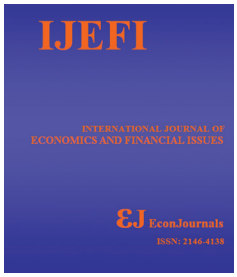

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Accounting Information Quality in Emerging Markets: Conservatism in Financial Reporting of Vietnamese Firms in the Context of International Economic Integration

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ABSTRACT

We test conservatism in financial reporting of Vietnamese listed firms over the period of 2005-2014. We find that Vietnamese financial statements ensure conservatism's specifications consisting of asymmetric gain and loss recognition timeliness and asymmetric persistence of earnings changes. We further find that the degree of conservatism has increased significantly over the post-crisis economic restructuring period. The findings provide empirical evidence to the improved quality of accounting information in Vietnam.

Keywords: Accounting, Accounting Information, Financial Reporting
JEL Classifications: M40, M48

1. INTRODUCTION

Givoly and Hayn (2000) claim that conservatism is an important convention of financial reporting. It implies a caution in the recognition and measurement of earnings and assets of a firm. Conservatism is considered as an indicator for measuring the quality of accounting information. In emerging markets, domestic accounting standards are quite different from international accounting standards. This leads to foreigner investors' doubt about the quality of accounting information, which is harmful to international capital mobilization. Accordingly, developing countries are in need of improving the quality of accounting information, and Vietnam is no exception in the context of the deep international economic integration. To achieve this, Vietnamese accounting standards (VASs) have to be adjusted to suit international accounting standards. One of the adjusted accounting standards is conservatism principle.

When Vietnamese economy integrates deeply into the global market, the business market for Vietnamese firms is an intercontinental market. Consequently, the barriers to the integration are necessary to be mitigated gradually, and the accounting information hurdle is too. Vietnam has done much preparation for the international economic integration. The Minister of Finance promulgated Decision 15/2006/QĐ-BTC dated March 20, 2006 on issuing Vietnamese enterprise accounting system based on international accounting standards[1]. Vietnam has been a member of Asian-Oceanian Standard-Setters Group (AOSSG) since 2011[2]. The purpose of the participation is to get the consultation from AOSSG in the process of setting up and adjusting Vietnam accounting standards to suit international accounting standards. As a result, circulation 200/2014/TT-BTC dated December 22, 2014[3] on guidelines for accounting policies

1 However, the difference between Vietnamese accounting standards and international accounting standards has been still rather large. In 2010, Virginia Foote, President of the US-Vietnam Trade Council, complained that Vietnamese accounting regime is too peculiar to understand and therefore unreliable.

2 The report on AOSSG's activities in 2011.

3 The circulation replaces decision No. 15/2006/QD-BTC dated March 20, 2006.

for enterprises was issued to lay the basis for the roadmap for the convergence of VASs with international accounting standards from 2016. With the increased reform of Vietnamese accounting system, to the extent that we expect conservatism to be ensured gradually in Vietnamese financial statements.

On the other hand, Ball et al. (2003) find that although accounting standards of emerging markets such as Malaysia, Singapore and Thai Lan are mostly based on international accounting standards, conservatism is not warranted. They attribute the cause of the phenomenon to influence of family control, "insider" networks and government codification and income taxation on financial reporting practices. Because Vietnam also has the same features, conservatism is unlikely to be exercised in Vietnamese financial statements.

For the above-mentioned reasons, we question whether conservatism is ensured in Vietnamese financial statements. Following Basu (1997), we test conservatism's specifications including asymmetric news recognition timeliness and asymmetric persistence of earnings changes. The results are consistent with Basu (1997). We contend that conservatism is warranted in financial reporting practices. Next, we examine the change in conservatism over time. We find that Vietnamese firms have complied with conservatism since the 2007-2008 financial crisis. This paper gives empirical evidence on the improved quality of accounting information in Vietnam.

The remainder of the paper proceeds as follows. Section 2 discusses the nature of conservatism and introduces its measurement. Section 3 explains research design. Section 4 describes sample selection procedures and empirical results and conclusions are reached in Section 5.

