Timeliness of Financial Reporting in the Energy Sector

Robert W. McGee, Barry University

Introduction

Transparency is one of those terms that has many facets. It is used in different ways. It can refer to the openness of governmental functions. It can refer to a country's economy. Or it can refer to various aspects of corporate governance and financial reporting. The OECD (1998) lists transparency as one element of good corporate governance. Kulzick (2004) and others (Blanchet, 2002; Prickett, 2002) view transparency from a user perspective. According to their view, transparency includes the following eight concepts:

! Accuracy

! Consistency

! Appropriateness

! Completeness

! Clarity

! Timeliness

! Convenience

! Governance and enforcement

This article focuses on just one aspect of transparency – timeliness.

The International Accounting Standards Board considers timeliness to be an essential aspect of financial reporting. In APB Statement No. 4, the Accounting Principles Board (1970) in the USA listed timeliness as one of the qualitative objectives of financial reporting disclosure. APB Statement No. 4 was later superseded but the Financial Accounting Standards Board continued to recognize the importance of timeliness in its Concepts Statement No. 2 (1980). The U.S. Securities and Exchange Commission also recognizes the importance of timeliness and requires that listed companies file their annual 10-K reports by a certain deadline.

The issue of timeliness has several facets. There is an inverse relationship between the quality of financial information and the timeliness with which it is reported (Kenley & Staubus, 1974). Accounting information becomes less relevant with the passage of time (Atiase, Bamber & Tse, 1989; Hendriksen & van Breeda, 1992; Lawrence & Glover, 1998).

Studies show mixed conclusions regarding the relationship of quickness of reporting and the nature of the information being reported. Some studies show that good news is reported before bad news whereas other studies show that bad news is reported before good news.

There is some evidence to suggest that it takes more time to report bad news than good news (Bates, 1968; Beaver, 1968), both because companies hesitate to report bad news and because companies take more time to massage the numbers or resort to creative accounting techniques when they have to report bad news (Givoli & Palmon, 1982; Chai & Tung, 2002; Trueman, 1990). Stated differently, there seems to be a tendency to rush good news to press, such as better than expected earnings, and delay the reporting of bad news or less than expected earnings (Chambers & Penman, 1984; Kross & Schroeder, 1984). Dwyer & Wilson (1989) found this relationship to hold true for municipalities. Haw, Qi and Wu (2000) found it to be the case with Chinese companies. Leventis and Weetman (2004) found it to be the case for Greek firms.

However, Annaert, DeCeuster, Polfliet & Campenhout (2002) found that this was not the case for Belgian companies and Han & Wang (1998) found that this was not the case for petroleum refining companies, which delayed reporting extraordinarily high profits during the Gulf crisis of the 1990s, perhaps because political repercussions outweighed what would otherwise have been a good market reaction. Rees & Giner (2001) found that companies in France, Germany and the UK tended to report bad news sooner than good news.

A study by Basu (1997) found that companies tend to report bad news quicker than good news, presumably because of conservatism. Gigler & Hemmer (2001) discuss this point in their study, which finds that firms with more conservative accounting systems are less likely to make timely voluntary disclosures than are firms with less conservative accounting systems.

Building upon the Basu study (1997), Pope and Walker (1997) found that there were cross-jurisdictional effects when extraordinary items were either included or excluded, using US and UK firms for comparison. Han & Wild (1997) examined the potential relationship between earnings timeliness and the share price reactions of competing firms. But Jindrichovska and Mcleay (2005) found that there was no evidence of conservatism in the Czech accounting system when it came to reporting bad news earlier than good news, presumably because the Czech tax system offers little incentive to do so. Ball, Kathari and Robin (2000) found that companies in jurisdictions that have a strong shareholder orientation tend to disclose earnings information sooner than companies in countries operating under a legal code system.

There is also a relationship between the speed with which financial results are announced and the effect the announcement has on stock prices. If information is released sooner, the effect on stock prices is more pronounced. The long the time lapse between year-end and the release of the financial information, the less effect there is on stock price, all other things being equal (Ball & Brown, 1968; Brown & Kennelly, 1972). This phenomenon can be explained by the fact that financial information seems to seep into the stock price over time, so the more time that elapses between year-end and the release of the financial reports, the more such information is already included in the stock price.

