

Addis Ababa University

School of Business and Public administration

Department of Accounting and Finance

(graduate programme)

Financial Reporting Quality in Privately owned companies: The Impact of private ownership on quality of accounting reports (Addis Ababa- Ethiopia)

By

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June 2011

Addis Ababa

26

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A research project submitted to the department of Accounting and Finance in partial fulfillment of the requirements for the degree of Master of Science in accounting and finance

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Acknowledgements

I deeply acknowledge all who have contributed and helped me in accomplishing this study.

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Abstract

The main aim of this study is to assess the overall quality of the financial reports the privately owned companies in Addis Ababa. With the sample size of 60 private companies and 93.3 percent response rate this study assessed the overall quality of the financial reports of those companies. And found that the companies do not all in all comply with the qualitative characteristics of the financial reports. Some fulfil the entire requirement and some do not. Therefore, the study shows that the overall financial quality of those companies is poor.

Chapter one

Introduction

Background

As a landlocked country with a difficult terrain and a legacy that has disrupted the development of market-supporting institutions, many economists would argue that private sector development is an uphill struggle for Ethiopia Sufian Ahmed, minister in MOFED 2007.

According to Bertelsmann Stiftung, *BTI 2010 — Ethiopia Country Report*, Ethiopia's economic upswing since 2002 – 2003 was driven to a large extent by favorable external conditions (average to good rainfall, a steady high inflow of official development assistance, and increasing levels of FDI). The government built on these positive conditions with solid macroeconomic management. The government's long-term development strategy, its Agricultural Development Led Industrialization (ADLI), attempts to make use of agricultural resources for a phased industrial expansion. Since 2003, foreign direct investment, particularly from India and China into the agricultural sector, has increased significantly. These foreign investments add to the development of private sectors. Despite this, Stiftung also added that the economy has a small private sector and a weak banking system, it is bogged down by a land tenure system in which the state owns all land, and its utilities are inefficient and monopolistic.

Derek Byerlee and Dawit Kelemework etals 2010 stated that over the past decade, policymakers have been searching for an appropriate blend of public and private sector roles to accelerate the intensification of food staple production, small holder commercialization, and sustainable market development in sub-Saharan Africa. In Ethiopia, steps taken to liberalize markets in the 1990s and promote fertilizer and seed packages have yet to generate payoffs in terms of higher cereal yields, lower food prices, or reduced dependency on food aid. This raises concern about the performance of the agricultural sector, specifically in terms of the systems for providing improved seed, fertilizer, credit, and extension services.

The Privatization process gathered momentum with the establishment of the Privatization and Public Enterprises Supervising Agency (PPESA) in 2004. It is an autonomous agency that is charged with “assisting state-owned enterprises to achieve commercial viability” before selling or leasing them to private investors. Under its supervision, 16 industrial companies, 12 agro businesses and 4 service firms were transferred to the private sector in FY 2007/08. Of the 360 public enterprises slated for privatization, 254 properties worth about \$460 mln have been sold, 18 returned to their original owners and 10 retail shops and 1 state farm have been closed. The US State Department Investment Climate Statement noted that “research indicates that companies owned by or affiliated with prominent Ethio-Saudi businessman Sheik Mohammed Al-Amoudi were awarded enterprises worth over \$400 million, over half of all privatizations by value.”¹

¹www.estandardsforum.org (2009)

Ethiopia retains a command economy system, making it one of the last countries in Africa with a diminished private sector. The International Monetary Fund estimates that in 2005-2006 the share of private investment in Ethiopia was only 11 percent, nearly unchanged since Zenawi came to power in 1991. There are few jobs available outside state-owned enterprises; in real terms, this equates to nearly three-quarters of the population being under- or unemployed (ibid).

The Private Sector as an Agent of Change

In order to deliver, democracy must be a participatory process that allows citizens to have their voices heard and to be a part of the governmental decision-making that impacts their daily lives. Given Ethiopia's economic woes, the input of private sector organizations is particularly timely and valuable. Engaging the private sector in a debate on the country's economic future not only ensures more informed economic policymaking, but also opens up much-needed channels for public-private dialogue.

Kibre Moges (2008) put in his research that the public sector still holds significant monopoly and dominance, not only in industries often considered as natural monopolies, such as energy, telecom, postal service, water supply, railway and airway, but also in manufacturing and services, such as cement, sugar, tobacco, textiles, banks and insurance companies. As noted earlier, a carefully planned and implemented privatization scheme expands the private sector, thereby enhancing competition. However, privatization in the Ethiopian context is taken as a mechanism for getting rid of relatively small enterprises while retaining large ones under the state control. Inspective of the number of enterprises

privatized, the Government still controls over 50 percent of the total value of production of medium and large scale enterprises and 70 percent of the value of modern economic activities. As a result, the structure of the economy still remains highly skewed and far from being competition inducing.

Two factors limit the volume of goods and services transacted through contested markets. First is the traditional sector, where production is for own consumption. This is largely due to agriculture where two-third of the produce is retained for home consumption. The second factor is state monopoly. Either because of explicit (or implicit) ban on entry, such as in telecommunications, postal service, electric energy

Barriers to entry in key sectors of the economy buttress inefficient state-owned enterprises by shielding them from competition. As such, minimizing the state's ownership of land, credit, and telecommunications, will help Ethiopia's economy become stronger and more productive. Limits on state control will also make Ethiopian citizens more prosperous and better able to hold the government accountable since their economic livelihood will no longer be linked to their support of state policies.

As experiences of other countries show, vibrant private sector can create a wealth-generating middle class that helps to tilt the accountability balance in favor of the citizens. In Ethiopia, the citizens feel accountable to the state because it controls their employment and livelihoods. With economic liberalization, the state will become more accountable towards the taxpayers who are financially independent and democratically engaged.

The parliamentary elections in Ethiopia scheduled for May 2010 offer renewed opportunity to engage the private sector in institutional reforms that can bring the country out of its political and economic doldrums. Ethiopia can move forward in two distinct and diametrically different directions; it can continue to be the impoverished recipient of international aid, or become an economic powerhouse of East Africa. The latter can happen with real market reforms and the full and transparent engagement of the private sector in economic policymaking.

Tilman Altenburg 2010 in his survey of Industrial policy in Ethiopia citing the world bank 2009, provided as the vast majority of Ethiopia's firms are micro and small. As a result, medium-sized and large firms are barely developed. In 2002 Ethiopia had only 49 manufacturing enterprises with more than 500 workers, plus 225 small and medium sized manufacturing firms which employed between 51 and 500 persons (Ethiopian Economic Association 2005, 26). Most industries are engaged in sugar processing, brewery, cement, publishing and printing, leather tanning, and textiles. Four groups of firms can be distinguished according to their ownership structure:

1. Many large enterprises are still state-owned enterprises (SOEs) going back to the socialist Derg regime. The current government created the Ethiopian Privatisation Agency and privatised 287 SOEs between 1997 and January 2009 (MoTI 2009). The government wants to privatise many more firms, but the process so far has been slow, not least because privatisation has often been linked to restrictive conditions, e.g. that the

new owners refrain from dismissing personnel. In 2006 the manufacturing sector was “still dominated by public enterprises that account for 72% of total manufacturing value added, 62% of gross value of production, employ 57% of the manufacturing workforce and account for 64% of wages and salaries” (European Union 2006). According to another source, the share of SOEs in the output of medium- to large-size manufacturers declined from 58% in 2000/2001 to 51% in 2004/05.⁷ As some of the larger SOEs are now going to be privatised, this share is likely to go further down. Moreover, SOEs in most manufacturing activities are now exposed to competition from private firms. Their performance varies. While some are in serious trouble, others outperform their private competitors, partly because they are larger and less constrained by tax administration, customs and trade regulations, access to land, cost of finance, and corruption. The government seems determined to maintain state ownership of enterprises in strategic sectors such as telecommunications, civil aviation, railways, energy, mining, chemicals, insurance, and banking. In the financial sector, private domestic banks have been admitted alongside the still dominant state banks and are rapidly growing.⁸ Likewise in the insurance industry, there are now eight private enterprises competing with one state-owned insurance company.

2. One private investor of Ethiopian and Saudi-Arabian nationality, Sheik Mohammed Al Amoudi, alone owns many of the leading firms across all economic sectors. According to Forbes magazine, he is the 43rd richest person in the world and is said to have invested more than US\$2 billion in Ethiopia (Forbes, 11 March, 2009). His investments in Ethiopia range from hotels, gold mines, glass, plastics, soft drinks, a

private airline, production and marketing of households furniture and office equipment, to food processing.

3. There is some foreign direct investment, mainly from the European Union, India, Israel, the United States, and Saudi-Arabia. FDI is concentrated in agricultural activities, including floriculture, horticulture, meat and, recently, biofuels (Weissleder 2009). in trade and services, foreign investors face considerable restrictions.

4. There are an increasing number of independent Ethiopian entrepreneurs. Among them, Ethiopians from the diaspora play a significant role, as many business people emigrated during the Derg and engaged in economic activities in their host countries, where some of them accumulated capital and learned about new international business opportunities. E.g. all tanneries and garment companies and the majority of shoe and textile companies are private Ethiopian enterprises. Overall, however, independent Ethiopian entrepreneurship is still weak, and entrepreneurs complain of unfair competition, alleging that state-owned, endowment-owned, and even foreign enterprises have better access to land, credit, foreign exchange and support services.

Ethiopia does not host any major expatriate business community. Businesses are mainly owned by Ethiopians. This is quite unique in Sub-Saharan Africa, where European citizens from the former colonial powers, Indian or Arab minorities often play a dominant role in the private sector. The Ethiopian exception is due to the fact that the country has maintained its independence. Productivity varies greatly among Ethiopian manufacturing firms (Gebreeyesus 2008; World Bank 2009). At the same time, firm turnover is high,

especially among micro and small firms. 60% of firms exit in the first three years after entry (Gebreyesus 2008). This reflects two phenomena; First, there is a big group of “necessity entrepreneurs” who start own-account activities for lack of employment alternatives and without any clear business idea. Among these necessity entrepreneurs, productivity tends to be far below the level of well-established medium-sized firms, failure rates are high, and owners frequently shift to other activities. Second, some firms are more constrained in their access to credit, land, and product markets than others.

