CHAPTER – 3

LEGISLATIVE AND REGULATORY FRAMEWORK OF CORPORATE FINANCIAL REPORTING

In this chapter, the main discussion is on the legal and regulatory framework for corporate financial reporting practices in six selected countries of Asia-Pacific region, namely Australia, China, Hong Kong, India, Japan and Korea. The main objective of this chapter is to study the legal environment for corporate financial reporting in selected countries. It is studied with the consideration of related company law, securities exchange law and accounting standards.

3.1 Legislative and Regulatory Framework of Corporate Financial Reporting

At the core of the corporate reporting model is the financial reporting model, consisting of financial statements and accompanying notes that comply with generally accepted accounting principles (GAAP). Financial reporting is the communication of financial information of an enterprise to the external world. Currently, the legal framework within which companies operate is governed extensively by financial reporting standards or accounting standards. The overview of the legal and regulatory requirements for corporate financial reporting considers laws and accounting standards.

The corporate and financial reporting regulation enshrined in the corporate and securities law is designed to make directors (formerly and generally entrepreneurs) accountable to shareholders and investors by requiring them to make disclosure of the utilization of the funds provided. Corporate accountability is now increasingly extended to a wider group of stakeholders. The current review of the law is to support this view in a move to recognize a broader range of concerns in the corporate environment (Soon, 2008).

3.1.1 Legislative and Regulatory Framework in Australia

In Australia, there are two basic frameworks to consider in order determining whether a particular business is required to prepare financial reports and the standard to which those financial reports are to be prepared. There is the legal framework and there is the accounting framework.
It ought to be no revelation that there are greater accounting compliance burdens on big businesses than on small businesses. ASX-listed entities prepare glossy Annual Reports containing the financial reports which are audited and easily available over the internet. At the other end of the scale, small owner-managed businesses may not necessarily prepare any financial reports at all.

3.1.1.1 The Legal Framework

The legal framework is predominately obtained from the Corporations Act (“the Act”). Section 292 of the Act requires certain companies (and also particular schemes and entities which I will not address here) to prepare financial reports. If a company is required to prepare financial reports under the Act, it usually has to comply with the accounting standards. The Act, however, does not prescribe any financial reporting requirements for unincorporated businesses operating through a trust or partnership.

Despite the potential absence of legislation which imposes requirements for financial reporting on entities such as most trusts or partnerships, there may be self-imposed requirements for financial reporting written into the formation documents, such as a trust deed, a partnership or shareholders agreement, or a company constitution. Typically, financial reporting requirements may be drafted into these types of documents intentionally to promote greater transparency between various equity providers. Occasionally, the inclusion of certain financial reporting requirements in such documents may be unintentional – usually because a pro-forma document has been adopted without proper consideration of actual needs. It is also not uncommon for financial reporting requirements to be externally imposed – e.g. debt providers may require a business to enter into some deed of arrangement which stipulates when and how financial reports are to be prepared.

3.1.1.2 The Accounting Framework

There are approximately 50 Accounting Standards currently in operation, many of which apply across different industries and businesses while some only apply to certain industries (e.g. construction or insurance). The Accounting Standards apply to all entities which are considered to be ‘reporting entities’.

3.1.2 Legislative and Regulatory Framework in China

3.1.2.1 The Legal Framework
“The Accounting Law of the PRC sets out the general principles of accounting for all enterprises and also empowers the Ministry of Finance to administer accounting affairs and establish uniform accounting regulations and systems. Under the mandate of the Accounting Law, the Ministry of Finance has issued various accounting regulations, including accounting standards.

Enterprises established in China shall draw up a yearly financial and accounting report. Some enterprises may also be required to draw up half-yearly, quarterly and monthly reports. According to Chinese law, a financial report is a written document which shows the financial situation and business results of the enterprise. The yearly accounting report shall reflect comparative data of at least two years or two interrelated periods. Accounting information provided by an enterprise shall reflect all important transactions or events that relate to its financial position, operating results and cash flows. Accounting elements include assets, liabilities, owners’ equity, revenue, expenses and profit.

