
Information Transparency on Financial Markets, an International View

Irina Diana IORDACHE, Ph. D. Student,
"1 Decembrie 1918" University of Alba Iulia, Romania,
e-mail: irina.iordache07@gmail.com

Abstract

In this study, the author analyzes the issue of transparency of financial information at the level of entities listed on the financial markets, as a solution to the process of optimizing management strategies in increasing the information users' confidence and in attracting investors.

The research consisted in analyzing the financial statements of 120 companies listed on 8 capital markets. In constructing the sample, it was assumed that the degree of transparency of the information presented by the companies is directly proportional to the weight they occupy in the structure of the stock indices. Finally, 10 stock indices were analyzed.

It was concluded that in order to meet transparency and regular reporting requirements, listed entities need to adapt their organization and communication according to good governance practices and accounting rules so that they are always engaged in an open market dialogue. The level of transparency also comes from the way in which the management of each entity knows how to take responsibility and build that optimal information system, based on the cost-benefit ratio and also to ensure that all shareholders and investors are treated equally.

Keywords: IFRS; US GAAP; accounting; transparency; stock exchange; stock indices

JEL Classification: M41

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Introduction

Through the notion of "corporate transparency" the regulators want to suggest to the entities the idea of visibility, credibility and openness in the process of reporting information to the persons they come in contact with, from employees, shareholders, business partners and even public authorities.

In general, when talking about corporate transparency, we all understand that in fact we refer to ensuring the publication of accurate, complete, credible, intelligible, but also accessible information in terms of presentation.

It is important to emphasize that good corporate transparency is achieved when there is also a regulatory framework for this aspect so that the information provided will convince its recipients, without manipulating their understanding. In this respect, entities must differentiate between marketing, advertising and transparency related to financial information.

However, from the analyzes carried out by various consulting organizations¹ it is observed that at the level of the entities in general, the management does not fully assume the optimum transparency, often trying to report either insufficient or useless information on the unfolded activity. This aspect affects the credibility and sustainability of the information, impacting both the internal activity of the company and the one with the external partners.

In ensuring transparency, regulatory accounting requirements play an important role, according to which an entity must disclose timely information about the financial position, financial and operational performance, and the entity's accounting policies². A high level of transparency is achieved when financial reporting ensures a good understanding of both the economic reality of an entity and the economic environment in which the entity operates in a competitive market. In antithesis, providing a minimum of information,

¹ *Transparency International – România, Campioni ai integrității: Linii directoare de conduită pentru o companie lider*, 2015, online at <https://www.transparency.org.ro/ro/content/campioni-ai-integritatii-linii-directoare-de-conduita-pentru-o-companie-lider>, accessed on 17.01.2020.

² Hlaciuc E., Măciucă G., Sandu (Ursachi) A., Mînișca C., The Convergence of National Accounting with the International Financial Reporting Standards – Comparative Study Regarding Reform in China and Romania, *World Journal of Social Science*, Vol. 5, nr. 3, 2015

according to any regulations, also means the publication of a minimum level of indicators that express the financial position and performance of the entity.

In order to facilitate transparency and for a good interpretation of the financial statements, internationally high-quality accounting standards have been created to ensure a common language in the processing and reporting of financial results. The most widely used and credible standards in business globalization are International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP).

Through this study we intend to analyze the issue of transparency of financial information at the level of entities listed on financial markets, as a solution to the process of optimizing management strategies in increasing the confidence of information users and attracting investors.

Theoretical framework

Over time, countries have developed their own accounting standards, based on rules, principles, business or tax orientations, etc.

As we mentioned, at international level, the most acceptable regulatory accounting frameworks for investors are IFRS and US GAAP. The two systems, while each offering a set of principles, evaluation rules, techniques for recording and reporting financial information, however, are based on different reasoning of regulatory frameworks.

