

## Building the Model to Measure the Quality of Financial Statements – A Case Study of Vietnamese Enterprises Listed on the Stock Market



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**ABSTRACT:** Bloomberg's recent recognition of Vietnam as Asia's "new tiger economy" is not coincidental. The country is experiencing a surge in mergers and acquisitions (M&A) activities, with foreign billionaires acquiring majority stakes in major Vietnamese enterprises. However, obstacles hinder foreign investment, mainly due to the poor and unclear quality of financial statements, as reported by the World Bank and IMF in 2014. Drawing from agency theory (Jensen and Meckling, 1976) and asymmetric information theory (Akerlof, Spence, and Stiglitz, 1970), we aim to develop a model that measures the quality of financial statement information. By consulting with experienced academics, experts, and specialists in accounting and auditing, we identify factors that impact the quality of financial statements.

We employ qualitative analysis and the CFA and EFA methods to validate these impacting factors, conducting surveys with listed enterprises in Vietnam. Based on our findings, we will propose solutions to enhance the quality of financial statements. Our case study focuses on listed enterprises in the Vietnam Stock market, as it is the primary and most effective platform for attracting direct investment through M&A activities and investment funds.

**KEYWORDS:** quality, financial statement, listed enterprises, impacting factors, Vietnam Stock market

### 1. INTRODUCTION

Vietnam's Stock Market has grown significantly throughout nearly 23 years since July 28<sup>th</sup>, 2000 – only two stocks were traded in the beginning, compared with 866 listed companies. It has been attracting many domestic investors and becoming a "crucial channel for companies that want to raise medium- and long-term capital". Just see some facts about the rate of increasing capital since the first date launching in the stock market of some companies: 1.719% of VIC, 1.694% of REE, 1.449 of ITA, 972% of KDC and 798% of DRC etc. And we all can believe that the positive economic picture will translate into continued stock gains when Deutsche Bank said in a note that they think Vietnam will achieve its impressive macro mix target of 6.2 percent growth and below 5 percent inflation in 2015.

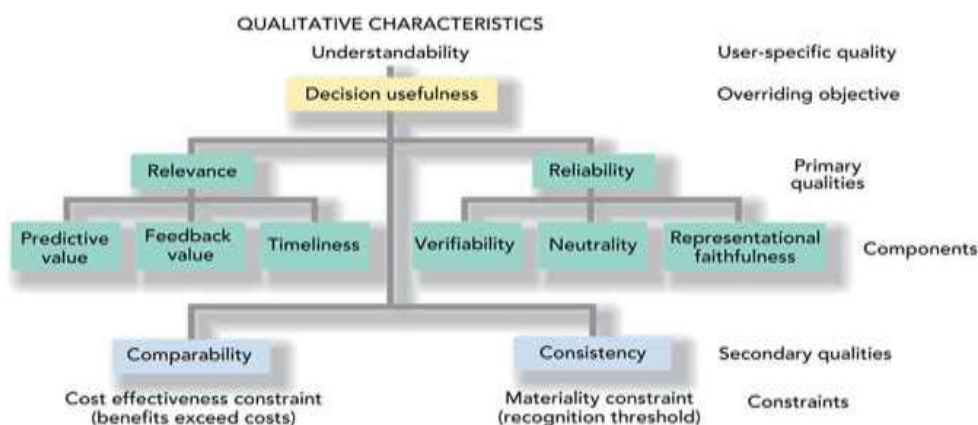
Everyone knows that investors should analyse the company's financials, business activities, history and management in the stock market before buying stocks. But in the research paper on Vietnam's stock exchange Roberta Karmel, a Brooklyn Law School professor and a former commissioner of the U.S. Securities and Exchange Commission, said that there has always been an element of gambling in stock markets everywhere. In Asian societies, it is more prevalent. And this gambling mentality may explain why some Vietnamese refer to themselves as "playing" rather than "investing" in stocks. But not all investors in the Vietnam stock market do the same things, especially foreign investors or funds. Instead of buying a stock like "play gamble", they consider all information they can collect for a company before making investment decisions. And, of course, one of the crucial channels which they can refer to support their investment decisions is published financial statements. So what happens if the quality of financial statements is so bad? Which potential factors may influence the quality of financial statements of Vietnamese listed companies? Which solutions are recommended to improve the quality of financial statements of Vietnamese companies listed in the stock market?

### 2. LITERATURE REVIEW

The content of financial statements is accounting information, and according to Jame A.Hall(2011) users consider the value of information by its reliability. Because the purpose of the information is to lead users to the desired action, it must possess

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certain attributes such as relevance, accuracy, completeness, summarisation and timeliness. And when these attributes are consistently present, information has reliability and provides value to users (Jame A.Hall, 2011, 19). Because information is often defined simply as processed data, accounting information is processed by accounting systems. According to Gelinas and Dull (2010), accounting information is facts and numbers being presented in financial reports and is helpful for end users to make decisions. The first stated financial reporting objective of *SFAC 1* is to provide comprehensible information to those who reasonably understand business and economic activities and are willing to study the information (Spiceland, Sepe, Tomassini).



