

The Role of Accounting Disclosure in the East Asian Financial Crisis: An Evaluation of the Lessons Learned

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CAPA Preface to Research Report

Weaknesses in corporate governance systems have been used to explain the breadth and depth of the Asian economic crisis (Johnson et al, 2000). The economic and legal environments are important determinants of the extent of confidence of domestic and foreign investors in a particular country and/or region. La Porta, Lopez-de-Silanes, Shleifer, and Vishny (2000) illustrate that, across countries, corporate governance is an important factor in financial market development and firm value. Country-specific measures of corporate governance rather than standard macroeconomic variables provide a better explanation of the extent of currency depreciation and stock market decline of emerging markets during the East Asian financial crisis (Johnson et al, 2000).

If corporate governance is a significant factor in explaining the crisis, differences in corporate governance should explain not only country-specific diversity in reaction but also firm specific reactions within countries. Firms that had indicators of higher disclosure quality were found to have experienced significantly better stock price performance during the East Asian crisis (Mitton, 2002). Higher disclosure quality can emerge formally, through mandated disclosure requirements of the listing exchange, for example via a listed American depository receipt, or informally, through a larger pool of investors generating increased demand for disclosure and increased scrutiny of the firm's reports. Thus while the economic and legal environments are important determinants of the extent of confidence of domestic and foreign investors in a particular country and/or region corporate governance could also explain cross-firm differences in performance within countries.

Rahman (1998) examined the 1997 reports of selected corporations and banks in five East Asian countries affected by the crisis and found that most of these entities did not follow International Accounting Standards (IAS)¹. He concluded that the provision of reliable microeconomic financial information would be enhanced by "concerted national and international efforts ... to develop and implement international accounting and reporting standards". This study examines an important component of the governance structure, viz. IAS¹ and in particular compliance with IAS¹ by the largest corporations in the East Asian region in 2001. It therefore provides an indication of the level of harmonisation of accounting relative to that observed in Rahman (1998).

While the level of overall compliance reported in this study exceeds that reported in Rahman (1998) the level of compliance varies markedly between countries within the sample. However, care should be adopted in drawing direct comparisons given the disparate sample sizes. Differences between domestic standards and IAS¹ as outlined in *GAAP 2001– A Survey of National Accounting Rules*, Pricewaterhouse Coopers 2001, are reflected in the *de facto* harmonisation identified in the study.

The study identified a number of cases where the requirements of IAS¹ had been adopted prior to recognition in the domestic standard. This may be interpreted as consistent with preparers of accounting information increasing the level of voluntary disclosures in line with IAS¹ where domestic regulation does not meet market expectations. Such a reaction is consistent with the finding that firms that had indicators of higher disclosure quality experienced significantly better stock price performance during the East Asian crisis (Mitton, 2002).

¹ IAS issued by the International Accounting Standards Board are now called International Financial Reporting Standards (IFRS)

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FORWARD BY CAPA PRESIDENT

The descriptor “Asian economic crisis” covers the period 1997-98 when many Asian countries suffered severe setbacks in their economies and where development stagnated or retreated. The governments of the affected countries adopted and implemented varying responses to cope with the crisis and its causes. However, there was one relatively common theme for the latter – that the accountancy profession, including its standards, policies and levels of information disclosure, had played a role in the genesis of the crisis, and perhaps had even worsened it. This situation of cause and effect was highlighted in the 1998 Rahman Study¹.

In recognition of this theme, CAPA commissioned this research project. CAPA believed it was important to examine the extent to which the accounting factors identified and examined by Rahman (1998) have been addressed to improve their level of disclosure thus providing a means to mitigate future financial crises by the provision of reliable financial information. In other words, we wanted to identify what actions the relevant governments had taken to comply with International Accounting Standards (IAS)².

The results of this study provide important lessons for CAPA member bodies and in turn their members. For instance, it revealed various factors such as better disclosure levels result in better stock performance; that the observance and compliance with IAS² are still variable; there are still variations with the interpretation and enforcement of accounting standards; there are varying standards of corporate governance being practised; greater transparency should assist in the efficient functioning of capital markets; and, the regulatory status of accounting standards and the roles and responsibilities of the profession vis a vis corporate and security regulators affects compliance with them.

Overall, this is an important study which highlights the critical role of the profession of accountancy. This role has been recognised by both IFAC and IASB in the many initiatives that they, supported by CAPA as a regional organisation, have taken to improve standards and compliance with them. I urge CAPA member bodies to examine this report and to identify areas where they may need to initiate further action to redress any weaknesses in the relevant areas of accounting standards as well as corporate governance. This is an ongoing challenge for all accountancy organisations, in both developing and developed countries.

This study was proposed by the member bodies from Australia – namely “CPA Australia” and “The Institute of Chartered Accountants in Australia” – who also acted as its project manager. I record my appreciation and thank the Australian representatives for their foresight and the production of this important report.”

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President
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¹ Rahman M Z. The role of accounting disclosure in the East Asian Financial Crisis: lessons learned Transnational Corporations – 1998

² IAS issued by the International Accounting Standards Board are now called International Financial Reporting Standards (IFRS)

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