Thus, IFRSs are established on a general framework, based on a set of principles, definitions, rules for evaluation, recognition and presentation of the structural elements that represent the financial position and performance (assets, liabilities, equity, income and expenses). Within this regulatory system, transparency is a qualitative requirement that an entity's management must meet when reporting financial statements³. In the case of the US GAAP, in order to comply with this regulatory framework, the entities construct their accounting policies in such a way as to respond to an

³ *Ernst and Young, US GAAP versus IFRS: The basics – February 2018*, online at [https://www.ey.com/Publication/vwLUAssets/IFRSBasics_00901181US_23February2018/\\$FILE/IFRSBasics_00901-181US_23February2018.pdf](https://www.ey.com/Publication/vwLUAssets/IFRSBasics_00901181US_23February2018/$FILE/IFRSBasics_00901-181US_23February2018.pdf), accessed on 12.12.2019.

exhaustive list of rules and requirements. Such an approach has in time generated a fluffy legislation, of about 140,000 pages, but which manages to answer most of the cases encountered in practice and very difficult to give rise to interpretations¹.

Starting from this different approach in drafting the two regulatory frameworks, the question arises whether US accounting standards and IFRSs are alike and whether information reported for transparency requirements is comparable. In this respect, there is a permanent concern to ensure the convergence of the two sets of standards, an objective expressed by common agreement since 2002 through the Norwalk agreement².

However, it is noted that there are still a number of differences between the two sets of regulations, especially that between the accounting specialists there are different opinions and loyal supporters of a single category of regulation. For example, David Tweedie in a 2012 statement argues that IFRSs are a stronger set of regulations, as they are based on principles³, while supporters of US GAAPs such as Bratton and Cunningham believe they are better because it offers clearer rules based on principles, but which better manage revenue recognition and evaluation⁴.

In such debates, it is difficult to find a consensus because the measurement of differences and the impact of the transparency of information are based on the technical approaches found in the two categories of accounting standards for the same kind of operations and activities.

Regardless of the accounting standard applied, the question is: "What is the optimum level of transparency that a public entity must present to users?"

Starting from this objective and from the inherent risks arising in the information and decision-making process through the study we propose to identify a stratification

of the degree of international transparency in which public entities can fall.

Research methodology

In order to reach the objective proposed in the first stage, we considered absolutely necessary to identify the area of application of the two regulatory systems by consulting at a general level the accounting regulatory frameworks (in 165 countries). Subsequently, we focused our study on public reporting of entities in countries where financial markets present a significant number of transactions or particularities. Thus, in the second stage we studied the regulatory frameworks and financial statements of the companies listed on 8 major stock exchanges: the New York Stock Exchange, the Shanghai Stock Exchange, the London Stock Exchange, the Swiss Stock Exchange, the Hong Kong Stock Exchange, the Stock Exchange from Tokyo, the Moscow Stock Exchange and the Bucharest Stock Exchange.

The study continued with the analysis of the financial statements of 120 companies listed on the 8 mentioned stock exchanges. In order to define the sample of the 120 companies, the stock market indices of the 8 stock exchanges were used. At the New York Stock Exchange, we used 3 more representative indices on both the US and global markets: the S&P500, Nasdaq and Dow Jones. In this regard, finally, 10 stock indexes were analyzed. Of the companies that are part of these stock indices, 12 companies were selected for each index as follows:

- the first 2 companies with the highest weight in the index structure were selected;
- the last 2 companies with the lowest weight in the index structure were selected;
- of the remaining companies in the structure of each index, 8 companies were selected randomly.

We decided to choose the stock index as a selection criterion due to the fact that the most capitalized entities in the international financial markets are analyzed from the point of view of this indicator. Next, based on this reasoning, but also the need to obtain a comparable data base, we have granted for each entity, separately, scores from 1 to 12, depending on the weight it holds in the index structure of which it is a part. Thus, in order to optimize the information that the entities report through the prism of transparency, we have built a scorecard

¹ KPMG, IFRS compared to US GAAP, Decembrie 2017, online at <https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/12/ifrs-us-gaap-2017.pdf>, accessed on 26.12.2019.