Accounting information is measured by relevance, accuracy, completeness and timeliness. There has been so much research about internal factors influencing the quality of accounting information, such as accounting information systems, the leadership of the organisation, and organisational structure (Sacer et al., 2006; Laudon & Laudon, 2014; Wang & Yeoh, 2009). In addition, other external factors also influence the quality of accounting information, such as the quality of the audit and legal system (Iana et al., 2013; Heidi, 2001). When discussing with some professors and experts who are lecturers of Accounting – Auditing Dean in universities, auditors, chief accountants or financial directors who have been working in listed companies in the Vietnam stock market, we concluded the research model below:

- + The organisation culture includes organisational structure, working environment, compensation and benefit, commitment, rule etc., can affect the quality of accounting information, which also affect the quality of financial statements;
- + The resources include highly qualified human resources, technologies, information system etc. can affect the quality of accounting information, which also affect the quality of financial statements;
- + Internal control such as strict internal rules, operation of internal auditing, management of above level etc., can affect the quality of accounting information so that also affect the quality of financial statements;
- + The quality of auditing companies includes high credit qualified auditors, the independence of auditors with enterprises, the size of auditing companies etc., can affect the quality of accounting information so that also affect the financial statements;
- + The legal system, such as Vietnamese Accounting Law, articles, circulars etc., can affect the quality of accounting information, which also affects the quality of financial statements;

Hereinafter is the conclusion of the research model:



Figure 1 - The theoretical framework of the study

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### 3. FINDINGS

With the sample as 200 investors, chief accountants, financial managers, directors of listed companies in Vietnam and 194 respondents, we use the Linker Scale to measure the positive association between these factors such as organisational culture, resources, internal control, quality audit and legal system and the quality of financial statements; with some variables including 18 independent variables and three dependent variables.

Using software SPSS 20.0 with Exploratory Factor Analysis, we have some results as below:

- $0.5 < KMO = 0.658 < 1$
- Sig.  $< 0.05$
- % cumulative variance = 63.48%

**Table 1 . KMO and Bartlett's Test**

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.658
	Approx. Chi-Square	85.260
Bartlett's Test of Sphericity	Df	3
	Sig.	.000

Renamed dependent variables into five scales and continued testing their reliability; we have all five scales with the appropriate reliability (their Cronbach's Alpha  $> 0.6$  and Corrected Item-Total Correlation  $> 0.3$ ) as below:

- RES (including variables RES1, RES2, RES3 and RES4);
- ORC (including variables ORC1, ORC2, ORC3 and ORC4);
- QUA (including variables QUA1, QUA2, QUA3 and QUA4);
- ITC (including variables ITC1, ITC2 and ITC3);
- LES (including variables LES1, LES2 and LES3);

Continue with Multiple Regression Analysis (MRA); we have the final result below:

For Coefficients testing: 5 of variables F1 to F4 have Sig.  $< 0.01$ , so they are appropriate meaning with variable SAT (general satisfaction), and their credit is 99%; variable F5 have Sig.  $= 0.014 < 0.05$ , so it is appropriate meaning with variable SAT (general satisfaction), and its credit is 95%.

**Table 2. Coefficients<sup>a</sup>**

Model	Unstandardised Coefficients		Standardised Coefficients Beta	T	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics		
	B	Std. Error				Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF	
(Constant)	7.817E-017	.052		.000	1.000	-.102	.102						
REGR factor score 1 for analysis 1	.269	.052	.269	5.204	.000	.167	.371	.269	.355	.269	1.000	1.000	
REGR factor score 2 for analysis 1	.546	.052	.546	10.556	.000	.444	.648	.546	.610	.546	1.000	1.000	
REGR factor score 3 for analysis 1	.291	.052	.291	5.624	.000	.189	.393	.291	.379	.291	1.000	1.000	
REGR factor score 4 for analysis 1	.160	.052	.160	3.093	.002	.058	.262	.160	.220	.160	1.000	1.000	

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REGR factor score analysis 1	5	.129	.052	.129	2.485	.014	.027	.231	.129	.178	.129	1.000	1.000
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a. Dependent Variable: REGR factor score 1 for analysis 2

For Model appropriation testing, we have the adjusted R square is 0.484, which means that 48.4% of the change of satisfaction with the quality of financial statements is explained by variables from F1 to F5.