Some countries report financial results faster than other countries. DeCeuster & Trappers (1993) found that Belgian companies take longer to report their financial results than do Anglo-Saxon countries. Annaert, DeCeuster, Polfliet & Campenhout (2002) found this to be the case for interim information as well. Companies can report financial results faster on the internet and the information can be more widely disbursed but posting two-year-old annual reports does nothing to improve timeliness (Ashbaugh, Johnstone & Warfield, 1999).

Atiase, Bamber & Tse (1989) found that large companies report earnings faster than small companies and that the reporting of earnings has a more significant market reaction for small firms than for large firms. In a study of Australian firms, Davies & Whittred (1980) found that small firms and large firms made significantly more timely reports than medium-size firms and that profitability was not a significant variable.

Whittred (1980) found that the release of financial information for Australian companies is delayed the first time an audit firm issues a qualified report and that the extent of the delay is longer in cases where the qualification is more serious. Keller (1986) replicated that study for US companies and found the same thing to be true. Whittred and Zimmer (1984) found that it took Australian firms in financial distress a significantly longer time to publish their financial information. A study of more than 5,000 annual reports of French companies found that it took longer to release audit reports where there had been a qualified opinion, and that the more serious the qualification, the greater the delay in releasing the report (Soltani, 2002).

Krishnan (2005) found that the audit firm's degree of expertise has an effect on the timeliness of the publication of bad earnings news. Audit firms that specialize in the industry in which the company operates are more timely in reporting bad financial news than are audit firms that have less industry expertise.

Timeliness

One measure of transparency and quality of financial reporting is timeliness. The lapse of time between a company's year-end and the date when financial information is released to the public is related to the quality of the information reported. Issuing excellent, accurate and comprehensive financial information two or three years after year-end is not as desirable as issuing less comprehensive and complete financial information a few months after year-end. Financial information becomes stale after a few months, and certainly after two or three years. The more stale it is, the less relevant it is to potential investors and creditors.

There are a number of reasons for the time lag between year-end and the issuance of the audit report and the publication of financial information. Ashton, Graul and Newton (1989) identified auditor size, industry classification, the presence or absence of extraordinary items and the sign of net income as some factors that influence timeliness. To that one might add the culture, political and economic system of the country in which the particular firm is located. One purpose of the present study is to determine whether Russian companies are any less timely in the speed of financial reporting than companies in Western Europe and the United States.

In the not too distant past, some Russian enterprises were criticized for waiting too long to issue their financial reports. Some Russian companies did not issue their annual reports until a year or more after the end of the year. In some cases, Russian firms did not even have annual audits.

Table 1. **Russian Oil, Gas & Energy Companies**

Company	Days Delay in Issuing Audit Report
Gazprom (2004) www.gazprom.ru	139
Lukoil (2004) www.lukoil.ru	144
RAO Unified Energy System of Russia (2004) www.rao-ees.ru	179
Sibneft (2004) www.sibneft.ru	181
Tatneft (2004) www.tatneft.ru	178
Mosenergo (2004) www.mosenergo.ru	109
Lenenergo (2004) www.lenenergo.ru	126
Novatek (2004) www.novatek.ru	147
Irkutskenergo (2004) www.irkutskenergo.ru	81
TNK-BP (2004) www.tnk-bp.ru	180
Rosneft (2004) www.rosneft.ru	175
Transneft (2004) www.transneft.ru	145
Average	**148.7**

Table 2. **Days Delay in Releasing Financial Information Non-Russian Companies in Petroleum Refining**

Company	Days Delay in Issuing Audit Report
BP [UK] (2004) www.bp.com	38
Exxon Mobil [USA] (2005) www.exxonmobil.com	59
Royal Dutch/Shell Group [Netherlands] (2005) www.shell.com	67
Total [France] (2005) www.total.com	74
Chevron Texaco [USA] (2005) www.chevrontexaco.com	58
ConocoPhillips [USA] (2005) www.conocophillips.com	57
Sinopec [China] (2005) www.sinopec.com.cn	90
ENI [Italy] (2004) www.eni.it	175
Valero Energy [USA] (2005) www.valero.com	60
Marathon Oil [USA] (2005) www.marathon.com	62
Statoil [Norway] (2005) www.statoil.no	68
Repsol YPF [Spain] (2004) www.respol-ypf.com	91
Petrobras [Brazil] (2004) www.petrobras.com.br	123
Average	**78.6**

Measuring timeliness is relatively easy. The present study measures timeliness by computing the number of days that elapse between the company's year-end and the date of the auditor's report. Data for some large Russian companies in the energy sector are calculated and compared to those of selected non-Russian companies in the petroleum refining industry.