Statement of the Problem

The increasing in number of private companies seems the result of extensive privatization being undertaken by government in Ethiopia. The aim of this widespread privatization may also be the implication of free market in an economy. Nevertheless, the international accounting standards board requires the companies on the earth, regardless of the ownership, to follow relatively similar accounting reporting principles. Companies that are publicly held (i.e. whose share of ownership is publicly traded and owned by ordinary persons in the public) are unlikely to be lead /managed by the share holders/owners. Companies that are not publicly held (i.e. whose share of ownership is not publicly traded and thus not owned by an ordinary persons in the public, but that are held by private individuals or high net-worth individual) are either owned by relatives/family or a single individual are mostly managed by those individuals that own them. Consequently, they violate the generally accepted accounting standards and principles for their own sake, Christopher Beuselinck and Sophie Manigart (2005). The audit assurance is also required to be undertaken in accordance to these generally accepted principles. Government, creditors and other users of accounting report of a company also want to know whether the accounting reports of the company is prepared according to these underlying principles in order to take action of their own decision. This paper is therefore tries to solve whether or not these privately owned companies are really violating the underlying accounting principles and guidelines in preparing their financial reports.

Objective of the study

The general objective of the research is to examine the overall quality of accounting reports of the privately owned companies by using five main qualitative characteristics in conceptual framework of Financial Accounting Standard Board in Ethiopia particularly in Addis Ababa.

Specifically this paper will evaluate the accounting reports of the randomized private companies in the following respects:

- ☞ The relevance of financial reports
- ☞ Faithful representation of the actual happenings
- ☞ Understandability of the accounting reports
- ☞ Comparability of the reports by looking at the consistency of the accounting assumptions and methods the companies use
- ☞ Timeliness of the financial reports
- ☞ Finally to give recommendation on the quality of accounting reports of the companies

Significance of the study

This research paper contributes a lot to the knowledge of accountancy. It broadens the awareness of the importance of the quality of accounting reports to those who intrude the GAAP for their own interest. This paves way to future researches, using larger samples (country wide), that may provide additional insights into the external validity this project. Such insights may also help to create deeper understanding concerning the assessment of the quality of financial reporting.

Scope of the study

Because of the difficulty due to the shortage of time, the study did not include private companies that are found in the other are of the country, it is rather confined to the area of Addis Ababa. The main coverage of this study is the initially privately created companies. It did not distinguish between the private family owned and non family ownership because many companies are created, owned and run by family.

Limitation of the study

The time limitation is the big. Some of the private companies filled the questionnaire reluctantly some still refused stating that they are busy by their own normal work.

Organization of the paper

This research paper contained five components divided into chapters. The first chapter presents introduction, general background, statement of the problem, objectives, limitation, significance, scope of the study in detail. The second chapter discusses the methodology of the study. Chapter three presents the related literature review in detail and the research gap. The fourth chapter is analysis of the findings and discussion and finally, the fifth chapter concludes and recommendations are included.

Chapter two

Literature review

This chapter presents the review of related literature; first, it presents the theoretical background; second, it talks about the related past studies and finally it gives hint of the research gap.

Theoretical background

Financial statements

IASB paragraph 9 defined financial statement as: a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's: (a) assets; (b) liabilities; (c) equity; (d) income and expenses, including gains and losses; (e) contributions by and distributions to owners in their capacity as owners; and (f) cash flows. This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

Many entities present, outside the financial statements, a financial review by management that describes and explains the main features of the entity's financial performance and financial position, and the principal uncertainties it faces. Such a report may include a review of: (a) the main factors and influences determining financial performance, including changes in the environment in which the entity operates, the entity's response to those changes and their effect, and the entity's policy for investment to maintain and enhance financial performance. (b) the entity's sources of funding and its targeted ratio of liabilities to equity; and (c) the entity's resources not recognised in the statement of financial position in accordance with IFRSs (IAS1 paragraph 13).

The objective of financial statements

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information. Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example,

whether to hold or sell their investment in the entity or whether to reappoint or replace the management. (paragraph 12- 14).

Conceptual Framework: Qualitative Characteristics: Relevance and Reliability

RELEVANCE

Relevance is a quality emphasized in every accounting framework. That is hardly new. There is at least one cross-cutting issue about relevance, about the meaning of predictive value, which is discussed below after reviewing what the staff considers a non-issue: that relevance belongs among the qualitative characteristics and consists of predictive value, confirmatory value, and timeliness.

The IASB Framework for the Preparation and Presentation of Financial Statements (IASB Framework) says in paragraph 26 that information is relevant “when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.” FASB Concepts Statement No. 2, Qualitative Characteristics of Accounting Information, (FASB Concepts Statement 2) says in paragraph 47 that, to be relevant, “accounting information must be capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct expectations,” and goes on to define event and outcome. Those definitions are quite similar. The italics added here emphasize the

only real difference: whether information must influence decisions or only be capable of influencing decisions. The staff plans to use the latter formulation, reasoning that information has whatever qualities it has even if some even all users fail to take advantage of it or already were aware of it.

IASB Framework paragraph 27 says “the predictive and confirmatory roles of information are interrelated,” illustrating that with an example about the utility, for both of those roles, of information about current asset holdings. FASB Concepts Statement 2 uses “feedback value” rather than confirmatory role, but paragraph 52 notes that “disclosure requirements almost always have the dual purpose of helping to predict and confirming or correcting earlier predictions,” illustrating that with the examples of business segment information and interim reporting. The concept is the same. The staff plans to retain that discussion, using confirmatory, in the broad sense of “confirming or correcting,” rather than FASB’s admittedly “inelegant term” feedback.

IASB Framework paragraphs 29 and 30 state that the relevance of information is affected by its nature and materiality, noting that materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic. FASB Concepts Statement 2 also characterizes materiality as a threshold but discusses materiality separately from relevance. The staff will discuss materiality, and its place among the qualitative characteristics, at the next meeting.

In IASB Framework paragraph 43, timeliness is cited as a necessary constraint lest information lose its relevance. In FASB Concepts Statement 2, paragraph 56, timeliness is considered “an ancillary aspect of relevance. If information is not available when it is needed or becomes available only so long after the reported events that it has no value for future action, it lacks relevance and is of little or no use.” The concept is the same. The staff plans to classify timeliness with relevance, following the usage in the FASB concepts.

Statisticians use predictability in a precise way and distinguish it from persistence. Predictability concerns the accuracy with which the next number in a series can be foretold. Persistence concerns the tendency of a series to keep going as it has been going, for example, to continue a random walk rather than reverting to a mean.

Accounting concepts have used predictive value in a much more general way. IASB Framework paragraph 28 explains that information need not be an explicit forecast to have predictive value, and that the predictive value of information is enhanced by the manner of display, citing the example of separately disclosing unusual, abnormal and infrequent items of income or expense. FASB Concepts Statement 2, paragraph 53, similarly explains that “to say that accounting information has predictive value is not to say that it is itself a prediction,” going on to analogize investors’ pursuit of information with predictive value to the constantly improving information meteorologists use in forecasting weather. While the FASB discussion alludes to the role of financial statement information as inputs to econometric

models, neither framework attempts any real tie-in with statistical techniques. Neither do any of the other frameworks.

The Board could ask the staff to look further into adopting statistical terminology in the discussion of predictive value. However, in the staff's view, the current concepts have got it right. Accounting information has predictive value if users use it, or could use it, in making their own predictions about the outcomes of past, present, or future events. That is, accountants supply the information, users make the predictions. The staff proposes not conducting further research in this area and not attempting to change the discussion of predictive value to incorporate statistical terminology.

RELIABILITY

Reliability is said, in FASB Concepts Statement 2, to comprise representational faithfulness, verifiability, and neutrality, with an overlay of completeness, freedom from bias, precision, and uncertainty. It is said in the IASB Framework to comprise faithful representation, substance over form, neutrality, prudence, and completeness. The UK ASB Principles also include freedom from material error. The Japanese draft uses the three qualities cited by FASB, while Canada's concepts add conservatism. AASB Concepts Statement 3 discusses almost all of those matters, without giving separate status to any of them. That is a lot of different sub-characteristics to fit under one label, possibly too many; for example, the staff has observed that many constituents seem to equate reliability with verifiability, not

representational faithfulness. For purposes of discussion at this meeting, the staff plans to collect those sub-characteristics into three groups:

- a. Faithful representation, including completeness and substance over form
- b. Verifiability, including precision and uncertainty
- c. Neutrality, including freedom from bias, prudence, and conservatism

Faithful representation, including completeness and substance over form

Concepts Statement 2 says that “representational faithfulness is correspondence or agreement between a measure or description and the phenomenon it purports to represent. In accounting, the phenomena to be represented are economic resources and obligations and the transactions and events that change those resources and obligations” (paragraph 63).

The IASB Framework says that “to be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent” (paragraph 33).

What sometimes is overlooked is the requirement that, to be representationally faithful, accounting measures or descriptions must reflect economic phenomena—economic resources and obligations and the transactions that change them—and not simply accounting notions. Consider, for example, so-called “deferred charges” or “deferred credits” sometimes seen in balance sheets. If deferred charges do not reflect economic resources that are assets, and if deferred credits do not reflect

economic obligations that are liabilities, those depictions are not representationally faithful and, hence, not useful.

In a forthcoming book, former AICPA research director Paul Rosenfield argues for distinguishing representativeness—do the data purport to represent real-world phenomena?—from faithfulness—if so, do they represent the phenomena faithfully? For example, reporting a deferred charge that does not reflect economic resources as an “asset” would not be representative, while reporting an allowance for bad debts that is too small would not be faithful.

FASB Concepts Statement 2 illustrates faithful representation using an analogy to maps and mapmaking.

FASB Concepts Statement 2 notes that “reliability implies completeness of information, at least within the bounds of what is material and feasible, considering the cost. A map that is 99 percent reliable but fails to show a bridge across a river where one exists can do much harm” (paragraph 79). (So can the opposite error of showing a bridge where there is none: a recent television advertisement in America showed a young man watching his car being hauled out of a river, sheepishly commenting that “the map was a disappointment.”) The IASB framework reports completeness as one of five subqualities of reliability, saying that “the information in financial statements must be complete within the bounds of materiality and cost” (paragraph 38). To the staff, completeness is closely related to representational faithfulness, while materiality and cost considerations are bounds (or constraints, or thresholds) for all the other qualitative characteristics.