2. MEASUREMENT OF CONSERVATISM

Financial Accounting Standards Board (FASB, 1980) states conservatism as a prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered. Vietnam Accounting Standards (MOF, 2002) defines conservatism as necessary consideration, caution and assessment are exercised to do accounting estimations under uncertain conditions. However, these definitions are improbable to offer a test method in empirical research. Basu (1997) gives an unambiguous description of conservatism as denoting the accountants' tendency to require a higher degree of verification to recognize good news as gains than to recognize bad news as losses. Following Basu (1997), Watts (2003) calls conservatism as the asymmetrical verification requirements for gains and losses. The interpretation is consistent with that of Vietnam Accounting Standards. It dictates that revenue and income are only recognized as there is enough solid evidence on the obtained economic benefits, whereas all probable expenditures are captured when they are incurred. For instance, setting aside provisions in financial reporting is one of the typical examples of conservatism.

In the spite of the fact that the definitions of conservatism and its reasons have been still on debate, Basu's definition (1997) and Watt's explanations (2003) lay the foundations for the development of conservatism research (Ball et al., 2003; Pae, 2007; Francis et al., 2013). In order to test conservatism, Basu (1997) suggests the two properties of conservatism. They are asymmetric news recognition timeliness and asymmetric persistence of earnings changes. Asymmetric news recognition timeliness is attributable to accountants' tendency to recognize bad news timelier than good news into earnings. For instance, unrealized losses will be recognized more instantly than unrealized gains. Furthermore, because economic information is reflected in stock prices (Ball and Brown, 1968; Beaver et al., 1980; Kothari and Sloan, 1992), Basu (1997) uses firm-level stock return to measure economic news. Negative returns and positive returns are proxies for bad news and good news, respectively.

Basu (1997) finds that asymmetric news recognition timeliness results into asymmetric persistence of earnings changes. In particular, nearly all bad news is captured immediately, whereas good news recognition is conducted partly or postponed to future periods. The deferment of good news recognition leads to the higher persistence of earnings in good news periods than that in bad news periods. In turn, the asymmetric persistence of earnings changes results in the greater tendency of the reversal of bad news earnings changes than that of good news earnings changes. In other words, firms with poor performance in prior year are inclined to reverse than firms with good performance in prior year on asymmetrically timely loss recognition basis.

Following Basu's specifications of conservatism (1997), we investigate conservatism in Vietnamese financial statements.

3. RESEARCH DESIGN

3.1. Measurement of Asymmetric News Recognition Timeliness

The timeliness of earnings in response to stock returns (economic news) is expressed by the pooled cross-sectional regression of beginning-of-fiscal-year price deflated accounting earnings (E_{it}/P_{t-1}) on concurrent stock returns (R_{it}):

$$\frac{E_{it}}{P_{it-1}} = \alpha_0 + \beta_0 R_{it} + \varepsilon_{it} \quad (1)$$

In regression (1), the slope coefficient on stock returns (β_0), measuring the sensitivity of earnings to stock returns, is expected to be positive. This implies that economic news navigates the timeliness of earnings. In addition, we regress separately earnings on negative stock returns ("bad news") and on positive stock returns "good news." Earnings are predicted to be timelier in recognizing "bad news" than "good news;" therefore, R^2 (Adjusted R^2) of regression (1) for "bad news" ($R_{it}<0$) sample is expected to be higher than that for "good news" ($R_{it}\geq 0$) sample.

The asymmetric timeliness of earnings in respect of stock returns is alternatively inferred from the pooled cross-sectional regression of beginning-of-fiscal-year price deflated accounting earnings on concurrent stock return with dummy variable (D_{it}),

which equals one for negative stock returns ("bad news"), zero otherwise:

$$\frac{E_{it}}{P_{it-1}} = \alpha_0 + \alpha_1 D_{it} + \beta_0 R_{it} + \beta_1 R_{it} D_{it} + \varepsilon_{it} \quad (2)$$

In regression (2), the slope coefficients on stock returns, β_0 and $(\beta_0+\beta_1)$, serve as the measures of the sensitivity of earnings to positive stock returns and negative stock returns, respectively. The interactive slope coefficient (β_1) measures the difference in the sensitivity of earnings to negative stock returns and positive stock returns. They are expected to be positive. This indicates that the timeliness of earnings is asymmetrically greater for "bad news" than for "good news". The relative sensitivity of earnings with "bad news" compared to "good news" is measured by the ratio of the slope coefficient on negative stock returns to that on positive stock returns $[(\beta_0+\beta_1)/\beta_0]$.