² Memorandum of Understanding "The Norwalk Agreement", 2002, online at <https://www.fasb.org/news/memorandum.pdf>, accessed on 16.01.2020.

³ An Interview with Sir David Tweedie, *Journal of International Financial Management & Accounting*, 13(1), 2012

⁴ Bratton, William W. and Cunningham, Lawrence A., "Treatment Differences and Political Realities in the GAAP-IFRS Debate", 2013, *Faculty Scholarship*, Paper 858

consisting of 21 elements, which represent categories of information necessary to determine the level of transparency.

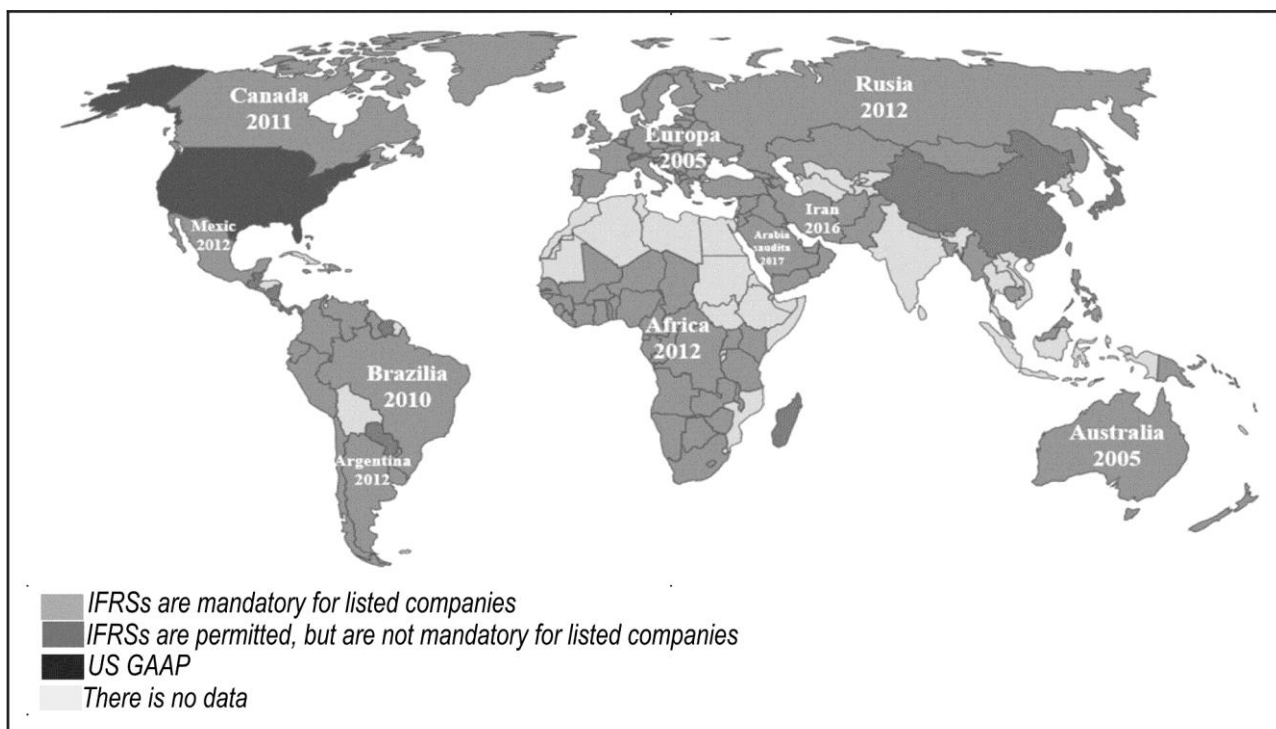
In constructing the sample, we started from the hypothesis that the degree of transparency of the information presented by a listed entity is directly proportional to the weight occupied by the stock indexes. In the study we've included the test of this hypothesis.