The IASB Framework includes substance over form among the sub-qualities of reliability, including an example of a transaction with documentation that purports to pass legal ownership but where side agreements “ensure that the enterprise continues to enjoy the future economic benefits embodied in the asset” (paragraph 35). FASB Concepts Statement 2 did not include substance over form “because it would be redundant. The quality of reliability and, in particular, of representational faithfulness leaves no room for accounting representations that subordinate substance to form. Substance over form is, in any case, a rather vague idea that defies precise definition” (paragraph 160).

The staff recommends that faithful representation continue to be identified as a key quality (or sub-quality) of accounting information, a quality that includes completeness and leaves no room for representations that subordinate substance to form.

Verifiability, including precision and uncertainty

The IASB Framework does not include verifiability among its qualities. However, it does say that “information has the quality of reliability when it is free from material error and bias and can be depended upon by users” (paragraph 31). Some might say the italicized words imply the sort of verification provided by internal

controls and auditing. FASB Concepts Statement 2 identifies verifiability as one of its three sub-qualities of reliability.

The FASB framework defines verifiability as “the ability through consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias.” It goes on to discuss verifiability, identifying three key aspects: (1) consensus among observers, (2) assurance of correspondence to economic things and events, and (3) direct verification versus indirect verification.

Verifiability implies consensus among observers. Accounting measures that are determined by one measurer should be capable of being confirmed or substantiated by other measurers. Consensus among observers cannot be assessed in isolation. Rather, it must be assessed in the context of both correspondence to economic things and events and direct verification versus indirect verification.

Concepts Statement 2 states that “the purpose of verification is to provide a significant degree of assurance that accounting measures represent what they purport to represent” (paragraph 81, emphasis added), that is, real-world economic phenomena. Accounting information may not correspond to economic things and events because of measurer bias, measurement bias, or both. Measurer bias may be unintentional (for example, because of lack of skill) or intentional (for example, because of lack of integrity), which may be evidenced by misapplication of the measurement method. Measurement bias results from using a measurement method that is unlikely to produce a result that represents what it purports to represent, such

as a method that consistently produces results that understate or overstate the item in question.

With direct (or separate) verification, the accounting measure itself is verified, such as by counting cash or observing quoted prices for marketable securities. With indirect verification, the accounting measure is verified by checking the inputs and recalculating the outputs, using the same accounting methodology. Direct verification tends to minimize both measurer bias and measurement bias. In contrast, indirect verification tends to minimize only measurer bias and not any measurement bias from the selection of accounting or allocation methods. Thus, even though there is consensus among measurers, an indirectly verified measurement may not be reliable if the accounting method results in a measure that does not correspond to the economic phenomena that it purports to represent.

Neutrality, including freedom from bias, prudence, and conservatism

The FASB framework defines neutrality as “the absence in reported information of bias intended to attain a predetermined result or to induce a particular mode of behavior.” The IASB Framework equates neutrality to freedom from bias and says “financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome” (paragraph 36).

How the Qualitative Characteristics Relate to the Objective of Financial Reporting and to Each Other?

Boards' existing frameworks discuss the need to exchange a degree of one desirable characteristic for an increased amount of another (trade-offs). For example, the IASB *Framework*, paragraph 45, says: In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgement. Concepts Statement 2 discusses necessary trade-offs at greater length, but the essence of that discussion is the same—that applying judgment is necessary to achieve an appropriate balance of the qualitative characteristics. The pervasive constraints on financial reporting may also be considered when making such trade-offs. To explain the relationships between the qualitative characteristics, the Boards considered using a chart, such as “A Hierarchy of Accounting Qualities” in Concepts Statement 2. However, the Boards agreed with Concepts Statement 2 that the chart is “a limited device for showing certain relationships among the qualities that make accounting information useful” (paragraph 33), and that “the hierarchy should be seen as no more than an explanatory device, the purpose of which is to clarify certain relationships . . .” (paragraph 34).

Therefore, the Boards decided to search for a better way of explaining the relationships between the characteristics. The Boards considered a chart that would illustrate how

standard setters might apply the qualitative characteristics in making decisions about financial reporting issues. However, they concluded that a chart that illustrated the standard setting process would necessarily involve matters that the Boards had not yet addressed in the conceptual framework project, including recognition, measurement, presentation (display), and disclosure. For that reason, the Boards concluded that to include such a chart in a chapter focusing solely on qualitative characteristics would be premature.

Balance between benefit and cost

Framework IASCF 73 in paragraph 44 says the balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgemental process. Furthermore, the costs do not necessarily Framework fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared; for example, the provision of further information to lenders may reduce the borrowing costs of an entity. For these reasons, it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this constraint.

Therefore, the balancing explained above is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgement.

Notes and supplementary schedules

In paragraph 21 it presents the financial statements to contain notes and supplementary schedules and other information. For example, they may contain additional information that is relevant to the needs of users about the items in the balance sheet and income statement. They may include disclosures about the risks and uncertainties affecting the entity and any resources and obligations not recognized in the balance sheet (such as mineral reserves). Information about geographical and industry segments and the effect on the entity of changing prices may also be provided in the form of supplementary information.

Constraints on relevant and reliable information Timeliness

In paragraph 43 it says that if there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the economic decision-making needs of users.

Disclosure of Accounting Policies

Disclosures require disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables, and financial liabilities include trade and other payables. Information on the expected date of recovery of non-monetary assets such as inventories and expected date of settlement for liabilities such as provisions is also useful (paragraph 65).

In paragraph 98 of IAS1 it states that disclosure of circumstances that would give rise to the separate disclosure of items of income and expense include: (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs; (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring; (c) disposals of items of property, plant and equipment; (d) disposals of investments; (e) discontinued operations; (f) litigation settlements; and (g) other reversals of provisions.

Related studies

According to the report that examines Indonesian accounting and auditing practices, a research conducted by Zhuang, Juzhong, David Edwards and David Webb (2003), a number of financial scandals were linked to misleading or fraudulent financial reporting. There were no requirements for public registration or disclosure of ownership and financial records, except in the case of listed or publicly traded companies. During periods of economic growth, this lack of disclosure and regulation was not considered a problem. In fact, the lack of transparency financial reporting has suited those who engage in profitable related-party transactions with

stated owned enterprises, those wishing to manipulate financial results to obtain finance or avoid taxation and those who sought to access state revenues outside the budget authorization process. However, Indonesia has experienced a number of severe economic crises and has needed to attract both foreign investment and foreign aid. In order to do so the government has had to respond, at least in part, to the demands of investors and aid agencies for accounting and other capital market reforms, Zhuang et al (2003).

Implementation of these reforms has not been smooth. Moreover, despite improvements in accounting standards, audit requirements and financial disclosures, there were still serious gaps in the financial reporting and disclosure regime. For example, calls for improvements in the qualifications and independence of auditors were not heeded until 1997. Before 1997, international auditing firms were forced to operate by forming relationships with domestic firms. From 1997 onwards, foreign auditors were permitted to operate as individuals but were still prohibited from establishing auditing firms. Effective enforcement of sanctions for non-compliance with the law remains a problem. (ibid).

Arthur Levitt (1998-1999), the former chair of the U.S. Securities and Exchange Commission (SEC), called for strengthening the audit committee as a means of enhancing the integrity and quality of the financial reporting process. Specifically, he claimed that qualified, committed, independent and tough minded audit committees represent the most reliable guardians of the public interest. A strong and independent audit committee may thus potentially serve as a vehicle for

auditors to use in their ability to maintain true independence from the pressures of management. In response to Levitt's speech, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (BRC) was formed by the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD). The BRC issued 10 recommendations that dealt with strengthening the independence of the audit committee (e.g., audit committees should be comprised solely of independent directors), processes and mechanisms to make the audit committee more effective (e.g., audit committees should have formal written charters), and mechanisms that will enable the audit committee to be more active participants in enhancing the effectiveness of the financial reporting process and thus assist auditors in their quest to maintain independence (e.g., all members of the audit committee must have financial literacy and at least one member must have financial expertise). They found that some of the audit committee characteristics later identified by the BRC are good indicators of a lower likelihood of financial reporting misstatement (e.g., independence of the members, frequency of meetings). They suggest that their study provides support for the BRC's effort to improve the financial reporting process.

Australian Accounting Review by Ganesh Krishnamoorthy, Arnie Wright and Jeffrey Cohen (2002) where Forty-two U. S. auditors (21 partners and 21 managers) average of 14 years of auditing experience from all of the Big-5 firms participated in a survey that examined the issues audit committee and quality of accounting reports revealed that there is a growing concern in Australia and around the world

about maintaining and enhancing the independence of external auditors and strengthening the role of audit committees could provide an important mechanism to aid the auditor in withstanding undue pressure from management to be overly aggressive in the financial reporting process. There need not only for mandatory audit committee formation for publicly traded companies, but also for this committee to be subject to standards aimed at enhancing its effectiveness. The report says this is in line with best practice in Canada, the United States and some other countries and would provide Australian investors important oversight protection. It then examined perceptions of U. S. auditors on three major issues that impact auditor independence: (1) factors and attributes that contribute to the effectiveness of audit committees; (2) the role of the audit committee in enhancing quality of the financial reporting process; and (3) communication and interactions between the auditor and the audit committee. Financial literacy/expertise, independence, and a strong commitment to perform the job effectively were identified as important attributes that enhance the effectiveness of audit committees, Ganesh et al (2002). The majority of the auditors believe that it is not important for each member of the audit committee to be a financial expert but it is important for all of them to be financially literate. Results also suggest that audit committees should play a greater role in ensuring financial reporting quality than they currently do. Competency and independence were also identified as crucial ingredients to effective communication between the auditor and the audit committee. These results have important implications for auditors, audit committees, board of directors, regulators, and professional bodies (e.g., the SEC in the U. S. and ASIC in

Australia) Ganesh et al (2002). The review added, the need for an effective audit committee as a means for enhancing financial reporting integrity and protecting the auditor's ability to be independent in fact as well as in perception has never been greater. Auditors in this study view audit committees as only moderately effective in fulfilling their financial reporting responsibilities. Citing (Levitt 1999, 2000), Ganesh et al (2002) put consistency of this with the widespread belief that audit committees are currently not very effective in curtailing aggressive accounting policies and ensuring superior financial reporting quality. However, increased demands and scrutiny by stakeholders and a heightened regulatory emphasis on the effectiveness of audit committees may finally be resulting in a trend for more effective audit committees. The pervasive need for effective communications between the external auditor and the audit committee is recent emphasis by regulators, Ganesh et al (2002). However, the role of the management in promoting an environment that can build the right kind of relationship between the auditor and the audit committee has not been fully explored. Ganesh et al (2002), suggest that auditors have a high degree of consensus on the factors that determine financial reporting quality. Increased consensus between auditors and audit committee about what constitutes quality financial reporting increases the likelihood that audit committees will support the auditors in disagreements with management, hence reducing independence risk to external auditors.