A financial report includes accounting statements and notes and a descriptive overview of the financial situation of the enterprise and other information or data that shall be disclosed in financial reports. The accounting statement shall at least comprise a balance sheet, an income statement and a cash flow statement. Small enterprises are not required to include a cash flow statement when preparing financial statements. Recognition, measurement and reporting for accounting purposes shall be on an accrual basis.


3.1.2.2 The Accounting Framework

“Chinese accounting standards are the accounting rules used in mainland China. As of February 2010, the Chinese accounting standard systems is composed of Basic Standard, 38 specific standards and application guidance.

Chinese accounting standards are unique because they originated in a socialist period in which the state was the sole owner of an industry. Therefore unlike Western accounting standards, they were less a tool of profit and loss, but an inventory of assets available to a company. In contrast to a Western balance sheet, Chinese accounting standards did not
include an accounting of the debts that a corporation holds, and were less suitable for management control than for accounting for tax purposes.

The existing system of accounting was widely considered to be unsuitable for managing corporations in a market economy. In 2006, the Chinese government introduced a revised accounting law. This was the fruit of considerable discussion and protracted debate, involving the Ministry of Finance, members of the International Accounting Standards Board and representatives of some Chinese firms.

This revised law marked a large step forward for the continuing integration of world trade and capital markets, with China adopting a significant number of the accounting standards laid out by the International Accounting Standards Board (IASB). The old Chinese Accounting Standards (CAS) were largely replaced by the International Financial Reporting Standards (IFRS), to bring China more in line with the rest of the world. The similarity between the new Chinese accounting standards and the IFRS is almost 90–95%.” (en.wikipedia.org, 2014).

3.1.3 Legislative and Regulatory Framework in Hong Kong

3.1.3.1 The Legal Framework

Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory licensing accounting body in Hong Kong for the regulation and development of the accounting profession and promulgation of financial reporting standards.

3.1.3.1 The Accounting Framework

Hong Kong GAAP consist the conventions, rules, and standards that accountants should follow in recognising, measuring and reporting transactions and in the preparation of financial statements in Hong Kong. “Hong Kong Financial Reporting Standards includes all HKFRS, Hong Kong Accounting Standards (HKAS), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants. HKFRS set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. HKFRS are based on The Framework for the Preparation and Presentation of Financial Statements, which addresses the concepts underlying the information, presented in general purpose financial statements. The appropriate application of HKFRS, with additional disclosure when necessary, results, in
virtually all circumstances, in financial statements that give a true and fair view.” (www.hkicpa.org.hk, 2006).

### 3.1.4 Legislative and Regulatory Framework in India

“India is a federal state with unitary bias. This is perhaps why, unlike in the USA, there is no separate company law for any state in India. Apart from professional regulation, corporate financial reporting in India is governed primarily by one central Act i.e., the Companies Act, 1956. Another body that has a major influence in reshaping Indian financial reporting is the Securities and Exchange Board of India (SEBI). The Companies Act, 1956 prescribes the financial reporting requirements for all the companies registered under it. The reporting requirements that are imposed by the SEBI through its Guidelines and through the Listing Agreement are in addition to those prescribed under the Companies Act. SEBI requirements are to be followed by the companies listed in the Indian stock exchanges. The Companies Act and the SEBI requirements together provide the legal framework of corporate reporting in India.” (www.icai.org, 2014). Before elaborating the legal requirements, it may be interesting to discuss the role of the SEBI as it is pioneer to introduce certain changes (e.g., cash flow statement) in the area of corporate financial reporting. Following sections sequentially discuss the role of the SEBI, the Companies Act and SEBI reporting requirements.

