ECONOMIC IMPLICATIONS OF CORPORATE FINANCIAL REPORTING IN BRAZILIAN AND EUROPEAN FINANCIAL MARKETS

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This research aims to compare Brazilian and European results of a survey on financial reporting and IFRS rules. Its main goal is to explore the economic implications of accounting disclosure practices in emerging and developed markets, as a way to shed light on aspects that have been previously neglected by accounting theory. This is extremely important due to the need for cross-country comparative studies leading to a better understanding of the financial decision-making process in different economic environments.

In addition, this research follows a recent wave of field studies in accounting[1] that aim to narrow the gap between academics and practitioners. Furthermore, the focus of this research is a cross-country comparative study, because of the relative rarity of this sort of work. This is of particular importance given that, in contrast to the literature based on ex-post data, the practice of accountancy in emerging markets has been largely ignored in accounting literature.

Accounting is the language of economy and it represents the firm's performance numerically (BENABDELLAH, 2008). The development of financial markets during the last decade created the need for a universal common 'language' or orientation in accounting (ERNST & YOUNG and FIPECAFI, 2009; HOARAU, 1995). Many countries have already moved in this direction by implementing the IFRS, and evolving towards a truly global economy. The European Union adopted the IFRS in January 1st, 2005, and other countries, Brazil for example, need to do the same (CVM, 2007).

Research Question

There is much conjecture about manager behavior (CEOs, CFOs or controllers) in Brazil because of the small number of exploratory studies done on the subject. This research aims to minimize un-informed assumptions about manager, auditor and financial analyst behaviors.

The main inquiry of this research is based on two questions, which will be the guidelines of the study. The questions are:

- What are the new accounting information needs in economies with capital markets that have become increasingly important?
- Is it expected that the IFRS will better satisfy those needs?

In order to answer these questions, only public firms in Brazil and in the European Union will be analyzed. In addition, the different types of mandatory-IFRS and voluntary information in reports that controllers, financial analysts and auditors find useful and reliable will be compared. There will also be an analysis of the reasons for their preferences in each market. The answer to these questions will help broaden the understanding of the effectiveness and the relative importance of accounting reporting for these different interest groups.

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[1] Although most studies are focused on the United States and Europe (e.g., BARKER and IMAM, 2008; GRAHAM, HARVEY and RAJGOPAL, 2005; SAGHROUN, 2003; BARKER, 1998; ARNOLD and MOIZER, 1984; MOIZER and ARNOLD, 1984)

To investigate these questions in Brazil and the European Union, a questionnaire was created, adapted from some of the questions developed by Ball (2008), Benabdellah (2008) and Graham, Harvey and Rajgopal (2005). This questionnaire will also be used in both markets, in order to allow direct comparisons between countries. Such comparisons will make it possible for an analysis of how the distinct economic environment of emerging and developed markets helps the shaping of accounting disclosure practices in these countries.

Graham and Harvey (2001, p. 189) highlight the potential problems inherent in a survey approach: "*Surveys measure beliefs and not necessarily actions. Survey analysis faces the risk that the respondents are not representative of the population of firms, or that the survey questions are misunderstood.*". In this research, the same questionnaire, written in English, Portuguese and French, will be used in each country, thus ensuring that the survey instrument carries the same meaning in both Brazil and the European Union.

Objectives

The main objective of this study is to discover the new role of accounting information in the economic environment of Brazil and Europe as well as to determine if the IFRS will help fulfill this role. For this we will compare the similarities and the differences in accounting report needs for managers, financial analysts and auditors; and for the European and Brazilian markets.

Motivation

Emerging markets, like Brazil, may serve as convenient laboratories for understanding the problems in accountancy and finance relevant to developed markets. Volatile economic conditions, less liquid capital markets, highly concentrated firm ownership, a non-negligible share of state-owned firms, inefficient and weak institutions, poor monitoring practices, financing restrictions, and large amounts of information asymmetry are among the many distinct features of such markets. Such imperfections exacerbate the issues that are thought to be important for financial decision-making, and highlight the difficulties that may lie in the financial executive's path.

Brazil is going through a transitional period in accounting. The switch to IAS/IFRS accounting rules is a unique and exceptional period in an emerging market to study the problems related to changes in accounting and the first adoption of IFRS. Raffournier (2007) and Hoogendoom (2006) state that the implementation of IFRS represents a transformation of accounting rules' philosophy.