**Table 3. Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. The error in the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. Change	
1	.705 <sup>a</sup>	.497	.484	.71846357	.497	37.179	5	188	.000	1.954

a. Predictors: (Constant), REGR factor score 5 for analysis 1, REGR factor score 4 for analysis 1, REGR factor score 3 for analysis 1, REGR factor score 2 for analysis 1, REGR factor score 1 for analysis 1

b. Dependent Variable: REGR factor score 1 for analysis 2

For ANOVA, we have Sig. < 0.01, so we can conclude that independent variables have a linear correlation with the dependent variable.

**Table 4. ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	95.956	5	19.191	37.179	.000 <sup>b</sup>
	Residual	97.044	188	.516		
	Total	193.000	193			

a. Dependent Variable: REGR factor score 1 for analysis 2

b. Predictors: (Constant), REGR factor score 5 for analysis 1, REGR factor score 4 for analysis 1, REGR factor score 3 for analysis 1, REGR factor score 2 for analysis 1, REGR factor score 1 for analysis 1

## 4. DISCUSSION AND CONCLUSIONS

Based on the results above, we have the rank of importance of factors as below:

**Table 5. Contribution of variables' importance**

Independent variable	Value	%
ORC (F2)	0.546	39.1
QUA (F3)	0.291	20.9
RES (F1)	0.269	19.3
ITC (F4)	0.160	11.5
LES (F5)	0.129	9.2
<b>Total</b>	<b>1.395</b>	<b>100%</b>

So we suggest some solutions for increasing the quality of financial statements of listed companies in the Vietnamese stock market to help them call more and more investors' interest.

Firstly, the enterprises should build a stable and robust organisational culture to have a high-quality financial statement. The more stable board of directors, the more improving commitment to the working environment, which is an essential factor directly affecting to information system. As a result, a higher-quality financial statement should be produced. Besides, employee participation also plays a crucial role in controlling the information reported, affecting the quality of financial statements. In Vietnam, the organisational culture still needs to be more popular, and sometimes this factor is not considered seriously. Moreover, job-hopping is still prevalent in Vietnam, even for high-level positions. So if the owners of enterprises do not care

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about compensating benefits and other rights of employees such as spiritual life, relaxation activities in communities etc., their human resources may be enticed by big foreign companies with more attractive offers.

Secondly, nowadays, the role of a third party who guarantees the quality of listed companies' financial statements has become increasingly important. Investors cannot sincerely contact enterprises' internal activities, so they only expect audited financial statements when making investment decisions. As usual, auditors would like to work professionally in big audit enterprises. So as a result, more significant audit enterprises have more talented auditors, producing more and higher quality audited financial statements. Another point to consider is that an auditor cannot know all, so choosing a suitable specialised audit firm can help enterprises to have higher quality audited financial statements. In Vietnam, we must recognise Big Four's important role, but it does not mean there is no chance for other small audit enterprises. Suppose they invest more in building their credit, images and high-level auditors by reasonable remuneration policy. In that case, they will develop their size and recognition in auditing.

Thirdly, concerning to resources of enterprises, we need good employees to have good products. So to have good quality financial statements, enterprises should continuously improve the quality of employees. It means that they should not only recruit excellent and suitable candidates but also train more and more during their work times. And one cannot make bricks without straw, so enterprises should also invest in hardware and software to help control and restore information more and more safely, being processed quickly and accurately. In Vietnam, some enterprises do not invest enough in management information systems because of limited financial resources. Its limitation creates difficulties for them when doing business in a highly competitive environment. In addition, Vietnamese enterprises need to care about the budget for training employees; this will put them in trouble when developing their size in the future.

Fourthly, when discussing internal control, investors immediately think about the supervisory board's role, which works independently with the board of directors. But this supervisory board role is so faint in Vietnam, primarily when some supervisory board members work inside enterprises. In the future, enterprises should invite more independent members outside who have suitable competence to increase the credit quality of financial statements. Besides, segregation of duties, responsibility for authorisation and rotation duties should also be considered and done in compliance.

Last the legal system's role in supporting and guiding the quality of financial statements. More specific and detailed laws, regulations, circulars, and decrees can help have higher-quality financial statements. In addition, the Vietnamese legal system must be increasingly severe and tight concerning fraud or cheating in financial statements. These errors should be considered criminal to prevent enterprises from cheating and stealing investors' assets. The responsibilities of the board of directors, supervisory board and auditors must be mentioned in-laws. This strong warning can help them be more careful when declaring the audited financial statements with higher quality.

In conclusion, there are still other factors mentioned above, such as the size of the enterprise, the other factors belonging to organisational culture etc., which can affect the quality of financial statements. Due to the limit and resources, the study only fulfils some aspects concerning this problem. In the future, we hope that more studies will focus more on details to find out and suggest more good solutions to help listed enterprises call for more investment capital.

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