Financial Reporting Quality: A Literature Review

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Abstract

The purpose *of this paper is to review current articles and research papers with regard to influences on and measures of the quality of financial reporting. The paper also examines some findings and some gaps in the existing literature.*

The Design/Methodology/Approach*: This paper reviews existing literature from some accounting journals, official accounting associations, and published papers from the period 2009 to 2015.*

Research Findings

This research recognized some instances of insufficient information and some gaps in the existing literature. For example, the size of some study samples is not big enough to draw reasonable conclusions.

Research limitations/Implications: *It identifies some gaps in the current literature and calls for additional research. Further, the paper offers some object lessons, and exposes the reader to different aspects of financial reporting quality.*

Keywords: Literature, Measure, Quality, Financial Reporting, Influences

Paper type: Literature review

Introduction

Some researchers have conducted general reviews on various facts surrounding the quality of financial reporting. Accounting standards convergence, accounting standards harmonization, economic crises, growth in disclosure requirements, and other factors have created an excessive focus on financial reporting. Also, the worldwide increase in accounting scandals in the early 21st century has pointed to weaknesses in financial reporting quality. The quality of financial reporting determines, and depends upon, the value of accounting reporting. Across the world, the demand has gone out for providing a clear and full definition of financial reporting quality. It is essential to provide high-quality financial reporting to influence users in making investments decisions, and to enhance market efficiency. Providing ideal methods for assessing the quality of financial reporting is another global demand. The higher the quality of financial reporting, the more significant are the benefits to be gained by investors and users of the financial reports. Moreover, financial reporting quality is a broad concept that does not just refer to financial information; it also includes other non-financial information that is useful for making decisions. This paper is a review of literature that focuses on what could influence the quality of financial reporting and how this quality could be assessed and measured.

According to the Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB), the Accounting Standard Board in the United Kingdom (ASB) [UK], and the Australia Accounting Standard Board (AASB), financial reporting quality represents financial statements that provide accurate and fair information about the underlying financial position and economic performance of an entity.

The review method

The review is supported mainly by accessing some leading accounting journals, and some research papers done by professors and students at universities around the world. Both sources are from the period 2009 to 2015. The search was carried out using the term "Quality of Financial Reporting", and is based on articles that are published in online databases. The search resulted in 24 research papers for review. Table I presents the articles and research papers this review used, and Table II shows journals that published the selected papers used in this review.

Table I:

	Study	Topic	Research Site
1	Ferdy Van Beest Geert Braam Suzanne Boelens. April 2009	Quality Of Financial Reporting: Measuring Qualitative Characteristics.	Using 231 Annual Reports From Companies Listed At US, UK, And Dutch Stock Markets In 2005 And 2007. Literature Overview
2	Qingliang Tang A, Huifa Chen B, And Zhijun Lin . May 18, 2012	How To Measure Country Level Financial Reporting Quality?	38 Main Capital Markets In The World From 2000 To 2007
3	Ole-Kristian Hope, Wayne B. Thomas, And Dushyantkumar Vyas. June 2, 2011	Financial Reporting Quality: In U.S. Private Firms	Prior Literature And Hypotheses Database
4	Esther Cheung, Elaine Evans And Sue Wright , 2010	An Historical Review Of Quality In Financial Reporting In Australia	Reviews The Relevant Academic And Professional Literature During The Period Australia Between 1961 And 2004
5	Kosal Ly, Waseda University, 2010	The Quality Level Of Corporate Annual Report And Cost Of Capital: Evidence From Japanese Firms	Nikkei Annual Report Award & Japanese Firms
6	Nicholas Apergis1*, George Artikis2, Sofia Eleftheriou2, John Sorros. 2011	Accounting Information And Cost Of Capital: A Theoretical Approach	Developed A Simple Equilibrium Model
7	Bartley R. Danielsen, David M. Harrison, Robert A. Van Ness, And Richard S. Warr 2010	Liquidity, Accounting Transparency, And The Cost Of Capital: Evidence From Real Estate Investment Trusts	Real Estate Investment Trust (REIT) Industry
8	Yadollah Tariverdi, Mehdi Moradzadehfard, And Maryam Rostami, 2012	The Effect Of Earnings Management On The Quality Of Financial Reporting	Through The Panel Data Gathered From 70 Listed Companies In Tehran Stock Exchange.
9	Mohammad Bakhshi Jozam, Hossein Shafii .European Online Journal Of Natural And Social Sciences 2015;	The Role Of Financial Reporting Quality On The Relation Between Reducing The Limitations Of Dividend And Investment Decisions	The Statistical Sample In This Research Includes 153 Companies In Tehran Stock Exchange
10	Wikil Kwak, Yong Shi, And Gang Kou, April 2012	Predicting Bankruptcy After The Sarbanes- Oxley Act Using The Most Current Data Mining Approaches	Sample Is Composed Of 306 Firm-Year Observations That Have Available Financial And Other Data In Form 10-K Filings Using Directedgar And Compustat.