3.2. Measurement of Asymmetric Persistence of Earnings Changes

The persistence of earnings changes is tested by the pooled cross-sectional regression of beginning-of-fiscal-year price deflated earnings change ($\Delta E_{it}/P_{it-1}$) on prior earnings change ($\Delta E_{it-1}/P_{it-2}$):

$$\frac{\Delta E_{it}}{P_{it-1}} = \alpha_0 + \beta_0 \frac{\Delta E_{it-1}}{P_{it-2}} + \varepsilon_{it} \quad (3)$$

In regression (3), the slope coefficient on preceding earnings change (β_0) is predicted to be negative, which indicates the reversal of earnings changes. In particular, an increase (decrease) in previous earnings results in a decrease (increase) in current earnings. This implies the persistence of earnings changes. For the purpose of testing asymmetrically persistent earnings changes, we run regression (3) separately with negative prior earnings change ("bad news" period) and positive prior earnings change ("good news" period) in succession. R^2 of the regression for "bad news" period sample ($\Delta E_{it-1}/P_{it-2}<0$) is predicted to be higher than that of the repression for "good news" period ($\Delta E_{it-1}/P_{it-2}\geq 0$).

Alternatively, the asymmetric persistence of earnings changes is tested by the pooled cross-sectional recognition of beginning-of-fiscal-year price deflated earnings change on prior earnings change with dummy variable (D_{it}), which equals one for negative prior earning change ("bad news"), zero otherwise:

$$\frac{\Delta E_{it}}{P_{it-1}} = \alpha_0 + \alpha_1 D_{it} + \beta_0 \frac{\Delta E_{it-1}}{P_{it-2}} + \beta_1 \frac{\Delta E_{it-1}}{P_{it-2}} D_{it} + \varepsilon_{it} \quad (4)$$

In regression (4), the slope coefficients on prior earnings change, β_0 and $(\beta_0+\beta_1)$, measure the reversal of "good news" earnings changes and "bad news" earnings changes, respectively. The earnings changes reverse completely in the following period if the slope coefficients equal minus one. The interactive slope coefficient (β_1) measures the difference in the reversal of "bad news" earnings changes and "good news" earnings changes. These coefficients are predicted to be negative, which shows that the reversal of "bad news" period is asymmetrically greater than that of "good news" period. Differently phrased, earnings changes would be less persistent for bad news than good news.

4. DATA AND EMPIRICAL RESULTS

4.1. Data

The sample is obtained from non-financial firms listed on Hochiminh stock exchange and Hanoi stock exchange over the period from 2005 to 2014. Earnings and stock returns, measured per share, are deflated by beginning-of-fiscal-year stock price to control heteroskedasticity (Christie, 1987). In addition, we use White-Huber standard errors to compute t-statistic, called heteroskedasitcity-robust t-statistic (White, 1980). Holding-period stock returns are computed to end three months after the fiscal year-end to exclude the market reaction to the prior year's earnings. Market-adjusted variables are used as alternatives for the regressions to control non-stationarity. We rule out observations falling in the top or bottom 1% of beginning-of-fiscal-year deflated earnings and stock returns to avoid potential influences of outliers on regression results. The change in observations corresponding requirements of each test is described in each table.