Ole-Kristian Hope John Christian Langli (March, 2008) under a survey of Auditor Independence in a Private Firm Setting with the sample periods: 1997-2002 and

2001- 2002 and sample consists of 49,154 (1997-2002) have found that whether auditors are willing to sacrifice their independence in exchange for retaining clients that pay fees for audit and/or non-audit services. Using a very large sample of private Norwegian firms, Ole-Kristian et al (2008), analyzed the relation between auditor fees (total fees, audit fees, and non-audit fees) and auditors' propensity to issue different types of qualified opinions. In contrast to regulators' concerns, there were no evidence that auditors compromise their objectivity through fee dependence and no evidence that auditors abuse their trust in the private firm market Ole-Kristian et al (2008). Specifically, there was no evidence that large fees received from clients translate into a lower likelihood of issuing qualified audit opinions, suggesting that concerns raised by regulators over auditors' reliance on client fees resulting in diminished auditor independence may be misplaced or exaggerated, at least with respect to the sample of Norwegian private firms. Thus, Ole-Kristian et al (2008), concluded that expected litigation costs are small in Norway, a likely interpretation of the findings is that auditors care deeply about their reputation. Thus, they are not willing to forego their independence by issuing fewer going concern opinions when they receive (large) fees from their clients. In contrast, Ole-Kristian et al (2008) set that prior research that has documented similar findings for samples of U.S. firms has not been able to parse out the effects of reputation effects and litigation costs.

Ray Ball and Lakshmanan Shivakumar, (May 2002) on Earnings Quality in United Kingdom (UK) Private Firms financial statement data on over 100,000 public and

private British companies for the fiscal years ending between January 1989 and December 1999 were conducted. Accordingly, the predominance of private companies in the economy makes their financial reporting practices interesting in their own right, but a feature of the UK institutional setting makes them especially interesting: under U.K. law, their financial statements must be audited and must comply with the same accounting standards and tax laws as publicly traded companies. Ray Ball et al (2002), hypothesized that private-company financial reporting nevertheless is lower in quality because that is what the market demands. Using time-series measures of quality, Ray Ball et al (2002) demonstrated that private-company earnings are lower quality, despite being prepared under the same rules. This result is not affected by controlling for size and industry differences between the samples, and holds in a sub-sample of firms with Big-5 audit firms. Ray Ball et al (2002), accounting standards are not absolute givens, and their effectiveness is subject to market demand.

Lower earnings quality on average in private firms does not imply the failure of accounting or auditing standards, or the need for stricter regulation of financial reporting by private firms, or that their financial reporting practices are sub-optimal. The observed lower earnings quality in private firms is an equilibrium outcome in the market for corporate financial reporting, reflecting differences in demand for financial reporting between private and public firms, and is not a failure in supply. It assists in understanding the economic role of accounting standards, an issue that is surprisingly neglected in the literature. Earnings quality is measurably lower in U.K. private companies than in public companies, even though their financial

statements are audited and certified as complying with the same accounting standards.

Mohammad Abdolmohammadi Erlend Kvaal and John Christian, (November 2010) conducted a survey under 'Earnings Management Priorities of Private Family Firms'. Mohammad et al (2010), private family firms are likely to manage earnings downward. However, under financial stress they manage earnings upward. Thus, Mohammad et al (2010) there are two opposite tendencies of earning management(EM) contingent on the financial situation in private family firms; whether the tendencies for EM in private family firms are different if the chief executive officer (CEO) is a member of the controlling family or if the company has board members that are independent of the family. Mohammad et al (2010), highly leveraged private family firms make more income increasing accounting choices. Finally, Mohammad et al (2010) documented that CEOs representing controlling families promote earnings management and independent board members somewhat mitigates it.

Jeffrey L. Coles (2005) stated in his study that the analysis of the relation between firm performance and managerial ownership represents a substantial and consistently-active segment of the empirical corporate finance. Shareholders maximize firm performance if they can induce managers to own precisely the amount of stock associated with the peak of the performance ownership relation.

Therefore, Jeffrey L. Coles (2005), in the private companies specially where owners

act as manager or undertake close company supervision, develops the interest of increasing company's earning and wealth for their own ambition so that may deviate from the accounting reporting guidelines by exaggerating the performance of the company .

Luc Renneboog (2000) in his study of 'why public firms go private' said the reasons as; Tax benefits, incentive realignment, control reasons, free cash flow reduction, transactions cost reduction, takeover defences, undervaluation and wealth transfers. According to Luc Renneboog (2000), the main sources of the shareholder wealth gains are undervaluation of the pre-transaction target firm, increased interest tax shields and incentive realignment.

Mohammad Abdolmohammadi (2010), survey in Norwegian argued that private firms' motivations to manage earnings (EM) are different from those of publicly traded companies, according to Mohammad Abdolmohammadi (2010) , while capital markets may be a key determinant of EM by public firms, capital markets effect on EM is negligible in private firms. Instead, the salient factor influencing EM in private family firms (that is still privately owned) is the relationship between the controlling family and other stakeholders. The controlling family may be motivated to conceal the true financial performance of the firm to outsiders (government), and manage earnings with the objective of reducing reported income.

Joseph P.H. (2002), examined the relationship between earning informativeness measure by the earning-return relation, and the ownership structure of 977 companies in seven East Asian economies. The study was consistent with two contemporary explanations. First, concentrated ownership and associated pyramidal and across holding structures create agency conflicts between controlling owners and outside investors, consequently, controlling owners are perceived to report accounting information for self interest purposes, causing the reported earnings to lose credibility to outside investors. Second, the concentrated ownership associated with preventing of leakage of proprietary information about the company's rent seeking activities.

Sa'adiyah Munir August (2009), using discretionary accruals quality (DAQ) and performance adjusted discretionary accruals (PACDA) as measures for earnings management of 236 Malaysian firms and found that, earnings quality of firms with huge family ownership (private) becomes much lower when they undertake related party transactions. Sa'adiyah Munir August (2009), related party transactions could help the controlling families to expropriate the minority shareholders of the firms, hence exacerbate the agency problem and lowering earnings quality.

Xin Wang (2010), in a research seminar stated that one objective of financial reporting information is to facilitate the efficient allocation of capital in the economy. An important aspect of this role is to improve firms' investment decisions. Specifically, Xin Wang (2010), theory suggests that improved financial

transparency has the potential to alleviate both over- and underinvestment problems and recent studies support this prediction. This is, however, has been mostly limited to large, publicly traded companies in the United States. Using firm-level survey data from the World Bank's Enterprise Survey, Xin Wang (2010), studied the relation between accounting quality and investment efficiency for a sample of relatively small private firms in emerging markets. And found strong evidence that accounting quality positively affects investment efficiency (i.e., is negatively related to both underinvestment and overinvestment). Xin Wang (2010), the relation between financial reporting quality and investment efficiency is stronger if a firm's investment is funded relatively more through bank financing than other sources of financing., Xin Wang (2010), documented that, for firms with the strongest incentives to manage earnings for tax purposes, the positive association between accounting quality and investment efficiency is significantly reduced.

Christopher Beuselinck and Sophie Manigart (2005), argued and empirically showed on a sample of 270 unquoted in US, private equity backed companies that the shareholder structure of private companies influences the quality of their accounting information. Christopher Beuselinck and Sophie Manigart (2005), showed that companies in which private equity (PE) investors have a higher equity stake produce accounting information that is of lower quality than companies in which private equity investors have a lower equity stake, controlling for company size and age. They argue that this is evidence that a large equity stake is a substitute for high earnings quality.

MEASUREMENT OF THE QUALITY OF FINANCIAL REPORTING IN TERMS OF THE QUALITATIVE CHARACTERISTICS: OPERATIONALIZATION OF THE QUALITATIVE CHARACTERISTICS

Financial reporting quality defined in terms of the fundamental and enhancing qualitative characteristics underlying decision usefulness as defined in the ED (Exposure Draft) ‘An improved Conceptual Framework for Financial Reporting’ of the FASB and the IASB (IASB, 2008); the fundamental qualitative characteristics (i.e. relevance and faithful representation) are most important and determine the content of financial reporting information. The enhancing qualitative characteristics (i.e. understandability, comparability, verifiability and timeliness) can improve decision usefulness when the fundamental qualitative characteristics are established. However, they cannot determine financial reporting quality on their own. (Ferdy van Beest Geert Braam Suzanne Boelens 2009).

Except for timeliness, each of the qualitative characteristics in the ED is measured using the multiple items that refer to the sub notions of the qualitative characteristics. To assure the internal validity of these items, Ferdy van Beest et.al, 2009 used five point rating scales to assess the scores on the items based on empirical literature. Subsequently, they computed a standardized outcome for the

qualitative characteristics relevance, faithful representation, understandability and comparability by adding the scores on the related items and dividing by the total number of items.

Relevance

Relevance is referred to as the capability “of making a difference in the decisions made by users in their capacity as capital providers” (IASB, 2008: 35). Drawing on prior literature, relevance is operationalized using **four** items referring to predictive and confirmatory value. In order to improve the comprehensiveness of the quality assessing measurement tool, Ferdy van Beest et.al, 2009, considered a broader perspective on predictive value including both financial and non-financial information.

Predictive value explicitly refers to information on the firm’s ability to generate future cash flows: “information about an economic phenomenon has predictive value if it has value as an input to predictive processes used by capital providers to form their own expectations about the future” (IASB, 2008: 36).

Ferdy van Beest et.al, 2009 used predictive value as most important indicator of relevance in terms of decision usefulness and measure predictive value using three items. The first item measures the extent to which annual reports provide forward-looking statements. The forward-looking statement usually describes management’s expectations for future years of the company. For capital providers and other users of the annual report this information is relevant since management has access to private information to produce a forecast that is not available to other stakeholders.