Results

A first result was the geographical identification of the application of the most representative

accounting standards, namely IFRS and US GAAP. Thus, out of the 65 countries studied, we found that at the level of 144 jurisdictions there is an obligation to apply IFRS for listed domestic companies, and in 12 countries IFRSs are recommended, but not necessarily. The rest of the 9 countries included in the study apply their own standards based on national rules, including the United States with its own accounting rules, which nevertheless significantly influence the capital markets, becoming the main competitor of IFRSs. *Figure no. 1* illustrates the territorial application of the two accounting systems.

Figure no. 1. Accounting systems around the world

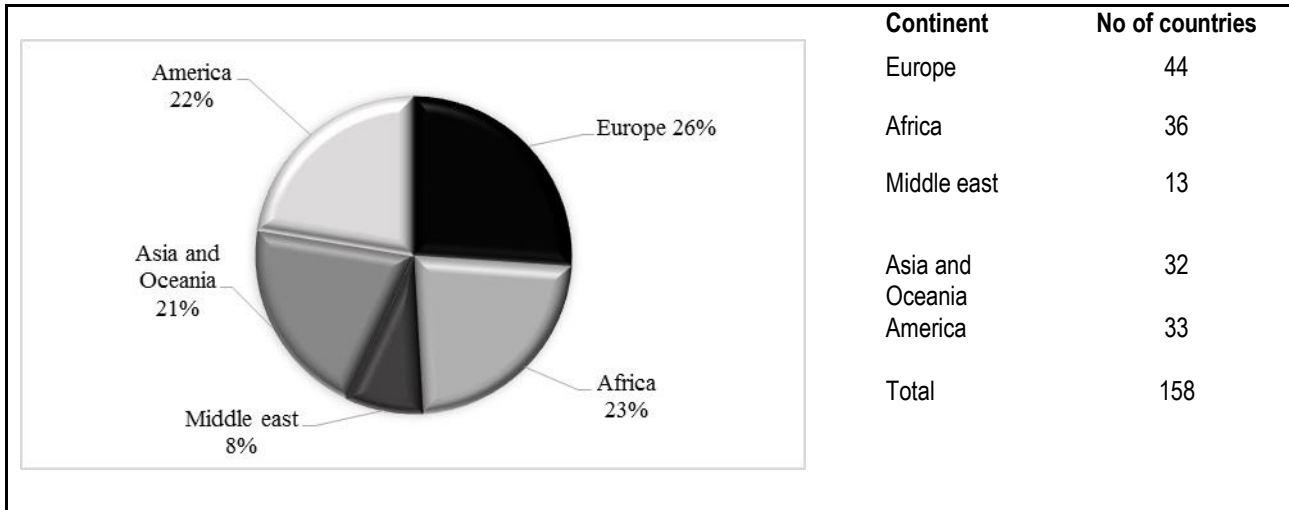


Source: Own processing based on ifrs.org data

We note that the application of International Financial Reporting Standards is not mandatory, but it is allowed among the companies listed in the following states: Switzerland, Japan, Paraguay, Suriname, Panama, Nicaragua, Guatemala, Madagascar, Timor-Leste.

Regarding the distribution on the continents level, according to *Figure no. 2*, it can be seen how most jurisdictions that oblige or allow the use of IFRS among listed companies are found in Europe (44 states), followed by Africa with 36 countries.

Figure no. 2. Distribution of IFRS by continent in 2018



Source: Own processing based on ifrs.org data

Also, from the analysis we conclude that among the listed companies that do not use IFRS, the vast majority (over 80%) are listed companies in the United States, China, Japan and India.

This first result was the starting point in the second phase of the study, namely in constructing the sample of 120 entities that validate the level of transparency of listed entities, being known that, in practice, various factors affect the degree of transparency.

Following the analysis of the 120 entities listed on the 8 capital markets, we identified a number of 21 elements that characterize the level of transparency of the information reported by each company.