4.2. Asymmetric News Recognition Timeliness

Table 1 reports regression results of earnings on stock returns. In Panel A, the results of regression (1) in row (1) shows that R^2 (19.87%) is fairly higher than that of the studies of Lev (1989) and Basu (1997). Consistent with Basu (1997), the estimated slope coefficient of 0.108 on stock returns is significantly positive at the 1% level, which implies that economic news affects accounting earnings. Row (2) and row (3) display the results of separate regressions (1) on positive return sample and negative return sample. R-squared of the negative return sample of 12.17% is higher than that of the positive return sample (4.98%). It indicates that earnings are more sensitive to bad news than good news. Row (4) reports the results of regression (2). The slope coefficients on R and (R x D) are 0.064 and 0.172 respectively, which are significant at 1% level. The sensitivity of earnings to "bad news" is 3.68 ([0,172+0,064]/0,064) times as much as that to good news. The result confirms "bad news" recognition into earnings on a timelier basis.

For time-series stationarity control, regression (1) and (2) are run with market-adjusted variables. The results shown in Panel B are completely consistent with those displayed in Panel A. These results strongly justify asymmetric news recognition timeliness specification of conservatism[4].

4.3. Asymmetric Persistence of Earnings Changes

Table 2 replicates Basu's regression of beginning-of-fiscal deflated earning changes on prior beginning-of-fiscal deflated earnings changes. In Panel A, the results of regression (3) in row (1) are consistent with Basu (1997). The tendency of earnings change reversal in the next period is tested with the slope coefficient of −0.211, which is significantly negative at

4 We test asymmetric news recognition timeliness for Hanoi stock exchange and Hochiminh stock exchange separately and achieve the same results.

Table 1: Asymmetric news recognition timeliness

Regression (1): $E_{it}/P_{it-1} = \alpha_0 + \beta_0 R_{it}$
(+)
Regression (2): $E_{it}/P_{it-1} = \alpha_0 + \alpha_1 D_{it} + \beta_0 R_{it} + \beta_1 R_{it} D_{it}$
(+) (+)

	Sample	α_0	α_1	β_0	β_1	Adjusted R^2 (%)
Panel A: Regression of earnings on returns[a]						
(1)		0.099		0.108		19.87
		(36.67)***		(20.94)***		
(2)	$R_{it} \geq 0$	0.131		0.064		4.98
	921 obs	(19.96)***		(7.77)***		
(3)	$R_{it} < 0$	0.136		0.236		12.17
	1,187 obs	(18.95)***		(11.76)***		
(4)		0.131	0.006	0.064	0.172	22.42
		(19.96)***	(0.52)	(7.77)***	(7.91)***	
Panel B: Regression of market-based earnings on market-based returns[b]						
(1)		0.0006		0.128		15.97
		(0.23)		(16.66)***		
(2)	$R_{it} \geq 0$	0.027		0.077		4.88
	1,120 obs	(5.11)***		(6.96)***		
(3)	$R_{it} < 0$	0.021		0.25		10.32
	989 obs	(3.91)***		(9.74)***		
(4)		0.027	−0.006	0.077	0.173	18.19
		(5.11)***	(−0.77)	(6.96)***	(6.18)***	

E_{it} is earnings per share for firm i at year t, P_{it-1} is stock price per share of the beginning day of fiscal year t. [a]R_{it} is stock return for firm i over the period from 9 months before fiscal year-end t to three months after fiscal year-end t, D_{it} is a dummy variable, equal to 1 if $R_{it}<0$, =0 otherwise. The full sample consists of 2,108 observations from 2005 to 2014. [b]E_{it}/P_{it-1} is the EP ratio less the average E_t/P_{t-1} in year t, R_{it} is adjusted by market return in the same fashion. The dummy variable is redefined to match the adjustment of R_{it}. The tests are conducted on 2,109 observations from 2005 to 2014. ***Significant at 1% level. Heteroskedascity-robust t-statistic is indicated in parentheses below estimated coefficients

Table 2: Alternative specification of conservatism: Asymmetric persistence of earnings changes

Regression (3): $\Delta E_{it}/P_{it-1} = \alpha_0 + \beta_0 \Delta E_{it-1}/P_{it-2}$
(−)
Regression (4): $\Delta E_{it}/P_{it-1} = \alpha_0 + \alpha_1 D_{it} + \beta_0 \Delta E_{it-1}/P_{it-2} + \beta_1 D_{it} \Delta E_{it-1}/P_{it-2}$
(−) (−)