The second item measures to what extent the annual reports **discloses** information in terms of business opportunities and risks. This is the complementation of financial information by non-financial information, when referring to predictive value, and the knowledge that can be obtained of business opportunities and risks, since it provides insight into possible future scenarios for the company (Ferdy van Beest et.al, 2009).

The third item measures company's use of **fair value**. It is often claimed that fair value accounting provides more relevant information than historical cost because it represents the current value of assets, instead of the purchase price. In addition, both the FASB and IASB are currently considering new standards to allow more fair value accounting to increase the relevance of financial reporting information, since they consider fair value as one of most important methods to increase relevance. (Ferdy van Beest et.al, 2009).

In addition to predictive value, confirmatory (feedback) value contributes to the relevance of financial reporting information. Information has confirmatory value “if it confirms or changes past (or present) expectations based on previous evaluations” (IASB, 2008: 36).

Faithful representation

Faithful representation is the second fundamental qualitative characteristic as elaborated in the ED. As stated previously, to faithfully represent economic phenomena that information purports to represent, annual reports must be complete, neutral, and free from material error (IASB, 2008: 36). Economic phenomena represented in the annual report are “economic resources and obligations and the transactions and other events and circumstances that change them” (IASB, 2006: 48). Faithful representation is measured using five items referring to neutrality, completeness, freedom from material error, and verifiability. (Ferdy van Beest et.al, 2009).

Jonas and Blanchet (2000) included one additional item referring to relevance and predictive value: “When identifying unusual or nonrecurring items for disclosure, are both gains and losses given equal importance?” Note that the ED distinguishes verifiability as a separate enhancing qualitative characteristic. “Verifiability is a quality of information that helps assure users that information faithfully represents Botosan (2004) argues that it is difficult to measure faithful representation directly by only assessing the annual report, since information about the actual economic phenomenon is necessary to assure faithful representation.

According to Maines and Wahlen (2006), however, estimates and assumptions that closely correspond to the underlying economic constructs the standards pursue can enhance faithful representation. Therefore, the focus on items in the annual report

that increase the probability of faithfully represented information important. These items do not always directly refer to the US GAAP or IFRS, yet they provide an indirect proxy of faithful representation of financial reporting information prepared in accordance with certain accounting standards. The first proxy refers to the issue 'free from biases. An annual report can never be completely free from bias, since economic phenomena presented in annual reports are frequently measured under conditions of uncertainty. Many estimates and assumptions are included in the annual report. Although complete lack of bias cannot be achieved, a certain level of accuracy is necessary for financial reporting information to be decision useful (IASB, 2008). If valid arguments are provided for the assumptions and estimates made, they are likely to represent the economic phenomena without bias. Moreover, the auditors' report adds value to financial reporting information by providing reasonable assurance about the degree to which the annual report represents economic phenomena faithfully. when the selected accounting principles are clearly described and well-founded, it increases the probability to reach consensus and to detect misstatements for the user of the financial report as well as for the auditor. Verifiability implies that different knowledgeable users of financial reporting information reach general consensus, although not necessarily complete agreement" (IASB, 2008; 39). Since the aim of the measurement tool is to assess each of the qualitative characteristics and verifiability directly refers to the assessment of faithful representation, verifiability is included in the measurement tool as a sub notion of this fundamental qualitative characteristic. This view is supported by the preliminary views on an improved conceptual framework for

financial reporting (IASB, 2006) and the concept statements of the FASE (1980), which both include verifiability as a sub notion of faithful representation and even argue that an unqualified audit report is a necessary condition to perceive the financial reporting information as reliable or faithfully represented. Finally, an increasingly important consideration in the annual report related to faithful representation is the corporate governance statement. Corporate governance can be defined as the mechanisms by which a business enterprise organized in a limited liability corporate form, is directed and controlled.

The third sub notion of faithful representation, neutrality, is defined as “the absence of bias intended to attain a predetermined result or to induce a particular behaviour. Neutral information does not colour the image it communicates to influence behaviour in a particular direction” (IASB, 2008: 37).

Ferdy van Beest et.al, (2009). The comprehensive measurement tool constructed, however, has several limitations relating to validity and reliability. Consistent with the definition of quality of financial reporting, i.e. decision usefulness (IASB, 2008), its validity should be established by comparing our measured results to the decision usefulness of financial reporting as perceived by stakeholders such as equity providers or lenders. In addition, comparing the results of our comprehensive measurement tool with the results of other quality assessment tools using the same sample may increase insight into the validity and reliability of financial reporting quality assessment tools.

The conceptual framework of accounting reports states and strives to bring the accounting reports of the companies worldwide to look similar and be comparable. Comprehensive assessment of the quality of financial reports is important as it may improve users' quality of economic decision making and enhance overall market efficiency (IASB, 2006; IASB, 2008), thereby reducing the cost of capital for companies. Despite of these enforceable global guidelines, as can be concluded from studies presented above, some companies, especially privately owned companies found to trespass the guidelines. Those studies are undertaken in different countries in the world, but there is no such study in Ethiopia. Therefore this paper tries to fill this gap of knowledge.

Chapter three

Methodology

Data type and sources

The researcher has used both primary data and secondary data and the quantitative research design. The primary data were collected through structured questionnaire that have been distributed to the executives of the sampled companies. The secondary data were obtained from the accounting reports and auditor reports of those sampled companies. Thus, the researcher used both types of data to assess about the quality of the accounting reports of private companies and also interpreted the results.

Sampling techniques and sample size

For the purpose of convenience, and to get the sample represent the population, companies were selected from trading sector, manufacturing sector and service sector. A sample size of 20 companies from each sector were taken randomly. The private companies that are required by law to prepare financial information are the targeted of this paper. Because others who are not required by law in Ethiopia to prepare financial information, cannot be assessed for quality of their reports.

Variables

Dependent variables and independent variables are identified. The dependent variable is the overall quality of the accounting reports and this affected by independent variables. These independent variables are identified as professions of people with accounting related duties, existence of internal and external auditors and their independence,

financial statements being audited, audit opinions. Processing way is also another variable that affects the quality of accounting reports. When companies use automated processing that traditional one (manual), the probability of committing error is reduced and thereby increases quality of the reports.

Data analysis and presentation

As this study generally aimed at the assessment of the quality of accounting reports of the private companies in Addis Ababa, this part presents an analysis of the data that were collected through questionnaire and document analysis/observations. So this study used both quantitative and qualitative methods of data analysis.

Data were presented for the purpose of discussion in tables and charts as necessary. Different statistical tools like the software called Statistical Package for Social Science (SPSS) was applied as necessary to test some statistical values to analyze the findings of the study. The researcher has used accounting reports quality assessing measurement tool taking the form of Ferdy van Beest et.al.,(2009) that are presented in the literature review.

Chapter four

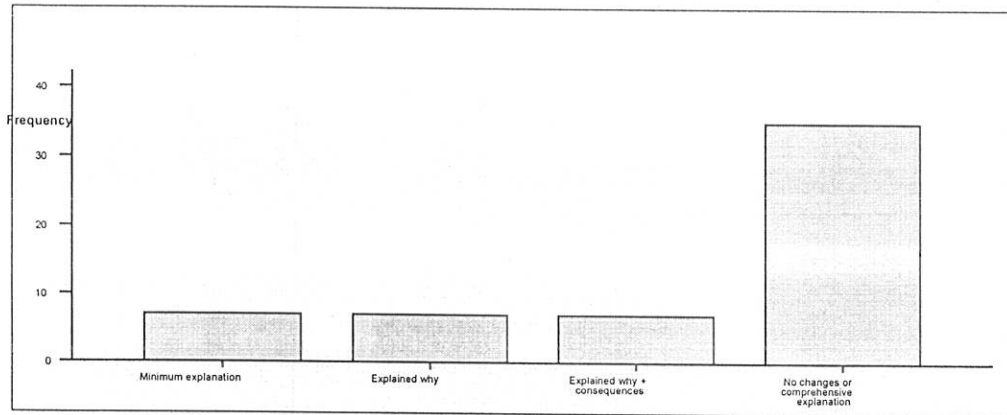
Analysis of the finding and discussion

This chapter presents only the findings of the research questionnaires. The researcher, to conduct this research constructed a compound measurement tool to comprehensively assess the quality of financial reporting in terms of the underlying fundamental qualitative characteristics (i.e. relevance and faithful representation) and the enhancing qualitative characteristics (i.e. understandability, comparability, and timeliness) as defined in ‘An improved Conceptual Framework for Financial Reporting’ of the FASB and the IASB (2008). The operationalization of these qualitative characteristics results in a 22 items described in the questionnaires at index. Accordingly, the response rate of the 60 companies received the questionnaires is only 56 at a rate of 93.3 percent in this study.

1. Comparability

To assess the comparability of the financial information of privately owned companies, as one of the qualitative characteristics of accounting information, six measurement tools were identified and used. The descriptive statistical results of these tools are presented following tables and charts.

Chart 4.11: notes to change in accounting policies



Source: survey questionnaires, 2011

As can be understood from chart 4.11 above, most of the companies (62.5percent) responded that they faced no changes to accounting policies. But still there are that faced change to accounting policies with different degree of explanation about the changes. 12.5 percent responded that the change exists with minimum explanation; the same percent said that they explain the reason for change and 12.5 percent responded that not only the explanation of the reason for change but also consequences is explained as well.

Table 4.11 Notes to revision to accounting estimates explaining the implications of the revision

	Frequency	Percent	Valid Percent
Revision without notes	1	1.8	1.8
Revision with few notes	17	30.4	30.4
No revision/ clear notes	30	53.6	53.6
Clear notes + implications (past)	1	1.8	1.8
Comprehensive notes	7	12.5	12.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

Regarding the revision of the accounting assumptions and estimates as a second tool, the result in the table 4.11 shows that 53.6 percent of the respondent do not make changes to the assumptions and estimates. And 30.4 percent make revision but with few note describing about the revisions. 12.5 percent make change with comprehensive notes together with other notes. Very small respondent (only 1.8 percent) said that they make revision without notes and revision with clear notes and its past implication.