We grouped and summarized the presented information according to the theoretical objectives of transparency, finding that a number of 11 elements can be found in the reports of all the studied companies. Thus, we concluded that the presentation of these 11 elements ensures a basic level of transparency regardless of the capital market where the entities operate. In addition to these elements, we also identified in the studied reports another set of information, such as risk factors, management remuneration policy etc. Their presentation, in addition to the 11 basic elements, we considered to extend the degree of transparency. In addition to the two categories of information, we also encountered a third set of informational elements, such as information on the production process or the

presentation of anti-corruption policies, information that is less often found in reports, but which we've considered to conduct to a more intensified transparency.

In order to test our hypothesis, according to which the companies with a higher weight in the stock market indexes (strong market capitalization) have the highest degree of transparency, we measured the correlation of these variables with the help of the Pearson coefficient.

$$r_{xy} = \frac{\frac{1}{n} \sum (x - \bar{x})(y - \bar{y})}{s_x s_y}$$

where,

n = sample size of 120 entities

x = weight of companies in stock indices – individual values

y = the score obtained regarding the degree of transparency – the individual values

\bar{x} = weight of companies in stock indices – arithmetic mean

\bar{y} = the score obtained regarding the degree of transparency – the arithmetic mean

s_x = weight of companies in stock indices – standard deviation

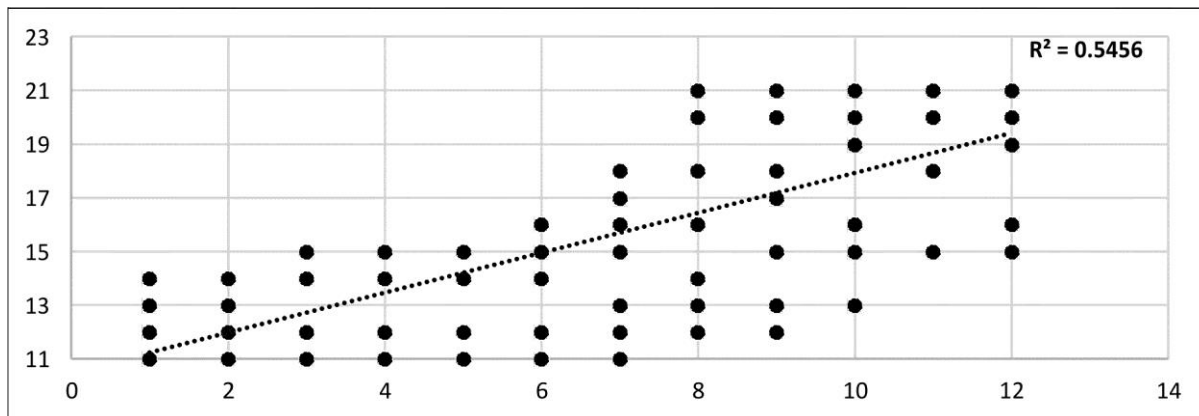
s_y = the score obtained on the degree of transparency – the standard deviation

In this respect, for the comparability of the data, following the analysis of the 21 informational elements, we assigned to each entity in our sample a score regarding the degree of transparency, included in the range 11-21.

We thus identify two significant elements in our research (*Figure no. 3*):

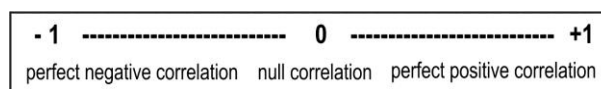
- Share of companies in stock indices (X axis)
- The score obtained on the 21 informational elements (Y axis).

Figure no. 3. The correlation between the information presented by the companies and their weight in the stock market indices



Source: Own projection based on Pearson correlation

From *Figure no. 3* it is observed that there is a direct and positive correlation between the two elements. Also, the combination of the two elements is relevant, concluding that there is a strong correlation between these two variables, as the Pearson correlation coefficient has the value of 0.73.