#### 3.1.4.1 The Legal Framework

**Securities and Exchange Board of India (SEBI):** It was constituted on April 12, 1988. SEBI has adopted another scheme to enforce continuous disclosures by the companies. “SEBI has imposed a number of disclosures and other requirements through this route. Some important requirements are as follows:

1) Dispatch of a copy of the complete and full annual report to the shareholders (Clause 32).
2) Disclosure on the Y2K preparedness level (Clause 32).
4) Disclosure of material developments and price sensitive information (Clause 36).
5) Compliance with Takeover Code (Clause 40B).
6) Disclosure of interim unaudited financial result (Clause 41).
7) Disclosure regarding listing fee payment status and the name and address of each stock exchange where the company’s securities are listed (Clause 48B).
8) Corporate governance report (Clause 49).
9) Compliance with Accounting Standards issued by the ICAI (Clause 50)

The process of the SEBI has resulted in a changed regime for imposition of financial disclosure requirements that is quick and does not require lengthy process of legislative changes. By virtue of the provisions contained in the Listing Agreement (Clause 50), listed companies are now under legal compulsion to comply with all the accounting standards issued by the ICAI.” (www.icai.org, 2014).

Companies Act, 1956: “The Companies Act, 1956 lays down the detailed provisions regarding the maintenance of books of accounts and the preparation and presentation of annual accounts. The Act also prescribes the mechanism for issuance of accounting standards. It specifies the roles and responsibilities of directors and also the matters to be reported upon by them in the annual reports of the companies. Under the provisions of the Act, audit of annual accounts is compulsory for all companies registered under it. The Act extensively deals with the qualification, appointment, removal, rights, duties and liabilities of auditors and provides contents of auditors’ report. In case of delinquency/ default by the management or auditor, penal provisions are prescribed. However, despite providing for detailed requirements in respect of maintenance of books of account, preparation and presentation of financial statements and audit of annual accounts, the main thrust under the Companies Act is upon the presentation of a ‘true and fair view’ of the state of affairs and operating results of the reporting companies.” (www.icai.org, 2014).

3.1.4.2 The Accounting Framework

Indian Accounting Standards, (Indian AS) are a set of thirty two accounting standards notified by the Ministry of Corporate Affairs which are converged with IFRS. These accounting standards are formulated by Accounting Standards Board of ICAI. Now India will have two sets of accounting standards viz. existing accounting standards under Companies (Accounting Standard) Rules, 2006 and IFRS converged Indian Accounting Standards (Ind AS). The Ind AS are named and numbered in the same way as the corresponding IFRS.

3.1.5 Legislative and Regulatory Framework in Japan

3.1.5.1 The Legal Framework

“Two legal codes govern the preparation of financial statements in Japan, the Companies Act and the FIEA. The form and content of the financial statements required
under the Companies Act are dictated by the Ordinance for Companies Accounting. The regulations are legally binding standards of accounting and reporting to be applied to all companies incorporated and operating in Japan. The standards of accounting and reporting to be followed under the FIEA by companies whose debt and equity securities are publicly traded or sold are regulated by "Regulations Concerning the Terminology, Forms and Preparation Methods of Financial Statements," which were first promulgated in 1963 by the Ministry of Finance.

Although there are certain differences in reporting under these two sets of regulations, over the years they have converged following a series of revisions.

**Reporting under the Companies Act:** All stock companies (kabushiki-kaisha) are regulated under the Companies Act, and are required to provide a business report and the following financial statements (Article 435(2) of the Companies Act): (1) Balance sheet; (2) Income statement; (3) Statement of changes in net assets; (4) Notes to non-consolidated financial statements; and (5) Supplementary schedules. In addition, large companies whose financial statements are filed with the FSA should prepare consolidated financial statements.

The main objectives of the accounting and disclosure system under the Companies Act are:

(a) To protect creditors and current shareholders;
(b) To compute the distributable earnings of the company; and
(c) To evaluate management's performance of its stewardship function.

**Reporting under the Japanese FIEA:** Under the FIEA, companies that offer securities to the public or whose outstanding securities are traded publicly (i.e. listed companies) must file financial statements with the FSA, as part of their security registration statement, annual securities report or quarterly report. Certain companies whose securities are not publicly traded (i.e. unlisted public companies) are also required to file their financial statements.