11	KEVIN T. RICH June 2009	Audit Committee Accounting Expertise And Changes In Financial Reporting Quality	S&P 1,500 Firms Listed In The Risk Metrics Database (Formerly The Investor Responsibility Research Center)
12	Zhiwei Lin, Yihong Jiang, Qingliang Tang And Xiangjian He 2015	Does High-Quality Financial Reporting Mitigate The Negative Impact Of Global Financial Crises On Firm Performance? Evidence From The United Kingdom	Equity Market During The 2008–2009 Global Financial Crisis In The United Kingdom.
13	Hua-Wei Huang, Ena Rose-Green, And Chih-Chen Lee. 2012	CEO Age And Financial Reporting Quality	Using A Sample Of 3,413 Firms For The Period 2005 To 2008, We Find A Positive Association Between CEO Age And Financial Reporting Quality.
14	Youngtae Yoo, Joohyun Lim, And Jinho Chang, November/December 2013	Financial Reporting Quality And Acquisition Profitability: Evidence From Korea	Sample Of 282 Acquisitions In South Korea Between 2001 And 2011
15	Dan Segal, Benjamin Segal ,Jae Bum Kim, And Yoonseok Zang. 2013	The Triangular Relationship Between Audit Committee Characteristics, Audit Inputs, And Financial Reporting Quality	Using The Exogenous Reforms To Audit Committees Mandated By The Sarbanes-Oxley Act Of 2002
16	Rudy A. Jacob And Christian N. Madu 2009	International Financial Reporting Standards: An Indicator Of High Quality?	Examine The Academic Literature
17	Hafiza Aishah Hashim. October 19, 2012	The Influence Of Culture On Financial Reporting Quality In Malaysia	649 Financial And Non-Financial Companies Listed On The Main Board.
18	Tae Hee Choi Jinhan Pae 2011	Business Ethics And Financial Reporting Quality: Evidence From Korea	
19	Andra Gajevszky, Monica-Veronica Honu . 2014	The Quality Of Financial Reporting And Corporate Governance: Evidence From Romanian`S Aeronautic Industry	Six Companies Observed For A Period Of Five Years (From 2008 Until 2012)
20	Edward Lee, Martin Walker, And Colin Zeng. 2013	Does IFRS Convergence Affect Financial Reporting Quality In China?	Listed Firms In China
21	Nemit Shroff 2015	Real Effects Of Financial Reporting Quality And Credibility: Evidence From The PCAOB Regulatory Regime	A Sample Of 89,225 Firm-Year Observations From 2003 To 2014
22	Nesrine Klai,Abdelwahed Omri. January 2011	Corporate Governance And Financial Reporting Quality: The Case Of Tunisian Firms	Using A Panel Of 22 Non Financial Firms Listed On The Tunis Stock Exchange During The Period 1997-2007
23	Cao, Ying, Linda, Omer & Thomas, July 2011	Does Company Reputation Matter For Financial Reporting Quality? Evidence From Restatements	A Sample Of 8,081 Fortune 1000 Company-Year Observations From 1995 Through 2009 With Available Data.
24	Lvana, Sacer; Ana Oluic., (2013).	Information Technology and Accounting Information System's Quality in Croatian Middle and Large Companies.	The research was conducted from May to July 2012. Two hundred eighty-seven accountants responses from Medium and large enterprises

Table II:

Journal	*Number of papers*
The Business & Management Review	*1*
International Business Research	*1*
The Journal of Applied Business Research	*2*
Audit Financiar	*2*
Canadian Academic Accounting Association	*1*
ProQuest LLC	*1*
The Journal of Real Estate Research	*1*
Academy of Accounting and Financial Studies Journal	*1*
Modern Economy	*1*
African Journal of Business Management	*1*
Financial Reporting Global financial crisis (GFC)	*1*
The Accounting Review	*1*
Pacific Accounting Review	*2*
The Journal for the Advancement of Educational Research.	*1*
Official Journal of the European Communities	*1*
American Accounting Association	*1*
Canadian Center of Science and Education	*1*
Journal of Business Ethics	*1*
Journal of Business Continuity & Emergency Planning	*1*
The Association of Chartered Certified Accountants	*1*
Journal of information and Organizational Sciences	*1*
Total	*24*

Review of Influences on and Measures of Financial Reporting Quality:

This section reviews articles and research papers dealing with influences on and measures of financial reporting quality, with regard to their focus, issues, and findings. This review contains: Section 1: Elements of Quality; Section 2: Influences of the Quality of Financial Reporting; Section 3: Approaches to Measure and Assess Accounting Quality; and Section 4: Gaps in Existing Literature and Suggestions for Future Research.

1. Elements of Quality

According to IASB, the essential principle of assessing the financial reporting quality is related to the faithfulness of the objectives and quality of disclosed information in a company's financial reports. These qualitative characteristics enhance the facilitation of assessing the usefulness of financial reports, which will also lead to a high level of quality. To achieve this level, financial reports must be faithfully represented, comparable, verifiable, timely, and understandable. Thus, the emphasis is on having transparent financial reports, and not having misleading financial reports to users; not to mention the importance of preciseness and predictability as indicators of a high financial reporting quality (Gajevszky, 2015).

As it is defined in the *Conceptual Framework for Financial Reporting* of the FASB and the IASB, there are agreed upon elements of high quality financial reporting. The qualitative characteristics of financial reporting quality include: relevance, faithful representation, understandability, comparability, verifiability, and timeliness. They are divided into fundamental qualitative characteristics and enhancing qualitative characteristics. A theoretical explanation for each of these terms emphasizes their importance as qualitative characteristics, and also indicates what qualities are considered fundamental among different frameworks.

1.1 Relevance:

Relevance is closely associated with the terms *usefulness* and *materiality*. Relevance illustrates the capability of making decisions by users. When information in financial reports influences users in their economic decisions, it is sad that this information has the quality of relevance. Also, when this information assists users to evaluate, correct, and confirm current and past events, it is useful.