Also, the correlation of the two variables is also proved by the coefficient of determination r^2 . According to the theory, if r^2 is greater than 0.5 it means that the variables introduced in the matrix system are strongly correlated and interdependent.

Formula	Interpretation based on Cohen (1988)
$r^2 = (r_{xy})^2$	$r^2 = <0.30$ there is no linear connection $0.30 < r^2 < 0.50$ there is an average link between the variables $r^2 > 0.50$ the variables are perfectly linked to each other

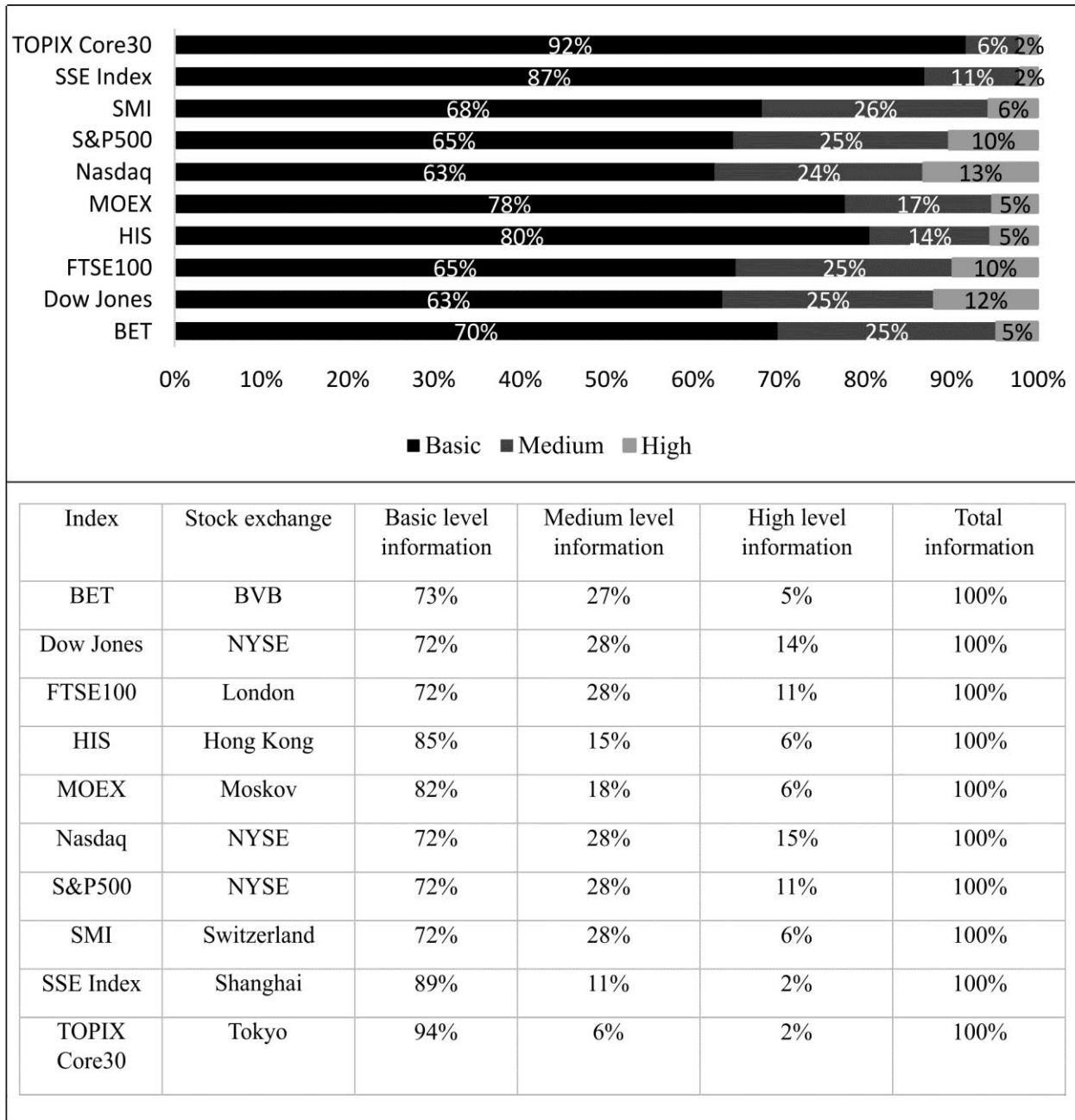
In our case r^2 being equal to 0.5456, we can say that 54% of the variation of the degree of transparency of the information presented by the studied entities is determined by the variation of the weights that these entities occupy within the stock market indices. In this respect, our hypothesis is accepted and we conclude that an entity obtains a leading position in the capital market on which it operates if it is concerned with increasing transparency.

