitability and financial reporting. The quality of information is more for a firm with a higher performance. This result indicated that profitable companies have growth opportunities they may disclose better information to show the reliability of their earnings and the projects that they presume to attain; this will spread their reputations and keep away from under-estimation of their actions (Fathi, 2013).

Moreover, this relationship can also be justified by the way of behaving of managers, as they present better information to demonstrate their capability to maximize value for shareholders and enlarge their compensation (Fathi, 2013). Conversely, Camfferman and Cooke (2002), Vandemele *et al.* (2009), Monday and Nancy (2016) and Ebrahimabadi and Asadi (2016) concluded that there is a negative relation between profitability and quality of the information disclosure. This finding can be explained by the fact that competitive costs of disclosure increase when the firm is highly profitable; thus, companies do not want to utilize their advantage to competitors and therefore the quality of information disclosed could decrease (Prencipe 2004). On the other hand, some studies have shown an insignificant relation between profitability and financial reporting (Hosseinzadeh *et al.*, 2014). Therefore, profitability may not influence the quality of information disclosure, or at least not be an important factor.

3.0 Methodology

This study adopts exploratory methodology. This involves review of extant literatures through the review of journal articles, textbooks and relevant materials.

4.0 Discussion

In the study of Financial Reporting Quality of Nigeria Firms: Users' Perception , Nyor, Terzungwe (2013) concludes that the quality of annual reports and accounts of Nigerian firms is adjudged to be restrained by users of accounting information in Nigeria, taking into consideration the reporting qualities of relevance, consistency, comparability, reliability and completeness Siriyama & Norah (2017) investigated Financial Reporting Quality: A Literature Review. It concluded reaching a phase where the quality of financial reporting can be measured precisely will assist in investigating other global issues related to accounting reforms and changes in capital markets around the world. That understanding of the quality of financial reporting, and having the knowledge about what the influences are needed due to complex and competitive business environments. Also Pius & Cletus (2014), examine the financial reporting framework in Nigeria and the adoption of the international financial reporting standards. It was concluded in the study that the conversion of financial reporting framework in Nigeria to IFRS will require an approach and timeline that can accomplish a measured transition to IFRS. The timeline for IFRS implementation is likely to take longer than many companies initially anticipate, as was seen in the European Union experience. Reasons for this include: the comparative financial statements that will be required upon adoption; the retrospective nature of implementation; and the pervasiveness of many of the impacts of IFRS. On Ndukwe (2015) Audit Expectations Gap and Perception of Financial Reporting, it was concluded that the role of external audit is crucial in today's corporate world. This is due to the separation of ownership from management as a result of numerous shareholders in companies. The external auditors' are usually perceived as independent and unbiased, thus, users of financial statements rely on these audit reports for decision making.

4.0 Conclusion

This study provides a detailed review of Conceptual framework for financial reporting and bridging users information needs' gap. This study has value for enlightening managers, investors, and other users about the different aspects of financial reporting quality. The understanding of the quality of financial reporting, and having the knowledge about what the influences are, is needed due to complex and competitive business environments. Reaching a phase where the quality of financial reporting can be measured precisely will assist in investigating other global issues related to accounting reforms and changes in capital markets around the world. The study conclude that the quality of annual reports and accounts of Nigerian firms is adjudged to be moderate by users of accounting information in Nigeria, taking into consideration the reporting qualities of understandability, relevance, consistency, comparability, reliability, objectivity and completeness.

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