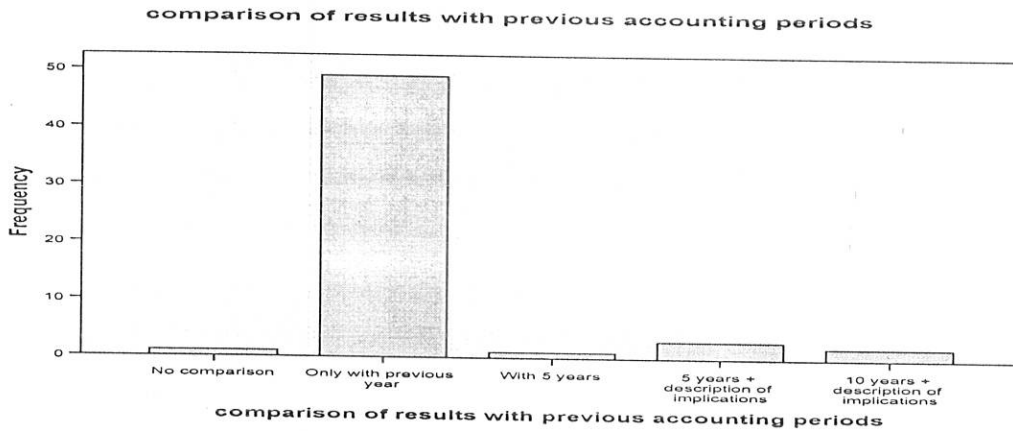
Table 4.12: previous accounting period's figure adjustments for effects of changes to accounting policies or revisions to accounting estimates

	Frequency	Percent	Valid Percent
No adjustments	28	50.0	50.0
Described adjustments	7	12.5	12.5
Actual adjustments (one year)	4	7.1	7.1
2 years	3	5.4	5.4
> 2 years + notes	14	25.0	25.0
Total	56	100.0	100.0

Source: survey questionnaires, 2011

As a third tool, whether companies that change their accounting policies or make revisions to assumptions and estimates make adjustment to previous accounting period's figures or not, the survey questionnaires provided the result shown in the table 4.12. As major number of them does not make change and revision 50 percent of the respondent does not make adjustment. Major of those who make the change together (25 percent) makes the adjustment for the period more than 2 year including the notes as disclosure. Only 7.1 percent make actual adjustment-one year back.

Chart 4.12



Source: survey questionnaires, 2011

As depicted in chart 4.12 above, 87.5 percent of the respondent companies make the financial report comparison only with one year (previous) financial report. Still some (5.4 percent) make comparison of current year accounting report with that of five years back and make description of implications of the trend of the financial reports. Very small percentage shows that they make no comparison of financial reports with previous accounting period's figures.

Table 4.13: comparison of financial report with other companies' reports

	Frequency	Percent	Valid Percent
accounting policies	1	1.8	1.8
explanation of events	2	3.6	3.6
other, please specify_____	53	94.6	94.6
Total	56	100.0	100.0

Source: survey questionnaires, 2011

As in the table 4.13, most of them (94.6 percent) specified that they makes no comparison of financial information to those of other companies. The intra-companies financial reports comparison is thus almost none.

Table 4.14: financial index numbers and ratios in the reports

	Frequency	Percent	Valid Percent
No ratios	35	62.5	62.5
1-2 ratios	7	12.5	12.5
6-10 ratios	14	25.0	25.0
Total	56	100.0	100.0

Source: survey questionnaires, 2011

The table 4.14 also provides that 62.5 percent use no ratio analysis in their reports. 25percent of the respondents uses from 6-to 10 ratios included in their annual financial

reports and 12.5 percent of the respondents include from 1 to 2 financial ratios in their annual financial reports.

2. Understandability

As understandability is one of the important qualitative characteristics of the financial reports, the researcher in this paper identified five items to test understandability of the financial reports of privately owned companies the results of which are presented in the following tables from table 4.21 to 4.25.

Table 4.21: the extent the annual report is presented in a well organized manner

	Frequency	Percent	Valid Percent
complete table of contents	21	37.5	37.5
headings	5	8.9	8.9
order of components	5	8.9	8.9
summary/ conclusion at the end of each subsection	20	35.7	35.7
other, please specify_____	5	8.9	8.9
Total	56	100.0	100.0

Source: survey questionnaires, 2011

The table 4.21 depicts that 37.5 percent of the reports are prepared including complete table of contents in addition to other financial statement bodies. 35.7 percent responded that the financial report includes summary and or conclusion at the end of each subsection. Still there are (8.9 percent) responded that the order of the component in the financial report is important that they consider that they make their report well organized.

Table 4.22: to what extent notes to the balance sheet and the income statement is sufficiently clear

	Frequency	Percent	Valid Percent
Very short description, difficult to understand	7	12.5	12.5
Explanation that describes what happens	28	50.0	50.0
Every thing that might be difficult to understand is explained	21	37.5	37.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

As shown in the table 4.22 above, 50 percent of respondents explain that clearly what happened to the economy the company is included in the note to the balance sheet and income statement. While 37.5 percent of the respondents provides in the notes every

thing that might be difficult to understand. Only 12.5 percent of the respondents provide very short description that is difficult to understand.

Table 4.23: graphs and tables clarifies the presented information

	Frequency	Percent	Valid Percent	Cumulative Percent
no graphs	42	75.0	75.0	75.0
3-5 graphs	14	25.0	25.0	25.0
Total	56	100.0	100.0	100.0

Source: survey questionnaires, 2011

As in the table 4.23 above, while 75 percent of the respondents do not use graphs and charts in their annual financial reports to support the clarification of financial figures presented in the financial statements, 25 percent of the respondents include from 3 to 5 graphs and charts to support to more clarify the financial figures.

Table 4.24: language and technical jargon in the annual report

	Frequency	Percent	Valid Percent
Jargon is explained in text/ glossary	14	25.0	25.0
Not much jargon, or well explained	14	25.0	25.0
No jargon, or extraordinary explanation	28	50.0	50.0
Total	56	100.0	100.0

Source: survey questionnaires, 2011

Regarding technical or terminological jargons in wordings, the table 4.24 shows 50 percent of the respondents uses no jargon words or term. 25 percent of the respondents used to explain term/words they consider jargon. 25 percent again responded that there is no more jargon or jargons are well explained.

Table 4.26: size of the glossary

	Frequency	Percent	Valid Percent
No glossary	42	75.0	75.0
Less than 1 page	7	12.5	12.5
Approximately one page	7	12.5	12.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

As in the table 4.25 above, 75 percent of the respondents do not include glossary to their annual financial reports. While only 12.5 percent of the respondents use to include less than one page as glossary, while 12.5 percent include 12.5 percent include approximately one page glossary.

3. Faithful representation

In this paper, to assess the faithful representation of the financial reports of privately owned companies, the researcher identified six items and the results are presented in the following tables and charts.

Table 4.31: the extent to which valid arguments are provided to support the decision for certain assumptions and estimates

	Frequency	Percent	Valid Percent
Only described estimations	7	12.5	12.5
General explanation	42	75.0	75.0
Specific explanation, formulas explained etc	7	12.5	12.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

Accordingly, 75 percent of the respondents provide general explanations as an argument to support the decisions for certain assumptions and estimations in the annual reports. 12.5 percent of the respondents provide only described estimations while the other 12.5 percent of the respondents provide specific explanation of the estimates and assumptions.

Table4.32: The extent the company bases its choice for certain accounting principles on valid arguments

	Frequency	Percent	Valid Percent
Explained why	14	25.0	25.0
Explained why + consequences	28	50.0	50.0
No comprehensive explanation	14	25.0	25.0
Total	56	100.0	100.0

Source: survey questionnaires, 2011

Regarding valid or persuasive argument on the choices of one accounting policy or principle over the other as the table 4.32 shows, 50 percent of the respondents explain why the policy or the principle is chosen and put the consequences thereon. 25 percent provide explanation of why they chosen the principle/policies and the rest 25 percent do not have comprehensive explanation at all.

Table 4.33: the extent to which in the discussion of the annual results, highlight the favorable events as well as the unfavorable events

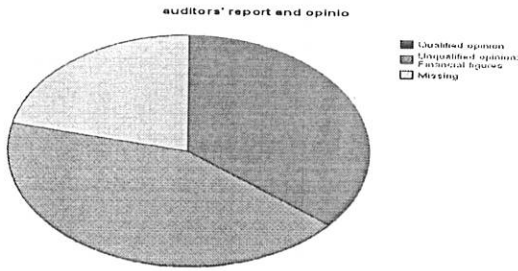
	Frequency	Percent	Valid Percent
unfavorable events only mentioned in footnotes	21	37.5	37.5
Emphasize on favourable events, but unfavourable events are mentioned; no unfavourable events occurred	7	12.5	12.5
Balance favourable /unfavourable events	7	12.5	12.5
Impact of favourable /unfavourable events is also explained	21	37.5	37.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

As shown in the table 4.33, 37.5 percent of the respondents emphasize the unfavorable events only in footnotes as s discussion of the annual results. The same amount of respondents emphasizes the impact of both unfavorable and favorable events. 25 percent

of the respondents balance emphasis on both events while the other 25 percent emphasize on favorable events with minimum focus to unfavorable events.

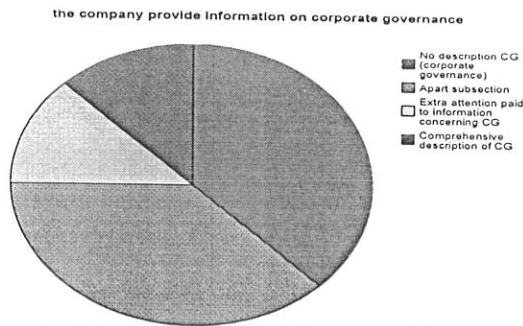
Chart 4.31



Source: survey questionnaires, 2011

As in the chart above of the sampled private companies, out of those that are audited, 45.5 percent of the respondents' audit opinion is qualified and 54.5 percent of the others' audit opinion is unqualified. The 21.43 percent of the total respondents represent the missing item that stands for those companies that are not audited. They have neither qualified nor unqualified audit opinion. The reason may be two: because of the cost and benefit do not employ external auditor. And the recent establishment of some of them is also got contribution to being not yet audited.