	Sample	α_0	α_1	β_0	β_1	Adjusted R^2 (%)
Panel A: Regression of beginning-of-fiscal-year deflated earnings changes on prior earning beginning-of-fiscal-year deflated earnings changes[a]						
(1)		−0.006		−0.211		3.06
		(−1.1)		(−3.88)***		
(2)	$\Delta E_{it-1}/P_{it-2} \geq 0$	−0.01		(−0.045)		0.012
	955 obs	(−1.27)		(−0.98)		
(3)	$\Delta E_{it-1}/P_{it-2} < 0$	−0.046		−0.507		8.68
	1,198 obs	(−4.81)***		(−4.94)***		
(4)		−0.01	−0.037	−0.045	−0.463	6.2
		(−1.27)	(−3)***	(−0.98)	(−4.11)***	

Alternate Regression (3): $\Delta E_{it}/P_{it-1} = \alpha_0 + \beta_0 E_{it-1}/P_{it-2}$
(−)
Alternate Regression (4): $\Delta E_{it}/P_{it-1} = \alpha_0 + \alpha_1 D + \beta_0 E_{it-1}/P_{it-2} + \beta_1 D E_{it-1}/P_{it-2}$
(−) (−)

Panel B: Regression of beginning-of-fiscal-year deflated earnings on prior earning beginning-of-fiscal-year deflated earnings[b]						
(1)		0.05		−0.498		12.69
		(7.70)***		(−17.86)***		
(2)	$E_{it-1}/P_{it-2} \geq 0$	−0.011		−0.108		0.48
	2,028 obs	(−1.62)		(−3.71)***		
(3)	$E_{it-1}/P_{it-2} < 0$	0.056		−0.743		16.34
	161 obs	(0.95)		(−5.21)***		
(4)		−0.011	0.067	−0.108	−0.636	17.07
		(−1.62)	(1.14)	(−3.71)***	(−4.39)***	

E_{it} is earnings per share for firm i at fiscal year t, ΔE_{ij} is earnings change from year j-1 to year j. P_{it-j} is the closing price at the end of fiscal year t-j. [a]D_{it}=1 if $\Delta E_{it-1}/P_{it-2}<0$ and=0 otherwise. There are 2,153 observations over the period from 2005 to 2014. [b]D_{it}=1 if $E_{it-1}/P_{it-2}<0$ and=0 otherwise. There are 2,189 over the period from 2005 to 2014. ***Significant at 1% level. Heteroskedasticity-robust t-statistic is indicated in parentheses below the estimated coefficients

the 1% level. Row (2) and row (3) show the results of regression (3) conducted separately on the two samples. The adjusted R^2 of negative previous earnings change sample (8.68%) is much higher than that of positive previous earnings sample (0.012%), which is consistent with the greater tendency for "bad news" earnings change reversal than "good news" earnings change reversal. Row (4) reports the results of regression (4). The slope coefficient on positive preceding earnings changes of −0.045 is insignificantly negative. It is consistent with lasting "good news" recognition in earnings. The slope coefficient on negative earnings changes of −0.508 [(−0.045)+(−0.463)] is significantly different from zero and minus one at the 1% level[5]. The estimated slope coefficient for the difference in the reversal of negative preceding earnings changes and that of positive preceding earnings changes is −0.463, which is significant at the 1% level. These results are consistent with earning changes being less persistent for earnings decreases ("bad news") than earnings increases ("good news").

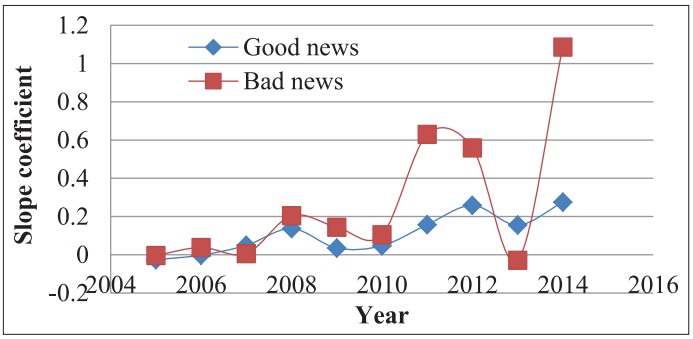
To provide more confidence about asymmetric persistence of earnings changes, we conduct regression (3) and (4) of beginning-of-fiscal-year deflated earnings changes on beginning-of-fiscal-year deflated earnings. The results shown in Panel B are primarily consistent with those shown in Panel A. These results support asymmetric persistence of earnings changes specification, an alternate measure of conservatism[6].