The usefulness of making a decision—an important part of relevance—is consistent with the conceptual framework (Cheung, Evans, & Wright, 2010). Fair value is considered one of the highly significant indicators of relevance. Using Fair Value in an entity, as a basis for measurement, is an indicator of a high level of relevance in financial reporting information (Beest, Braam, & Boelens, 2009). Annual reports have a crucial role in determining the level of relevance by disclosing forward-looking information, disclosing information about business opportunities and risks, and providing feedback on how major market events and significant transactions affected entities (Beest, Braam, & Boelens, 2009).

1.2 Reliability

Reliability is another critical factor of financial reporting quality. In financial reporting, information must have the quality of reliability in order to be useful. This quality is achieved when information, which users depend upon, is free from bias and material mistakes. Reliability is analyzed based on the qualities of faithful, verifiable, and neutral information (Cheung, Evans & Wright, 2010).

1.3 Comparability

Comparability is the concept of allowing users to compare financial statements to determine the financial position, cash flow, and performance of an entity. This comparison allows users to compare across time and among other companies in the same period. As Cheung, Evans & Wright (2010) remarked:
"Comparability demands that identical events in the two situations will be reflected by identical accounting facts and figures . . . different events will be reflected by different accounting facts and figures in a way which quantitatively reflects those differences in a comparable and easily interpretable manner". (Cheung et al.2010).

To indicate this point, the notes in financial reports should disclose and explain all the changes in accounting policies and the implications of these changes, not to mention the importance of consistency in applying accounting policies and principles. Also, the current accounting period results can be compared with the ones from previous periods. Lastly, presenting financial index numbers and ratios contributes to the comparison with other organizations (Beest et al.2009).

1.4 Understandability

Understandability is one of the essential qualities of information in financial reports. Achieving the quality of understandability is through effective communication. Thus, the better the understanding of the information from users, the higher the quality that will be achieved (Cheung, Evans, & Wright, 2010). It is one of the enhancing qualitative characteristics that will increase when information is presented and classified clearly and sufficiently. When annual reports are well organized, users can comprehend what their needs are (Beest, Braam, & Boelens, 2009). Usage of graphs and tables helps to present information clearly, and the usage of language and technical jargon can be followed easily.

1.5 Timeliness

Timeliness is another enhancing qualitative characteristic. Timeliness illustrates that information must be available to decision makers before losing its powerful and good influences. When assessing the quality of reporting in an annual report, timeliness is evaluated using the period between the year-end and the issuing date of the auditor's report—the period of days it took for the auditor to sign the report after the financial year-end (Beest, Braam, & Boelens, 2009).

1.6 Faithful Representation

Faithful representation is the concept of reflecting and representing the real economic position of the financial information that has been reported. This concept has the value of explaining how well the obligations and economic resources, including transactions and events, are fully represented in the financial reporting. Moreover, this quality has neutrality—as a sub notion—which is about objectivity and balance. According to Willekens (2008), "researchers concluded that 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." Additionally, how business organizations are controlled and directed affects the faithful presentation quality; this, in fact, is represented as a corporate governance factor when there is extensively disclosed information on corporate governance issues in the annual report (Beest, Braam, & Boelens, 2009). Besides, the annual report clarifies assumptions and estimates and explains the usage of the accounting principles in the company clearly.

It also highlights positive and negative changes and events by discussing them in the annual results. The last important factor that strengthens this quality is having an unqualified auditor's report in the annual report.

Reliability as a quality of financial reporting used to be considered as the primary factor of accounting information. In FASB's old framework, reliability was the primary quality, and it was comprised of representational faithfulness, neutrality, and verifiability. However, in the new framework, faithful representation becomes the primary and the fundamental quality, instead of reliability. Moreover, faithful representation is comprised of completeness, neutrality, and accuracy. FASB also believes that reliability is one of the critical qualities to accounting information (Downen, 2014).

To summarize, according to the *FASB Conceptual Framework*, FASB has defined the fundamental qualities as reliability and relevance. Figure 1—based on the previous FASB definition—presents a descriptive hierarchy defining those two primary qualities and how they are related to decision makers (Sacer, Oluic, 2013).