Comparing Russian and non-Russian company data

Data were collected from company websites. The dates used were the dates of the auditor's report, which is not necessarily the same as the date the financial information was released to the public. However, it was not possible to determine when the annual financial reports were published, so the date of the audit opinion was selected as a surrogate. Using this date also made it possible to compare Russian and non-Russian company data.

Table 1 shows the number of days it took Russian companies to issue their audit report. The range was 81 to 181 days, with an average of 148.7 days. In other words, assuming the company's year-end was December 31, some companies published their audit opinion as early as 22 March while others took until 30 June. The average company from this group published its audit report on 29 May.

Non-Russian companies were taken from the *Fortune Global 500* list for 2005, which was published in the July 25, 2005 issue of *Fortune*. The *Fortune* article classified the selected companies as being in the petroleum refining industry. Data for the most recently reported year was chosen. Many companies had already issued their 2005 annual reports by the date this article was written but a few have not. The year in parentheses indicates the year of the annual report.

Table 2 shows the date of the most recent audit report for non-Russian companies in the petroleum refining industry. The range was 38 to 175 days, with an average of 78.6 days. In other words, assuming the company's year-end was December 31, some companies published their audit opinion as early as 7 February while others took until 24 June. The average company from this group published its audit report on 20 March, or about 70 days before the average Russian energy company.

Chart 1 shows the differences between Russian and non-Russian companies graphically.

Concluding comments

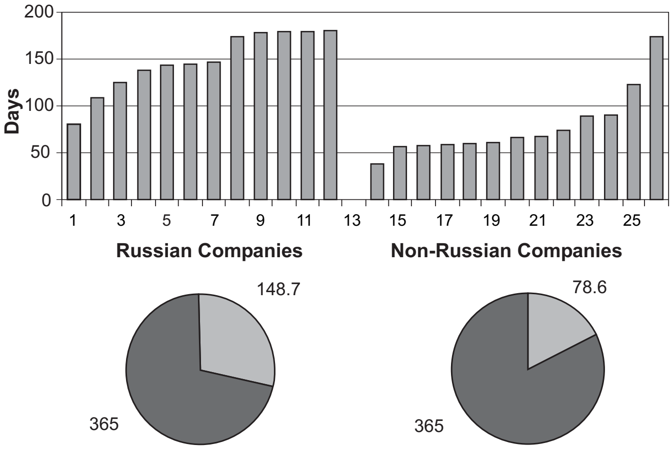
Russian companies take more than two months longer to issue their financial statements than do non-Russian companies, which makes their shares less desirable in the international marketplace. The information is not as fresh if its release is delayed by 149 days, which is the average delay. That is 89 percent longer than it takes non-Russian companies to issue their financial statements.

However, this lag in issuing financial statements may not be as bleak as first appears. Early release of financial information is extremely important in a country like the United States, where a large percentage of capital is equity capital. But many Russian companies rely more on debt capital for financing, which makes the timely release of audited financial statements somewhat less important.

Russian companies must satisfy a different audience – bankers rather than shareholders. Although the views, wants and needs of shareholders are important in Russia, there is a tendency to pay more attention to bankers if that is where the capital is coming from. Bankers have access to financial information that shareholders do not. If bankers want financial information that is not reported in the annual financial statements, all they need do is demand it as a condition of giving the loan.

Another factor that reduces the importance of this difference in the timeliness of financial reporting is the attractiveness of investment in the industry. Energy has become an increasingly important industry in recent years. Profitability has increased and is expected to remain good for years to come. It is not likely that energy prices will drop significantly. That being the case, potential investors might not place as much emphasis on timely financial reporting as would be the case in a less profitable industry. Thus, although Russian energy companies need to make an effort to be more timely in their financial reporting, the fact that they are not as quick to report financial results as their non-Russian competitors is not necessarily fatal.

Chart 1.**Days Delay**



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