Thus, using this methodology, we obtained a second result that highlights the overall stratification of the level of transparency on the 8 studied markets. As seen in *Figure no. 4* it follows that the biggest concern in presenting a high level of information is to be observed in companies listed on the New York stock exchanges (Nasdaq – 13%, Dow Jones – 12%, S & P500 – 10%) and those in London (FTSE100 – 10%). A low level of transparency can be seen in the Asian stock markets, compared to those in Europe and America. Thus, we found that on the Tokyo and Shanghai stock exchanges, only 2% of the information presented is from the information category with high level of transparency. Most of the companies listed on these exchanges (about 90%) have the minimum (basic) level of information that

ensures transparency. At the BVB level it is observed that 73% of the information presented ensures a basic level of transparency and, at the same time, the listed entities are concerned to increase the degree of

transparency by registering a significant percentage, of 27%, of the information with average level of transparency. However, few entities manage to provide information with a higher degree of confidence (5%).

Figure no. 4. The tendency of companies in presenting information towards a high degree of transparency on the 8 studied stock exchanges



Source: Own projection

Conclusions and recommendations

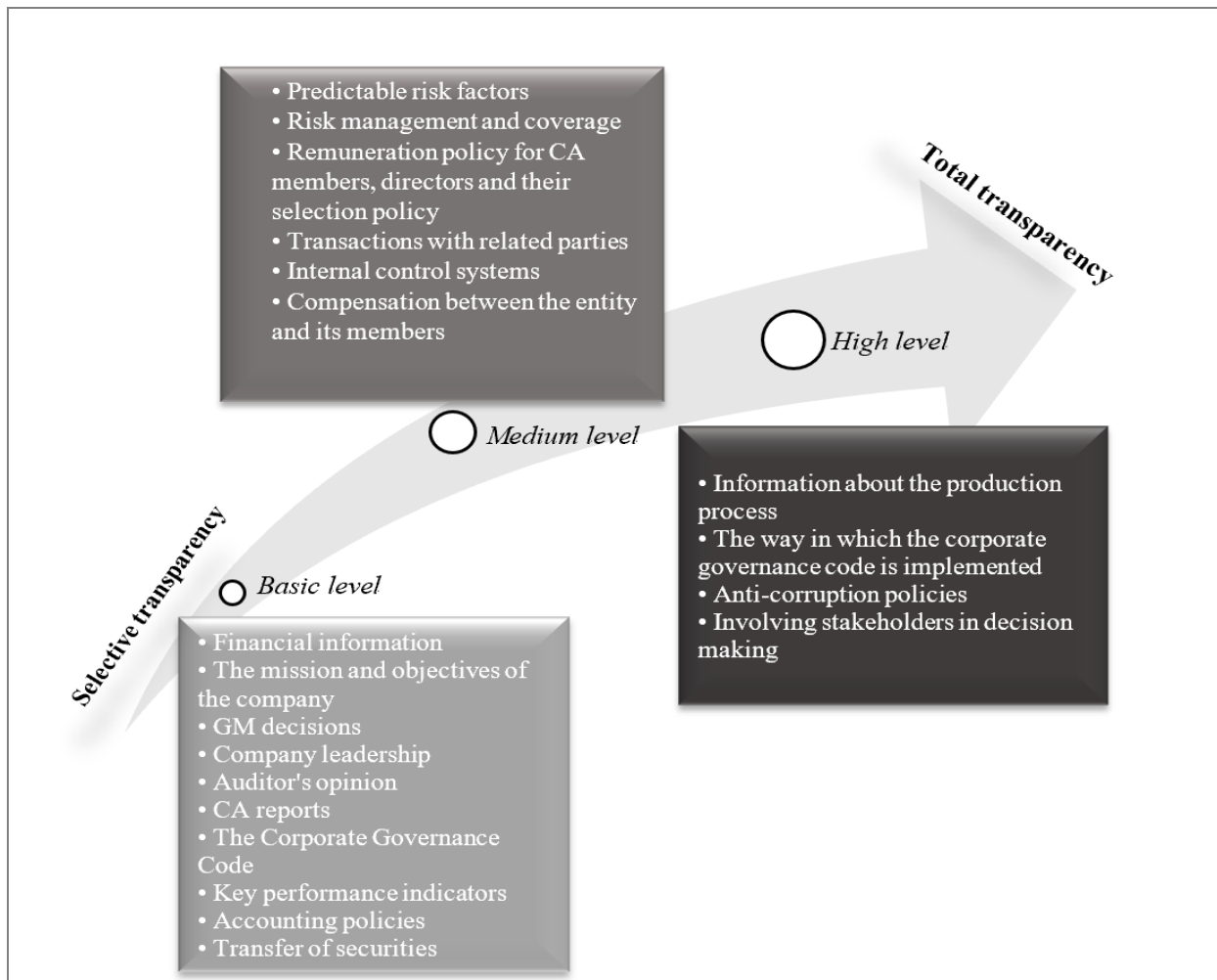
Synthesizing the results of the research and taking into account our objective to find optimal solutions in presenting the most transparent information, we identified three categories of entities, depending on the level of information presented. Finally, we've found that in management strategies an important place is occupied by the understanding of the process of obtaining and presenting information through the prism of transparency, which is why an essential condition in improving the performance of the entity is the awareness of the differences

between a selective and subjective information presentation and a total.

Since we have tested and observed that the highest level of transparency at present means the presentation of the 21 elements, we consider that the way of selecting the categories of information presented depends on by each entity in determining the optimization of the degree of transparency.