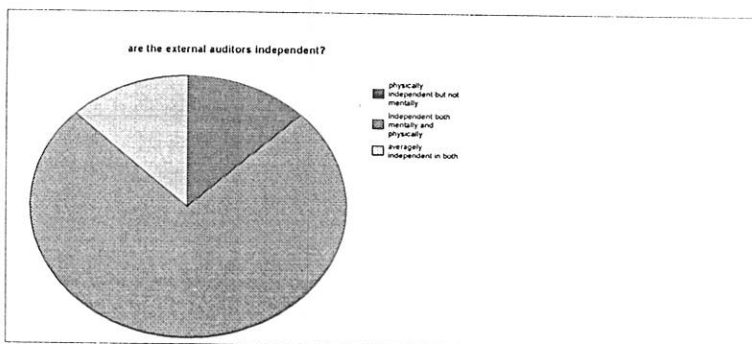
Chart 4.32



Source: survey questionnaires, 2011

The chart 4.32 represents the extent to which the companies provide the information concerning the corporate governance in their annual reports. Of the total respondents, 37.5 percent of them have no any description of the corporate governance included in their annual financial reports. The other 37.5 percent provide information on corporate governance as apart subsection to their reports. And 12.5 percent responded that they pay extra attention to information concerning the corporate governance and the other 12.5 percent provide comprehensive description of the corporate governance in their annual financial reports.

Chart 4.33



Source: survey questionnaires, 2011

The above chart presents that of the total companies audited of the respondents, 75 percent are responded that the auditors are in dependent both mentally and physically and 12.5 percent responded that auditors are independent mentally and the other 12.5 percent showed that the auditors are independent in average.

4. Relevance

Four items are identified as tools for testing of relevance of financial information.

Timeliness is another item that can measure relevance of financial information.

Table 4. 41: presence of the forward looking statement help forming expectations and Predictions

	Frequency	Percent	Valid Percent
Valid No forward-looking information	14	25.0	25.0
Extensive predictions	21	37.5	37.5
Extensive predictions useful for making expectation	21	37.5	37.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

Accordingly as depicted in the table 4.41, 37.5 percent of the respondents provide extensive predictions in helping forward looking information. And another 37.5 percent provide extensive predictions that are useful for making expectation. While 25 percent of

the companies responded that their financial reports do not provide any forward looking information.

Table 4.42: presence of non-financial information in terms of business opportunities and risks complement

	Frequency	Percent	Valid Percent
Valid No non-financial information	21	37.5	37.5
Useful non-financial information, helpful for developing expectations	21	37.5	37.5
Non-financial information presents additional information which helps developing expectations	14	25.0	25.0
Total	56	100.0	100.0

Source: survey questionnaires, 2011

As presented in table 4.42, 37.5 percent of the respondents provide no non-financial information on their annual financial information. Again another 37.5 percent responded that they provide useful non-financial information that is helpful for developing expectations. And 25 percent of the respondents include non financial information, either outside the company or inside the company, which may concern the company that presents additional information which helps to develop expectation.

Table 4.43: does the company use fair value instead of historical cost?

	Frequency	Percent	Valid Percent
Only historical cost	42	75.0	75.0
Most historical cost	12	21.43	21.43
Balance fair value/historical cost	2	3.57	3.57
Total	56	100.0	100.0

Source: survey questionnaires, 2011

The table 4.43 presents whether companies use fair value instead of historical cost. Therefore 75 percent of the respondents use historical cost and 21.57 percent use most historical cost with little fair value in their annual financial reports. And very small account of them responded that they balance the fair value and historical cost.

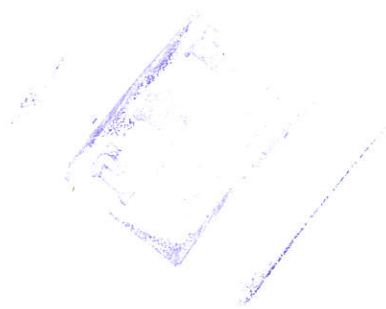
Regarding the feedback value of the financial reports, 25 percent responded that the financial reports provides no feedback to users of the annual reports as to how various market events and significant transactions affected the company. Another 25 percent of the companies provide this information or feedback that helps understanding how events and transactions influenced the company.

Table 4.44: the reported results provide feedback to users of the annual report as to how various market events and transactions affected the company

	Frequency	Percent	Valid Percent
No feedback	14	25.0	25.0
Little feedback on the past	7	12.5	12.5
Feedback is present	14	25.0	25.0
Feedback helps understanding how events and transactions influenced the company	14	25.0	25.0
Comprehensive feedback	7	12.5	12.5
Total	56	100.0	100.0

Source: survey questionnaires, 2011

More over, for all audited companies the financial reports are audited with in fifteen days after the end of the accounting period of the companies. All of the respondents provided that it takes the maximum of fifteen days in average for the auditor to sign the audit reports.



Discussion

The aim of this study was to develop and test a compound measurement tool to comprehensively assess the quality of financial reports of privately owned companies. Therefore the researcher constructed a 22 item index in order to comprehensively measure the quality of financial reporting in terms of the underlying fundamental and enhancing qualitative characteristics as defined in the ED (IASB, 2008). Comprehensive assessment of the quality of financial reports is important as it may improve users' quality of economic decision making and enhance overall market efficiency (IASB, 2006; IASB, 2008), thereby reducing the cost of capital for companies.

The comprehensive measurement tool constructed, however, has several limitations relating to validity and reliability. Consistent with the definition of quality of financial reporting, i.e. decision usefulness (IASB, 2008), its validity should be established by comparing the measured results to the decision usefulness of financial reporting as perceived by stakeholders such as equity providers or lenders. Finally, the reader should bear in mind that the study is based on a relatively small sample. Future research, using larger samples, may provide additional insights into the external validity of the results.

1. Comparability

To test the 22-item index quality assessment tool on internal validity internal consistency reliability the researcher use a sample of 60 at 93.3% annual reports from private

companies. IAS1, Presentation of Financial Statements prescribes the basis for presentation of financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. In my survey, Most of the companies are consistent in the use of similar accounting policies and assumptions from time to time. Even though some of the companies face change to the underlying assumptions and policies with no frequency, they use to describe in the foot notes the changes and the reason thereby and the consequences that follows due to the changes to the accounting policies and assumptions. In addition, most of the companies provide their annual financial reports only with a comparison to the previous years' financial reports. As is presented in the analysis, no companies found that make a comparison of annual financial reports with other companies Very small number of companies provides their annual financial reports in comparison of five years financial reports in their management report. This is quite limited to companies with large amount of capital is also in accordance with IAS1 paragraph 38-39, that says "... an entity shall disclose comparative information in respect of the previous period.... and related notes". Enhancing the inter-period comparability of information assists users in making economic decisions, especially by allowing the assessment of trends in financial information for predictive purposes.

2. Understandability

IAS1 paragraph 52 gives guideline as; an entity meets the requirements in paragraph 51 by presenting appropriate headings for pages, statements, notes, columns and the like. Judgment is required in determining the best way of presenting such information. For

example, when an entity presents the financial statements electronically, separate pages are not always used; an entity then presents the above items to ensure that the information included in the financial statements can be understood. Therefore, in the analysis, most of the companies include heading, table contents and very easy ordering of the components of the financial reports in their annual reports. For the purpose of easing some of them put very sort notes to their balance sheet and income statement and cash flow statement. And still some provide every thing that might be difficult to understand in the footnotes. The result showed that most of the companies do not include graphs and charts in their annual financial reports that additionally help the users of financial information easily understand the financial reports. Very small percentage includes graphs and charts and tables in their annual financial reports. This figure is limited to companies with very large companies and those that have long life in the market. Similarly about half of the companies use no jargon terms and no technical jargons used in the preparation of the annual financial reports. Still some have little such a terms but with explanation in text and or glossary. More over, some of them provide approximately one page of glossary to their annual financial reports and some still provide a glossary that is below one page. But most of the do not have glossary on their annual financial reports.

3. Faithful Presentation

Verifiability

For the study in particular, the researcher assessed the faithful representation as the qualitative characteristics to test the quality of the selected companies' annual reports.

The analysis of the descriptive statistics for quality of financial reports related to accounting standards (faithful representation) and the measurement tools is presented. These results suggest that companies provide general explanation on the extent that valid arguments are provided to support the decision for certain assumptions and estimates in the annual report. In addition, the results show that only described estimations and Specific explanation, explained formulas are provided to support their choice of particular accounting principle.

Neutrality

The result shows that, some put the emphasis to unfavorable events only in footnotes and Impact of favorable /unfavorable events is also explained in the discussion of the annual results to highlight the favorable events as well as the unfavorable events. There are also some that focuses only unfavorable events.

Free from error, verification, neutrality, and completeness

Free from material error, verifiability, neutrality and completeness are the items that help to measure the faithful representation of the annual financial reports of a company. For the purpose of this study, one of the methods used to determine these items is consideration of the audit opinion. The analysis shows that half of the companies' auditor's opinion is qualified while the other half companies' auditor's opinion is unqualified for those that are audited. But 21.43 % have skipped the question on the paper implying that they do not have external auditors. This amount is limited to

companies with very short life in the market and those with lesser capital relatively below one million Ethiopian birr. This can not give assurance to the dependability to the financial report provided by such a company

Observation of the auditors' report

The researcher looked at the auditors' reports of all the respondent companies and determined that the auditors' focus is on the financial figure only. They did not give opinion on the internal consistency and inconsistency of the clients. Again the detailed of what caused the exceptions to their opinion. Some of them reason out why they give an unqualified opinion but still what caused that reason is not done in detail. All of the auditors did not work on the internal control effectiveness of the client companies. The result of the table 4.3 also is in the support of this idea in that 0% of the auditors give unqualified opinion: Financial figures and internal control. Those whose opinion is unqualified is on the financial figures and other accounting principles for example a company that prepared its annual financial reports in a going concern having a loss of 75% of its paid up capital is required to report in a quitting concern. The company failed to do so and thus the auditor given unqualified opinion. These auditors are also independent.

Most of the companies do not provide information on corporate governance. Strong corporate governance is considered as one of the important internal control. Nevertheless, the companies pay less attention on the effectiveness of the corporate governance in the

preparation of their annual financial reports. Some of them provide no description of corporate governance in their reports. But still some provide it as an apart subsection.

4. Relevance

There are two competing world views as put by Geoffrey Whittington (2008): a Fair Value View, implicit in the IASB's public pronouncements, and an Alternative View implicit in publicly expressed criticisms of the IASB's pronouncements. The Fair Value View assumes that markets are relatively perfect and complete and that, in such a setting, financial reports should meet the needs of passive investors and creditors by reporting fair values derived from current market prices.

The Alternative View assumes that markets are relatively imperfect and incomplete and that, in such a market setting, financial reports should also meet the monitoring requirements of current shareholders (stewardship) by reporting past transactions and events using entity-specific measurements that reflect the opportunities actually available to the reporting entity, Geoffrey Whittington (2008).