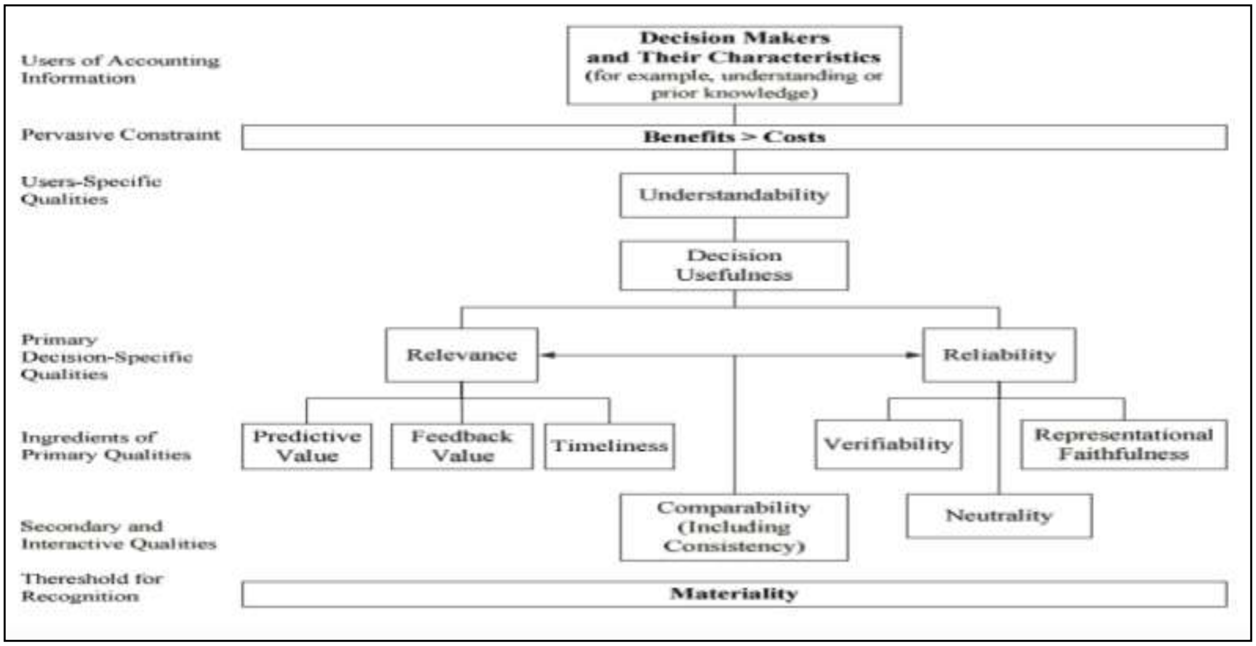

Figure 1. A Hierarchy of Accounting Qualities, Acquiring, Developing and implementing Accounting Information systems, Thomson South-Western, 2005.

On one hand, the fundamental qualitative characteristics—relevance and faithful representation—are the most critical and determinative of content in financial reporting. On the other hand, the enhancing qualitative characteristics—understandability, comparability, verifiability, and timelines—assist in improving the decision usefulness when the fundamental qualitative characteristics are recognized. However, according to the *International Accounting Standards Board* (IASB), the enhancing qualitative characteristics cannot, by themselves, determine financial reporting quality. This point has encouraged many specialists in the field to undertake studies to determine what could influence financial reporting quality. In the next section, this paper lists some of the influences found in the literature.

2. Influences on Financial Reporting Quality

In the accounting literature, many studies measure the quality of financial reporting through influences on financial reporting. Studies show that the quality of financial reporting is associated with many different influences. Governance, the accounting profession, economic factors, international forces, taxation, and political systems are some of the factors that influence and control the quality of financial reporting (Gajevszky, 2015). These influences include: Earnings Management, Corporate Governance Practices,_Capital Markets, Internal control, Internal Reporting Systems, Accounting Standards,_Information Technologies and Accounting Information Systems, Auditing, Accounting Conservatism, Financial Restatements, Company Reputation, Culture, Business Ethics, Chief Executive Officers (CEO) Age, CEO inside debt holdings, the Entity Size, Age, and the Board Size.

Moreover, researchers have revealed an association between financial reporting quality and executive compensation, and corporate management turnover. Thus, measuring quality may be based on information other than financial information in an entity's reports (Pounder, 2013). In the following section, there is an explanation and an illustration of findings in the literature about these influences.

2.1 Earnings Management

Investors and users are interested in achieving a high quality of financial information, and this quality can be derived from having a high quality of earnings that is known as one of the most important indicators of capital market efficiency. This notion is one of the major concerns in assessing the financial health of entities to signify the level of reliability of reported earnings (Usman, 2013). Moreover, this indicator has been used as an analysis tool to evaluate the impacts of converting accounting standards, external auditing, enforcement and corporate governance, and the cost of capital. In the literature, there are several metrics to proxy the earnings quality, such as: persistence, predictability, smoothness, abnormal accruals, accruals quality, value relevance, timeliness, conservatism, and earnings variability (Ewert & Wagenhofer, 2011). Earnings quality has an important role in decision usefulness. It is also affected by other factors, such as managerial incentives and regulatory actions. The more extensively an entity engages in earnings management, the lower the entity's financial reporting quality. However, focusing on accruals management rather than on management earnings or cash flows—R&D expenditure reduction, for example—has a negative impact because accruals are easier to manipulate and less visible to stakeholders than cash flows. (Choi & Pae, 2011). Using this factor, securities analysts often interpret financial information to forecast earnings and cash flows of an entity. The analysts' forecasts often show changing degrees of accuracy—the difference between the average of forecasted results and actual results—and precision—the "tightness" of the range of forecasted results (Pounder, 2013). Therefore, a high level of precision and accuracy should result in high accounting quality. It is possible to infer the quality of information based on those forecasts.

2.2 Corporate Governance Practices

Corporate governance has an essential role in ensuring financial reporting quality. The relationship between corporate governance and financial reporting quality has been extensively considered. Multiple studies reveal several results about the governance mechanism, and how it positively and significantly influences the financial information quality of companies (Honu & Gajevszky, 2014). Mainly, influence from outside users, families, and stockholders negatively affect the financial reporting quality; however, control by government and financial institutions is linked with a high-level quality in financial disclosures. Investigating the rule of governance mechanisms on financial information quality illustrates that corporate governance affects accounting quality (Klai, & Omri, 2011). Many studies in the literature find that firms with strong corporate governance can issue high quality financial reports (Cao, Ying, Linda, Omer & Thomas, 2011). In the literature also, ownership concentration has the effect of decreasing the tendency of managers' earnings manipulation. Moreover, managerial ownership and earnings manipulation are negatively associated; however, another study shows that managerial ownership does not reduce earnings management and thus affect the quality of financial reporting (Usman, 2013). The efficient corporate governance of financial reporting processing constitutes an important tool in allowing companies and their auditors to fulfill all these responsibilities. (Hope, Thomas & Vyas, 2011).