Financial statements are prepared on both consolidated and non-consolidated bases and consist of the following: (1) Balance sheet; (2) Income statement; (3) Statement of changes in net assets; (4) Statement of cash flows (non-consolidated basis is not required if a consolidated statement is prepared); and (5) Supplementary schedules. In addition, listed companies are required to submit the following reports to FSA: (1) Internal control report audited by CPAs included in the annual securities report; and (2) Quarterly reports with financial statements reviewed by CPAs.
The main objectives of the accounting and disclosure system under the FIEA are:

a) To provide information to investors for decision-making; and

b) To facilitate fair and smooth securities transactions.”


3.1.5.2 The Accounting Framework

“Accounting principles and practices in Japan have evolved through general usage and practice over a period of time and have been codified into a series of promulgations and related amendments by the BAC. Accounting standards or principles for business enterprises issued by the BAC have been regarded as Generally Accepted Accounting Principles (GAAP) in Japan.

The FASF was established in 2001, and the ASBJ was organized under the auspices of the FASF as an independent, private-sector entity to develop accounting standards in Japan substantially taking over the role of setting accounting standards from the BAC. Since its inception, the ASBJ has issued many accounting standards, guidance and other documents that address practical issues.” (www.hp.jicpa.or.jp, 2011).

3.1.6 Legislative and Regulatory Framework in Korea

3.1.6.1 The Legal Framework

“In Korea, laws that regulate financial reports resulting from business activities include the Commercial Act, Tax Law, the Financial Investment Services and Capital Markets Act, the Act on External Audit of Stock Companies, the Certified Public Accountant Act, business accounting standards, and the accounting auditing standards. In the Commercial Act, financial statements are listed as the balance sheet, income statement, statement of appropriation of retained earnings and statement of disposition of deficit. However, the business accounting standards add statement of cash flow chart and annotations to the list of financial statements. The Tax Law is based on the major premise of obligation principle and equal taxation. Therefore, its standards differ from the financial reports under the business accounting standards, which are based on principles of accrual and realization. The gap between business accounting and tax accounting has been narrowed in recent legislation.” (www.investkorea.org, 2013).

3.1.6.2 The Accounting Framework
“Korea's accounting system was overhauled to meet international standards after the Asian financial crisis in 1997. Korean Financial Accounting Standards (KFAS) comply with International Accounting Standards (IAS), as Korea has released the Korean International Financial Reporting Standards (K-IFRS). Korea's accounting and auditing system includes external audit and internal accounting control system. External audit means an examination of a company's records and reports by an outside party. Under the internal accounting control system, internal standards are established, so that financial statements are drawn and announced in line with accounting standards. One permanent director is designated to be responsible for internal accounting control.” (www.investkorea.org, 2013).

“Since the 1997 Asian financial crisis, the Financial Services Commission (FSC) of Korea has accepted the recommendations of the IMF and the World Bank to fully revise Korean business accounting standards to fit international standards. This resulted in a shift from the legal provision-like form of the past to the current business accounting standards that adhere to the global standard. From July 2007, the Korean Accounting Institute (KAI) has been commissioned by the FSC on setting, revising and interpreting the business accounting standards, and has been enacting and declaring the Statements of Korea Accounting Standards whenever enacting new or revising existing business accounting standards by designating a serial number for each issue. The Statements of Korea Accounting Standards apply to corporations under the Act on External Audit of Stock Companies, creating financial statements for external users, as well as for audits by external auditors.” (www.investkorea.org, 2013).

Concluding Remarks

The chapter is aimed how interim financial reporting regulation varies across the Asia-Pacific region or to familiarise the legal and regulatory environment of selected countries in Asia – Pacific region. The legal and regulatory considerations relating to corporate financial reporting, is the determining factor in choosing a particular reporting structure. It is noticed that the legal and regulatory framework governing corporate financial reporting, is timely reviewed and, where necessary, strengthened. To be effective, it need to embody the features of the framework for normal times described in terms of financial reporting. The relevant regulations in eight selected countries in the Asia-Pacific region are differing in a number of country-level attributes.
Bibliographical Notes

The legal environment of corporate financial reporting practices are studied from the number of books on fundamentals of corporate financial reporting practices such as Lal (2005) and study material of ICAI for final course entitled Financial Reporting (2010).