In sum, the tests give empirical evidence on conservatism in Vietnamese financial statements. We examine next conservatism over time in the context of the increased international economic integration.

4.4. Conservatism Over Time

We conduct regression (2) in Panel B of Table 1 for each year to obtain the slope coefficients on "good" and "bad" news, β_0 and $(\beta_0+\beta_1)$ respectively. These annual coefficients are plotted in Figure 1 over the period from 2005 to 2014. There is no difference in the slope coefficients in the years prior to the 2007-2008 financial crash. It suggests that conservatism is not exercised in the beginning period of the deep international economic integration[7]. Except for 2010 and 2013, the gap between the two coefficients has been widening since 2008. The tendency indicates that the sensitivity of earnings to bad news has been increasingly higher than that to good news. In other words, conservatism has improved since the crisis. In 2010,

Figure 1: Slope coefficients of market-adjusted earnings on positive and negative market-adjusted returns from 2005 to 2014



Vietnamese firms found it difficult to obtain external funding via credit institutions because of the Circular 13/2010/TT-NHNN stipulating prudential ratios in operations of credit institutions. Instead, they funded their growth through equity financing. This leads to a boom in the issuance of additional shares[8]. In 2013, Vietnamese stock market strongly recovered; therefore, Vietnamese firms seized this opportunity to mobilize capital through the stock market[9]. To the extent that Vietnamese firms were likely to decorate financial statements to attract investors and hence not conform to conservatism principle in financial reporting.

Evidently, the accounting information of Vietnamese financial statements has improved since 2008. Following Ball and his fellow researchers' stance (2003), we suggest that the adoption of international accounting standards into domestic accounting standards and the post-crisis economic restructuring policies influence financial statements preparers' incentives effectively. This drives them to abide by conservatism in financial reporting practices and enrich the quality of accounting information.

5. CONCLUSION

This paper tests conservatism in financial statements of Vietnamese listed firms over the period from 2005 to 2014. The results are consistent with Basu (1997). Accordingly, conservatism's specifications including asymmetric news recognition timeliness and asymmetric persistence of earnings changes are statistically significant; therefore, we have empirical evidence to suggest that Vietnamese firms exercise conservatism in financial reporting. In addition, we also realize that conservatism has been warranted increasingly since the financial crunch. The results implies that the adoption of international accounting standards into VASs and the post-crisis economic restructuring policies have made a positive impact on improving the quality of accounting information in the context of international economic integration.

5 H_0:$\beta_0+\beta_1=0$ is rejected in favor of H_1:$\beta_0+\beta_1\neq0$, F statistic equals 24.35; H_0: $\beta_0+\beta_1=-1$ is rejected in favor of H_1: $\beta_0+\beta_1\neq-1$, F statistic equals 22.95.

6 We test asymmetric persistence of earnings changes for Hanoi stock exchange and Hochiminh stock exchange separately and achieve the same results.

7 The book titled "Globalization and Development Volume II: Country Experiences" (edited by Shigeru Thomas Otsubo) reads "Trade liberation was largely conducted on a unilateral basis in the 1990s, but it was accelerated in the 2000s under regional trading agreements and during Vietnam's accession to the WTO. In 2007, the acquisition of WTO membership after more than 10 years of preparation and negotiation marked a turning point in Vietnam's international economic integration" (2016, p. 153).

8 The State Securities Commission this year has approved the largest ever number of share offerings by listed firms. The amount of mobilized capital in 2010 was three times as much as that in 2009.

9 In 2013, market capitalization to gross domestic product ratio was about 31%. The amount of raised capital through private placement in 2013 was five times as large as that in 2012.

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