2.3 Capital Markets

Based on a study that used 166,903 annual financial statements of publicly listed firms in 38 main capital markets from 2000 to 2007, Capital Markets of developed countries—e.g. The United States, Germany, Japan, United Kingdom, and Australia—have reported a higher financial reporting quality than what emerging markets have reported. Those capital markets have strong investor protection and legal enforcement that produces high financial reporting quality—which connects again to the considerable impact of corporate governance in a country's economic and financial position (Tang, Chen & Lin, 2012).

2.4 Internal control

Effective internal control always lowers information risk and enhances the completeness and accuracy of planned information. According to the American Institute of Certified Public Accountants (AICPA), for the purpose of producing reliable financial statements and achieving financial reporting objectives, strong internal control over financial reporting is one of the essential factors to achieve this purpose. It is also one of the important influences of financial reporting quality that impacts information risk and credit ratings (Elbannan, 2009).

Therefore, the stronger and more effective the internal control is, the higher the quality of financial reporting achieved.

2.5 Internal Reporting System

The internal reporting system checks whether the financial information meets the criteria of understandability, relevance, reliability, and comparability to ensure that economic decisions are achieved. It also enables interactions and communication between the management and operational levels. The importance of the reporting system comes from being a tool that provides representative and relevant information (Lius, 2011). Furthermore, the internal reporting system emphasizes that more reliability should be achieved. An effective internal reporting system encourages producing high qualitative disclosures. How managers of firms deal with the disclosures to outside parties depends upon how the information is reported internally (Lius, 2011).

2.6 Accounting Standards

Producing high quality financial statements is largely determined by what incentives firms have to achieve this goal. Findings indicate that reporting under using United States Generally Accepted Accounting Principles (U.S. GAAP) provides more faithfully represented information than reporting under International Financial Reporting Standards (IFRS). On the other hand, reporting under IFRS provides more relevant information than annual reports under U.S. GAAP. The influences on the fundamental qualitative characteristics between U.S. GAAP and IFRS vary considerably (Beest, Braam, & Boelens, 2009). To illustrate this point, U.S. GAAP emphasizes the fundamental qualitative characteristic—faithful representation—, and IFRS emphasizes the relevance characteristic. A study, conducted for three-year periods, investigates the effects of IFRS first time adoption of financial reporting quality of fifty listed companies on the Bucharest Stock Exchange and their financial statements. The main finding of this study illustrates that accrual quality—which is associated positively with financial reporting quality—has increased after the adoption of IFRS (Gajevszky, 2015). However, several studies indicate that financial reporting quality is not determined only by accounting standards (Walker, Zeng, & Lee, 2013).

2.7 Information Technologies and Accounting Information Systems

The accounting information system should produce relevant and reliable information (Sacer, Oluic, 2013). The usage of appropriate Information Technology (IT) is essential to the accounting information system because of all the supports to accounting information system in order to generate required information in a short period of time. IT has a considerable influence on the accounting information system from the perspectives of operating, preparing, processing, presenting, and delivering the accounting information. Thus, this significantly helps to support timeliness as a qualitative characteristic of financial information which results in increasing financial reporting quality and also supporting the quality of accuracy by using effective IT (Sacer & Oluic, 2013).

2.8 Auditing

Auditing is an independent verification that enhances financial statement reliability and usefulness (Francis et al., 1999). Since auditing is an integral part of the system, the inclusion of auditing variables better reflects overall financial reporting quality (Tang, Chen & Lin, 2012).

2.8.1 Audit committees

First, the audit committee has the responsibility for hiring, evaluating performance, and compensating external auditors in entities. Also, the audit committees oversee and supervise financial reports and disclosures of entities by monitoring choices of policies and accounting principles, and what internal control designs managements have used (Blue Ribbon Committee 1999; DeZoort 1997). In the literature, audit committees have contributed to enhancing the quality of financial reporting. The more independent, more capable, and more qualified the audit committees are, the better their ability to detect material misstatements in the financial information, and the better their ability to deter any opportunities for managements to manipulate reporting. Thus, the audit committee attributes have fundamental impacts on both financial reporting quality and audit inputs. Furthermore, changes in the audit committee governance are associated with enhancements of financial reporting quality (Zang, Kim, Benjamin& Dan, 2013).

Prior researchers have provided some evidence that suggests an association between the existence of a financial expert on an audit committee and a higher level of financial reporting quality (Krishnan & Visvanathan, 2008).

However, the importance of including a financial accounting expert on the audit committee has resulted in higher financial reporting quality more than just including a financial expert (Zang, Kim, Benjamin& Dan, 2013). Therefore, the United States Securities and Exchange Commission's (SEC) current definition of financial expertise might be broad, and should specify the importance of including a financial accounting expert on audit committees. Having a financial accounting expert on audit committees is positively associated with forecast accuracy and negatively associated with forecast dispersion (Abernathy, 2010).

2.8.2 Other Audit Influences

There is a positive and a significant influence on financial reporting quality based upon the size of the auditing firms, and fees paid to external auditors (Gajevszky, 2015& Hashim, 2012).