As a result of the hierarchy of the elements identified by our study, the schematic construction of the strategies for optimizing transparency can be achieved by completing the levels of transparency presented in *Figure no. 5*.

Figure no. 5. Selective transparency versus total transparency



Source: Own projection

Thus, in order to meet the requirements of transparency and periodic reporting, listed entities must adapt their organization and communication according to good governance practices and accounting rules, so that they are always engaged in an open market dialogue. The level of transparency also comes from how the management of each entity knows how to take responsibility and build an optimal information system based on the cost-benefit ratio, which ensures that all shareholders and investors are treated equally. All these steps to build a transparent and open investor information system inevitably have effects on the share price.

As a result of this study, it is advisable for the listed entities to have a proactive attitude, so that their management is aware of the possibility of building an optimal transparency strategy without having the fear that it will affect their competitive position on the market if they also present so-called "sensitive" information.

As a final conclusion, based on the results of this study, we find that the entities listed on any capital market are concerned about the transparency of the information

presented and that this aspect represents for them an evolutionary process related both to the requirements of the regulatory frameworks and also to the policies and management strategies of reporting entities. This conclusion is especially evident after we tested the correlation between the optimization of the level of transparency and the competitive success of each entity, as a management strategy on the capital market. A possible limitation of this research could be represented by the fact that only 8 financial markets were studied. For future studies, an interesting perspective might be to explore financial markets with different particularities, such as financial markets in China or those in Islamic countries.

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