The result of this paper shows that most of the companies are in compliance with Generally Accepted Accounting Principles of the FASB where 75 percent use historical cost. Still small amount of the companies use most historical cost and use to report inventories at their retail price.

IAS1 paragraph 40 suggests that narrative information ... continues to be relevant in the current period thus previous periods information in the current period's report it help create the forward looking statement forming expectations and predictions concerning the future of the company. In this regard, the result of this study presents that most of the companies provide information that help make extensive predictions and extensive predictions useful for making expectation (i.e. forward looking information). Beside, some o the companies presents no non-financial information in terms of business opportunities and risks complement the financial information that have predictive value in their financial reports.

The result also shows that some of the companies in reporting annual financial results provide no feedback to users of the annual report as to how various market events and significant transactions affected the company. Some other provides feedback and others still provide feedback that helps understanding how events and transactions influenced the company.

Chapter five

Conclusion and Recommendation

Conclusion

Base on the analysis and discussion, the researcher deduces that the financial information provided by those private companies is comparable in the context of consistency and understandable. Depending on the audit works of these companies the researcher can conclude that the financial statement provided by private companies are faithfully represents what happened and the actual results of the financial figures.

As most of them do not include the non financial information, it is a loss to the predictive value which implies that it is less relevant. Some provide useful non-financial information that is helpful for developing expectations. This may be limited to companies with large capital and long life in the market. There fore, significant amount of them provide no feedback to users of annual reports. The relevance of the annual financial report private companies is generally questionable. The over all quality of some private companies is also under question and being private is responsible for this.

Recommendation

This part is to give some recommendation based on the discussion and conclusions provided in the forgoing paragraphs. As mentioned earlier the aim of this paper is to test the quality of the financial reports of the privately owned companies in Addis Ababa. Therefore, the researcher leave recommendation to different responsible parties based o the finding and conclusions derived.

1. The relevance of the financial reports seems in some context appear relevant and in other context fail to be relevant (for example most of them do not include sufficient no-financial information and some include previous financial figures up to five years to provide extensive forward looking ability of the financial information users). This may not be actually failure because those who able to include all the necessary financial and non-financial information to their annual financial reports are those companies with large capital investment that are expected to undertake large volume of transactions. Thus I recommend that those with small amount of capital are better to include the non-financial information to their annual reports to help user make a forward looking and prediction.
2. The reliability may depend on faithful representation of the financial reports. Except few companies there is no evidence found that the reports are not reliable. Those few companies do not have external auditors. This reduces the reliability of the financial information provided by those companies. Therefore, I recommend that these companies shall employ external auditors to have their financial reports get audited to increase credibility of their reports. The cost and benefit analysis should not be forgotten.
3. In addition, auditors shall be enforced also to give their opinion on the internal control effectiveness of the company rather than only give opinion on the financial figures. The Federal auditors should pay close administration of the auditors as to the quality of their audit works.

4. The privately owned companies also must try to compare their annual financial reports across the companies and must include graphs and glossary to more clarify and increase comparability and understandability of the financial reports.
5. Finally, the researcher suggests that not all of the private companies prepare less quality financial reports. Those with relatively small amount of capital and less volume of transactions don't have their financial reports audited. Companies should try to fulfill all of the requirement set by IAS and FASB for qualitative financial information.

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Appendix: Addis Ababa University

**School of Business and Public administration
Department of Accounting and Finance
Questionnaire**

Dear Sir/Madam

This survey is conducted as part of an MSc research project, which shall be in partial completion of the Master of Science in Accounting and Finance. The general purpose of this research is to examine the extent to which organizations; especially Private companies prepare **qualified accounting reports**.

I would like to invite your participation in this survey by filling up (tick \surd mark) the attached questionnaire *with out bias*. **Please be sure that all the information will be treated with the strictest confidentiality and only the aggregate data will be analyzed and is used only for academic purpose.**

Thank you in advance for your cooperation!

Title: Financial Reporting Quality in Privately owned companies: The Impact of private ownership on quality of accounting reports.

Objective: to assess the extent to which the privately owned companies prepare quality accounting reports.

Target: sample large private limited companies in Addis Ababa

Attention: you need not to write your name and company's name!

A. General

1. The life of your firm in the market (since establishment)

- below 5 years
- from 5 to 10 years
- form 10 to 15 years
- from 20 to 30 years
- above 30 years

2. The current capital of your firm? _____

3. The total number of employees in your firm

- below 10
- from 10 to 20
- from 20 to 30
- from 30 to 50
-
- above 50

4. How many employees do you have in accounting profession?

- 3 and below
- from 3 to 5
- from 5 to 10
- above 10

5. Number and level education of accountants including the finance officer

- Certificate + experience _____
- Diploma + experience _____
- BA Degree _____
- Masters and above _____
- CPA/ACCA _____

B. Main Measurement tools

Timeliness

1. How many days did it take for the auditor to sign the auditors' report after book year end? - IASB, 2008
- 1 to 2
 - 2 to 3
 - 3 to 4
 - 4 to 5
 - 5 to 6
 - other, please specify _____

Comparability

1. To what extent do the notes to changes in accounting policies explain the implications of the change? – Consistency
- Changes not explained
 - Minimum explanation
 - Explained why
 - Explained why + consequences
 - No changes or comprehensive explanation
2. To what extent do the notes to revisions in accounting estimates and judgments explain the implications of the revision?
- Revision without notes
 - Revision with few notes
 - No revision/ clear notes
 - Clear notes + implications (past)
 - Comprehensive notes
3. To what extent did the company adjust previous accounting period's figures, for the effect of the implementation of a change in accounting policy or revisions in accounting estimates?
- No adjustments
 - Described adjustments
 - Actual adjustments (one year)
 - 2 years
 - > 2 years + notes
4. To what extent does the company provide a comparison of the results of current accounting period with previous accounting periods?
- No comparison
 - Only with previous year
 - With 5 years

- 5 years + description of implications
- 10 years + description of implications

5. To what extent is the information in the annual report comparable to information provided by other organizations? In other words: an overall conclusion of comparability compared to annual reports of other organizations

Judgment based on:

- accounting policies
- structure of the report
- explanation of events
- other, please specify _____

6. To what extent does the company presents financial index numbers and ratios in the annual report?

- No ratios
- 1-2 ratios
- 3-5 ratios
- 6-10 ratios
- > 10 ratios

Understandability

1. To what extent is the annual report presented in a well organized manner? Judgment based on:

- complete table of contents
- headings
- order of components
- summary/ conclusion at the end of each subsection
- other, please specify _____

2. To what extent are the notes to the balance sheet and the income statement sufficiently clear?

- No explanation
- Very short description, difficult to understand
-

Explanation that describes what happens

- Terms are explained (which assumptions etc.)
- Every thing that might be difficult to understand is explained

3. To what extent does the presence of graphs and tables clarifies the presented information? IASB, 2006

- no graphs
- 1-2 graphs
- 3-5 graphs

- 6-10 graphs
- > 10 graphs

4. To what extent is the use of language and technical jargon in the annual report easy to follow? IASB, 2006

- Much jargon (industry), not explained
- Much jargon, minimal explanation
- Jargon is explained in text/ glossary
- Not much jargon, or well explained
- No jargon, or extraordinary explanation

5. What is the size of the glossary?

- No glossary
- Less than 1 page
- Approximately one page
- 1-2 pages
- > 2 pages

Faithful representation

1. To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the annual report? – Verifiability

- Only described estimations

- General explanation
- Specific explanation of estimations
- Specific explanation, formulas explained etc.
- Comprehensive argumentation

2. To what extent does the company base its choice for certain accounting principles on valid arguments? - Verification
- Changes not explained
 - Minimum explanation
 - Explained why

 - Explained why + consequences
 - No changes or comprehensive explanation
3. To what extent does the company, in the discussion of the annual results, highlight the favorable events as well as the unfavorable events? - Neutrality
- Unfavorable events only mentioned in footnotes
 - Emphasize on favorable events
 - Emphasize on favorable events, but unfavorable events are mentioned; no unfavorable events occurred
 - Balance favorable / unfavorable events
 - Impact of favorable / unfavorable events is also explained
4. Which type of auditors' report is included in the annual report? - Free from material error, verification, neutrality, and completeness
- Adverse opinion
 - Disclaimer of opinion
 - Qualified opinion
 - Unqualified opinion: Financial figures
 - Unqualified opinion: Financial figures + internal control
5. To what extent does the company provide information on corporate governance? - Completeness, verifiability, and free from material error
- No description CG (corporate governance)
 - Information on CG limited, not in apart subsection
 - Apart subsection
 - Extra attention paid to information concerning CG
 - Comprehensive description of CG
6. To what extent are the external auditors independent?
- not independent
 - mentally independent but not physically
 - physically independent but not mentally

Independent both mentally and physically

averagely independent in both

NA (not applicable)

Relevance

1. To what extent does the presence of the forward looking statement help forming expectations and predictions concerning the future of the company? - Predictive value
 - No forward-looking information
 - Forward-looking information not an apart subsection
 - Apart subsection
 - Extensive predictions
 - Extensive predictions useful for making expectation
2. To what extent does the presence of non-financial information in terms of business opportunities and risks complement the financial information? - Predictive value
 - No non-financial information
 - Little non-financial information, no useful for forming expectations
 - Useful non-financial information
 - Useful non-financial information, helpful for developing expectations
 - Non-financial information presents additional information which helps developing expectations
3. To what extent does the company use fair value instead of historical cost? - Predictive value
 - Only historical cost
 - Most historical cost
 - Balance fair value/historical cost
 - Most fair value
 - Only fair value
4. To what extent do the reported results provide feedback to users of the annual report as to how various market events and significant transactions affected the company? - Confirmatory value
 - No feedback
 - Little feedback on the past
 - Feedback is present
 - Feedback helps understanding how events and transactions influenced the company
 - Comprehensive feedback

Ended

DECLARATION

I hereby declare that this project is my original work and has not been presented for a degree in any other university. And the materials used for this project have been duly acknowledged.

Name: Mekonnen Aboneh


Signature: _____

Place: Addis Ababa University

Date: June 2011

This project has been submitted for examination with my approval as a university advisor.

Name: Dr S Ulaganathan

Signature: 

Date: 22-06-2011