2.9 Accounting Conservatism

In Statement No. 2 of Financial Accounting Concepts, FASB defines conservatism as "… a prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered." On one hand, accounting conservatism is a significant feature of financial reporting quality (LaFond and Watts 2008). According to Watts (2003), accounting conservatism decreases the managers' ability to manipulate earnings. On the other hand, it is also considered as a proxy for financial reporting quality (Dechow et al., 1996). Additionally, many firms regard accounting conservatism as one of the audit committee responsibilities (Abernathy, 2010).

2.10 Financial Restatements

Financial restatement information—obtained from Audit Analytics—is a clear indicator of material misstatements in the preparation of financial statements. It is also considered the most noticeable evidence of improper accounting. It has been argued whether or not the results of financial restatement have an effect on the quality of financial reporting. Furthermore, the frequency of financial restatements has raised the level of concerns about the quality of financial reporting. These indicators suggest that reporting financial restatements is considered an appropriate measure of the quality of financial reporting (Lee, Rose-Green & Huang, 2012). Romanus et al. (2008) noted that larger companies that establish effective internal controls and are heavily subject to closer scrutiny from auditors have fewer restatements (Lee, et al., 2012).

2.11 Company reputation

An entity's reputation is associated with the probability of financial statements restatements that could result from material misstatement. Restatements are one of the most obvious indicators of impaired financial reporting quality. Hence, entities' reputation will influence the process of reporting and reduce the risk of financial reporting misstatements that will lead to financial restatements. After taking control of CEO tenure, corporate governance, and other variables, studies show that companies that have high reputations are less likely to misstate their annual financial statements. A company reputation is positively associated with accruals quality and audit fees (Cao, et al., 2011).

2.12 Culture

The quality of financial reporting is associated with culture; also, government policies have large impacts on it. The positive and significant impact of boards that are dominated by citizens of countries in which firms are located has on the quality of financial reporting has been demonstrated. The connection between ethnicity and the quality of financial reporting supports the political cost theory; so it is not clear from this study whether or not other variables may play a role (Hashim, 2012).

Finally, despite enormous international efforts that have been made towards convergence and harmonization, results show that considerable diversity in accounting and auditing still exists around the world; hence, the effectiveness of global harmonization remains a crucial issue to be explored further. (Tang, et al., 2012).

2.13 Business Ethics:

Ethical commitment is essential for business, and has a direct bearing on financial reporting quality. Firms committed to a higher level of business ethics show better financial reporting quality than those having a lower level of business ethics. Furthermore, accruals in companies with a high level of ethical commitment show faithful reflection in future operating cash flows (Choi & Pae, 2011).

Studies that examine the outcomes of business ethics on the quality of financial reporting are limited because of the lack of quantitative measures. Based on all the facts listed above, education in ethical business can lead to the enhancement of financial reporting quality (Choi & Pae2011). Figure 2 from one of the studies shows the corporate commitment to business ethics, and how this concept is related to financial reporting quality (Choi & Pae, 2011).

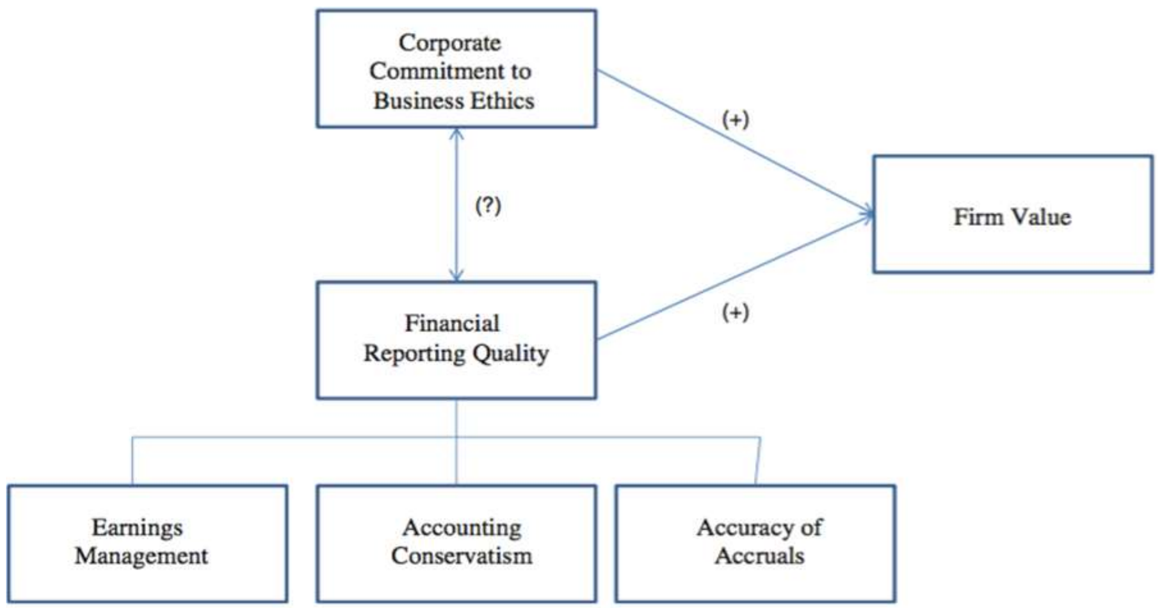

Figure 2. Corporate commitment to business ethics and financial reporting quality. Adapted from "*Business Ethics and Financial Reporting Quality: Evidence from Korea,"* by T.H. Choi and J. Pae, 2011, Journal of Business Ethics, (p.404).