Thus, this research will focus on the disclosure of mandatory reports and the first problems related with the adoption of IFRS. Manager's accounting reports are important to all stakeholders as they describe the last annual enterprise performance, which are made by firms' controllers (GRAHAM, HARVEY and RAJGOPAL, 2005). These public reports are published in journals, magazines or websites according to the accounting rules of different countries. Stakeholders may use such reports, for example, to study their own companies as financial analysts (BAKER and IMAM, 2008; ARNOLD and MOIZER, 1984; MOIZER and ARNOLD, 1984) or to investigate their own companies as auditors (NELSON, ELLIOTT and TARPLEY, 2002).

Investment analysts often use corporate accounting reports to make decisions (SAGHROUN, 2003). Furthermore, as auditors are also stakeholders, analysts or managers, they use the accounting reports to verify and to give more credibility to the firms' reports. In this research only public firms will be analyzed, and for these companies, a periodical auditing process is mandatory. (NELSON, ELLIOTT and TARPLEY, 2002; LEV, 2003). To observe how this process of the adoption of IFRS works in Brazil and Europe, a questionnaire survey will be used to investigate three groups of Brazilian and European stakeholders. After that, the questionnaires answers will be compared. It is expected that the results will bring a better comprehension of the economic implications of accounting disclosure practices in emerging and developed markets, and they may also help Brazilian companies solve the main problems raised by the adoption of IFRS in Brazil.

A final and important observation about prior research in this field is that there has not been a combined study of controllers/finance directors, financial analysts and auditors, despite the fact that the behavior of these groups will inevitably influence each other. The evidence in this research, therefore, will offer a unique opportunity to develop a grounded theory based on primary market information and on the evidence that comes from the interactions among each of the major constituent market groups.

This research will also contribute to the literature in several ways. First, it will explore the field study method in accounting, which, to this date, remains a relatively rare approach in this discipline. Second, it will focus on an emerging market context, which is even rarer in this field. Finally, by employing exactly the same questionnaire in two different markets, this study will highlight the similarities and differences between emerging and developed markets.

RESEARCH DESIGN

Ethical Procedures

The research itself will rely on the voluntary support of thirty two financial professionals, consisting of both academics and practitioners. Ten participants evaluated the Portuguese version of the questionnaire, ten judged the French version and ten the English version. Participants were assured that all information provided will remain confidential, and that it will only be used for scientific purposes. Moreover, any release of information will be anonymous, and in conjunction with other participants' answers. Finally, participants were assured that they will be exempted from any responsibility for the opinions expressed in any publication based on this research.

Methodological Procedures

This is a not conventional finance and accounting study. This is exploratory research, and only primary data will be used.

The CFO target population will be all the public corporations from the São Paulo Stock Exchange (Bovespa) directory, and all the public corporations from Euronext. This population consists of almost 8,000 enterprises. All financial analysts being questioned are registered in APIMECs in Brazil and in Europe and the auditors are members of four[2] big auditing enterprises in Brazil and in Europe.

First, all firms[3] will receive an email directed to its Chief Financial Officer (CFO), or to the equivalent financial analyst or auditor, explaining the purposes of the survey, and with the link to the research website. Next, the participant will be contacted by telephone as a follow-up[4]. Based on the work of Klassen and Jacobs (2001), several ways to answer the questionnaire will be offered to the participants: by post, by fax, by email, and by a website built specifically to that end. The usual confidentiality assurances will be given through a document to all participants.

The CEOs will be invited to participate in two successive waves. The first one will start on March 1st, 2010 and the second one will start on April 1st 2010. The CEO data collection will end on May 15th 2010. The auditors and financial analysts will be also invited to participate in two successive waves. The first one will start on May 1st, 2010, and the second one will start on June 1st, 2010. The data collection from auditors and financial analysts will finish on July 15th, 2010.

The website will change the order of the questions for each new respondent as a way to prevent the questions in the beginning of the questionnaire to be the ones that are more likely to be answered. The answers will be controlled by a user and password[5] mechanism. Non-response bias will also be tested, and the difference between main responses of the firms in the first wave and those in the second wave will be observed and analyzed.

The Instruments

The questionnaire has five sections. The first section has seven questions about the role of accounting information, to introduce the subject of accounting information and/or voluntary or mandatory financial reports to the respondents. The second section has four questions about performance measures, and the third section has six questions about earnings quality and earnings management. In both sections, the questions are based only on mandatory reports. The final theoretical section illustrates contributions that the IFRS can potentially make to accounting practices. The questionnaire ends by asking for information about the respondent or firm.

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[2] Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers

[3] All public firms, the big firms of auditing and all associations of financial analysts will be included in this part.

[4] The biggest firms in Brazil and 500 in Europe, in terms of revenues, the big four auditing enterprises in each country and the president of each financial analyst associations in each country will be contacted in this part.

[5] user: IFRS password: IFRS.