2.14 Chief Executive Officers Age

The Sarbanes–Oxley Act (SOX) requires that chief executive officers (CEOs) and chief financial officers (CFOs) certify their firms' financial statements. The recent regulation of the role of corporate executives emphasizes how that is related to ensuring a high-level financial reporting quality. According to research that has been done by Lee, Rose-Green & Huang (2012), using a sample of 3,413 nonfinancial firms, there is a positive connection between the older ages of chief executive officers (CEOs) and financial reporting quality. As a result, firms that hire older CEOs can expect to lower the cost of capital and increase the firms' value. That connection was based on an investigation of how well firms are meeting or beating analyst earnings forecasts and from the aspect of financial restatements. This suggests that the older CEOs would be more conservative and less involved in aggressive earnings management (Lee, Rose-Green & Huang, 2012).

2.15 CEOs' Inside Debt Holdings

The inside debt—a debt that is held by the manager of a firm—has an effect on financial reporting quality. Guanming examined this effect and reached this conclusion:

"…the effect of CEOs inside debt holdings on financial reporting quality. I find that higher CEO inside debt holdings are associated with lower abnormal accruals, higher accruals quality, a lower likelihood of an earnings misstatement, and a lower incidence of earnings benchmark beating, suggesting that CEO inside debt promotes high financial reporting quality" (He, 2015).

2.16 The Entity Size, Age, and the Board Size

Findings illustrate that there is a large and a negative correlation between an entity size and the financial reporting quality because larger entities expose negative discretionary accruals (Hope, Thomas & Vyas, 2011). This factor has a large and a significant influence on financial reporting quality (Hashim, 2012). Also, studies show that financial reporting quality is strongly and positively associated with, and influenced by, the entity age (Hashim, 2012).

3. Approaches to Measure and Assess Accounting Quality

Assessing the quality of financial reporting requires a broad range of measurements using models, proxies, qualitative characteristics, and other elements of financial reports. In the literature, three different dimensions of financial reporting quality are frequently used: Accrual-Based Models, Accounting Conservatism, and Earnings Managements (abnormal accrual). Many approaches have been used to measure and assess financial reporting quality, and new approaches are still being developed. In this paper, some of the approaches are used—in the literature, for example—to measure and assess the financial reporting quality: Standardized Score, Accrual-based models (or Accruals Quality), Beneish model's "M-Score," Indices (or scores) method of Internal Control, and the degree of Accounting Conservatism. In the literature and prior studies, the reason behind the large reliance upon using indirect measures (e.g. proxies for the financial reporting quality or stock prices) is that some of the financial reporting qualities are unobservable (Abernathy, 2010).

3.1 Using Standardized Scores

Assessing the quality of financial reporting requires computing standardized scores using the fundamental and enhancing qualitative characteristics listed previously. By equally weighing the fundamental qualitative characteristics, the standardized scores of the fundamental qualitative characteristics are calculated by adding the standardized scores of relevance and faithful representation and dividing them by 2. The same process is applied for enhancing qualitative characteristics. The results will be shown in scores from 1 to 5—implying a poor score and an excellent score respectively—for the qualitative characteristics. Thus, quality of financial reporting is measured by melding the scores of the fundamental and the enhancing qualitative characteristics. This approach has a unique way of measuring the quality of financial reporting. It is a compound tool to assess the quality of the financial and non-financial information in the annual reports comprehensively. This tool considers all the aspects of decision-usefulness as they are defined in the Exposure Draft (ED)—released by FASB. According to Beest, Braam, & Boelens (2009),

"…None of these measurement methods enables a comprehensive assessment of financial reporting quality including all qualitative characteristics as defined in the Exposure Draft 'An improved Conceptual Framework for Financial Reporting' [ED] of the FASB and the IASB (IASB, 2008)."

On the other hand, to assess the quality of financial reporting, all other indirect-measurement tools focus on specific attributes that are expected to influence the quality of financial reporting, and on information disclosed in the financial statements. To emphasize this point, earnings management is used to highlight the quality of earnings instead of focusing on the quality of financial reporting as the primary objective (Beest, Braam, & Boelens, 2009). Earnings quality is defined as the level to which the economic reality and the company's financial performance are reflected; however, the quality of financial reporting has a broad range. It is not restricted to the financial information, but it also refers to other non-financial information and disclosures that are useful to the decision making by users. Thus, this tool reflects the qualitative characteristics because they all lead to achieving the decision usefulness of financial reporting information. In the literature, the value-relevance can determine the elements and qualitative characteristics in annual financial reports (Beest et al., 2009).

3.2 Accrual Quality or Accrual-Based Models

Accrual Quality is a significant model that has been used to measure the quality of financial reporting. It is known under the accrual basis in accounting that revenues are recognized separately from cash collection, and expenses are recognized separately from cash payment. In general, and within the operating cycle before or after accrual, the entity cash flows should match its accrued revenue and expense. Nevertheless, the actual match between them varies in practice among entities and over time. Thus, accrued estimations of generated revenues or derived costs might be more than the cash that is actually collected from revenues or paid for costs. Research on Accrual Quality has led to the acceptance and approval of this approach (Pounder, 2013). This has resulted in a significant improvement in measuring the quality of financial reporting. The Accrual Quality approach concentrates on the level of uncertainty of an entity's cash flow to the accrual correspondence. Theoretically, the more variability between the accruals and the cash flows in an entity during the operation cycle, the lower the entity's Accrual Quality, therefore, the lower the quality of the entity's accounting (Pounder, 2013). It is considered as an indirect method, and it is based on observation. In addition, it was used by Dechow and Dichevs to measure discretionary accruals, and check robustness (Gajevszky, 2015). It also demonstrates the connection between accruals and earnings quality. Moreover, measurement error in accruals affects the Accrual Quality.

This error is created by assumptions and estimates—the basis of the accrual—and it should be corrected (Hashim, 2012). One of the functions of the accrual-basis accounting tool is the ability to provide the forecasting of better future cash flows. When the current net income is informative about future cash flows' performance, financial reporting quality is deemed higher (Hope, Thomas & Vyas, 2011). In some of the literature, studies assess the quality of financial reporting when these two accrual models have been adopted—Dechow et al. (1995) model, and Kothari et al. (2005) model (Gajevszky, 2015).

3.3 Beneish Model or "M-Score,"

This approach is considered as a direct measure of the quality of financial information. The M-Score uses eight variables and these variables are based on quantitative accounting metrics such as the number of sales in accounts receivable. Also, the M-Score shows the level of an entity's reported earnings and how they are likely to be manipulated by management (Pounder, 2013).

3.4 Indexes (or scores) method of Internal Control

Finance researchers often use this method to measure the presence of items in the internal control system. It is considered a valid measuring tool (Prencipe, 2004). The method contains a description of elements that are selected in accordance with the research representativeness in the system to be measured. The score "1" for the item that needs to be measured qualifies as relevant, and a score of "0" qualifies as not relevant. After scores have been assigned, they can be compared to one another. This process allows for creating groups and testing variables by the scores received. Thus, to compare information in disclosures, various aspects—e.g. reliability, representativeness, relevance, and accessibility—have been measured through this tool. Hence, this index permits measurement of the quality of reporting systems and financial disclosures when using a sample of listed companies. As a result, the better the internal reporting quality is, the better the quality of financial reporting should be (Lius, 2011).

3.5 Persistence of Accruals

Persistence of Accruals is a measure of financial reporting quality. This test has the advantages of precise controls for cash flow persistence, not just relying on measures that are unobservable (Walker, Zeng, & Lee, 2013).

3.6 Degree of Earnings Management

The degree of earnings management is often measured using management discretion over accruals, and faithful representation is measured using the negative of earnings management through accrual (Choi & Pae2011).

To summarize, in the literature, some of the studies suggest using more than one measurement, based on the nature of the factors that need to be measured. Some of the situations require using more measurements because of the large-scale of their samples; and some of the tools will not cover all the factors associated with financial reporting quality. Also, the use of multiple proxies supports generalizing results (Dechow, Ge, and Schrand 2010). Moreover, using alternative measures reduces the possibility that other measures may not demonstrate (Givoly 2010). To illustrate this point, some studies need to employ measures to highlight several dimensions of the financial reporting quality at the same time, such as applying accruals persistence, cash flow predictability, and accruals quality (Chen 2011).

4. Gaps in the Existing Literature and Suggestions for Future Research

This research recognized some instances of insufficient information and some gaps in the existing literature. For example, the size of some study samples is not big enough to draw reasonable conclusions. In addition, the board size just shows the connection with the quality of financial reporting in corporate governance as an influence (Honu & Gajevszky, 2014). This indicates that there should be further research on the corporate governance factor to emphasis how it affects the quality of financial reporting. By increasing and expanding samples' sizes, the ability to compare the level of information quality among other industries (Hashim, 2012).

Another limitation of studies reviewed in this paper is the inaccessibility of some data that is related to the accounting and auditing in the markets—especially emerging markets. This also restricts the ability to take into account some other possible indicators that might be essential for assessing the financial reporting quality, such as earnings forecasts and other useful ratios of firms. Also, the availability of data throughout the years would support the importance of being consistent in evaluating the quality of financial reporting in different periods.

Furthermore, it is necessary to verify the results by including the financial companies—banks—and make the sample more diverse, not to mention the importance of including other variables and other measures (e.g. voluntary disclosure). Also, in most of the studies reviewed in this paper, ignoring the importance of including non-listed companies might not yield a full representation of the financial reporting position of entities in economies worldwide. Evaluating the influences of financial reporting quality by including small and medium enterprises in the samples to examine what effects they might cause different statistical results to come to light. So, that will lead to support the findings and cover all the different levels of business.

In many studies, the lack of control-related and essential variables that are associated with other factors is clear and noticeable. Therefore, there should be emphasis to ensure that there are enough controls on all variables that might threaten the results of the studies. In one study for instance, it is not clear whether outside, not included variables might have played a role, had they been included along with the variables taken into account in the study (Hashim, 2012). Moreover, several studies indicate that financial reporting quality is not determined only by accounting standards (Walker, Zeng, & Lee, 2013).

5. Concluding remarks

This paper provides a thorough review of influences and measures of financial reporting quality. It also identifies some gaps in the literature and provides suggestions for future research. This paper has practical significance and value for enlightening managers, investors, and other users about the different aspects of financial reporting quality. The understanding of the quality of financial reporting, and having the knowledge about what the influences are, is needed due to complex and competitive business environments. Reaching a phase where the quality of financial reporting can be measured precisely will assist in investigating other global issues related to accounting reforms and changes in capital markets around the world.

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