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Objektif utama jurnal ini diterbitkan ialah untuk menggalakkan kakitangan akademik menerbitkan penulisan ilmiah bagi menambah bahan bacaan yang meliputi ilmu dari pelbagai bidang. Selain itu, usaha ini dibuat agar budaya penulisan dapat dipupuk di kalangan kakitangan akademik sesuai dengan tarafnya sebagai sebuah universiti.

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KANDUNGAN

DARIPADA KETUA PENYUNTING

Assalamualaikum Warahmatullahi Wabarakatuh

Y.A.B. Dato' Seri Setia Di Raja Dato' Seri Syed Razak Syed Zain, Menteri Besar Kedah telah melakukan lawatan rasmi ke UiTM Cawangan Kedah pada 3 Julai 2003 yang lalu. Sempena lawatan beliau, Pengarah Kampus telah memberi taklimat mengenai kemajuan dan sumbangan UiTM Cawangan Kedah melalui penyelidikan dan perundingan terhadap negara khususnya negeri Kedah. Kata alu-aluan Y. Bhg. Dato' Naib Canselor UiTM dalam buku "UiTM Kedah Sepintas Lalu" sempena lawatan Menteri Besar Kedah telah menekankan peranan UiTM terhadap negara terutamanya dalam bidang penyelidikan dan perundingan untuk membantu kerajaan negeri bagi memajukan negeri masing-masing. Oleh itu, satu saluran perlu diwujudkan bagi mendokumentasikan hasilan penyelidikan dan perundingan supaya ianya boleh dijadikan sumber rujukan oleh semua pihak yang berminat.

Justeru itu, UiTM Kedah telah menerbitkan jurnal akademik bertajuk 'Wahana Akademik' untuk menampung keperluan penerbitan tersebut. Untuk itu, Jawatankuasa Jurnal Akademik, Universiti Teknologi MARA Cawangan Kedah amat mengalu-alukan hasilan penulisan akademik samaada hasil penyelidikan dan perundingan ataupun analisa *'literature'* untuk dimuatkan dalam penerbitannya.

Wan Faizah Wan Abdullah

CORPORATE FINANCIAL REPORTING: THE CHALLENGES IN THE NEW MILLENNIUM

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ABSTRACT

The objective of the paper is to look at several challenges posed by the new information technology towards corporate financial reporting in the era where knowledge assets constitute a larger portion of a firm's worth. The two challenges to corporate financial reporting discussed are the contents of corporate financial reports and the new medium of disseminating the corporate report through the World Wide Web.

The challenges in the contents of corporate reports include the need to meet the new requirements for financial reporting such as to account for intellectual assets, and the need to use soft data in managers' performance evaluation with particular emphasis on the balanced scorecard approach. The third challenge is posed by the demand to serve the information needs of global investors through the World Wide Web in which the security issues are discussed.

It is therefore concluded that a national consensus need to be reached with regard to the treatment of the intellectual capital in the corporate reports. Clear guidelines on what to measure, how to measure, and how to account for the intellectual capital in the report need to be addressed. Furthermore, there is also a need to incorporate multiple measures in evaluating the managers' performance without depending too much on the financial figures. The system of a balanced scorecard is one of the alternatives that fulfil the purpose. Lastly, the security threats of presenting the corporate report over the web need to be addressed by tightening the firm's internal control system.

Key words **:** ***Globalization, Corporate Financial Reporting, Web-Based Reporting, Security Threats, New Requirements, Intellectual Capital, Balanced Scorecard***

INTRODUCTION

Globalization and advancements in information technology have transformed the industrial economy into a knowledge and information based service economy, where knowledge and information are the key ingredients in creating wealth. Organizations now have moved from national, multi-national or trans-national players to global players and the key assets of most of the organizations today are knowledge and core competencies from which all products and services are derived. Realizing this, there is a need to reflect on all those changes posed by the advancements in the digital economy and to account for new things such as knowledge capital base in the scope of financial reports prepared by a company for the users of the financial statements. Several challenges of incorporating web-based reporting to reach greater audience need to be addressed.

Besides that, a traditional approach of evaluating the performance of managers based on accounting numbers needs to be revamped and a multi-disciplinary approach of evaluating performance needs to be adopted. The balanced scorecard approach in particular helps to incorporate a multi-disciplinary approach in evaluating the manager's performance. This is more appropriate in the new era of the digital age where knowledge and innovations are almost a must in order to stay competitive.

The challenges posed by the new medium of disseminating corporate reports should be tackled by companies involved in web-based reporting to meet the needs of global investors. The contents of financial reports should reflect on information such as knowledge and intellectual assets, and the soft data necessary for the manager's performance evaluation. It is therefore important for the managers to be aware of the function of the corporate report and to understand the rationale for the preparation of such reports in order to incorporate useful information in it.

RATIONALE OF CORPORATE FINANCIAL REPORTING

Corporate financial reporting is necessary not only to satisfy statutory requirements, but also to inform the owners of the business and other investors (who are increasingly divorced from the management of the business in larger organizations) what has happened in the business and how it has performed. There is also a perceived need to report on the activities and plans of the organization to a wider community of stakeholders. Reporting, therefore, is partly concerned with an organization's accountability and with satisfying its informative and public relations needs. Reporting is also concerned with the performance of the organization both in the immediate past, and plans for the immediate future.

It is widely held that the basic objective of financial statements is to provide useful information for making economic decisions. In other words, the role of financial statements is to provide factual and interpretive information about transactions and other events, which is useful for predicting, comparing and evaluating the earning power of the business.

Some reasons that necessitate the preparation of financial reports could be associated with the agency theory. According to this theory, an agency relationship may exist between managers and other groups such as shareholders, lending institutions, auditors, stock exchange officials and government institutions. The agency theory in financial reporting considers mainly the stewardship demand for information. It concentrates more on the relationships in which the welfare of one person, the principal (owner/shareholder), is entrusted to another, the agent (manager). The demand for stewardship information relates to the desire to motivate the agent. Therefore, the corporate financial report is important to show the extent to which those stewardship roles are fulfilled by the manager.

As an agency relationship also involves the relationship between the lender and the manager, it is argued in the agency theory that, as gearing ratio increases, managers have a greater incentive to transfer wealth from creditors to themselves and existing shareholders, given the existence of information asymmetry (Jensen and Meckling, 1976). The corporate financial report plays a role here as the contract imposed on the lender and manager relationship to restrict the manager's opportunistic behaviour (the debt covenant) is usually based on accounting numbers and because extensive disclosure is often required by the creditors. Thus, the corporate financial reports serve as mechanisms for the lender to see whether the debt covenants are violated resulting in costly re-negotiation of the contract.

Realizing the potential roles of corporate financial reporting to various parties, it is important for the managers to meet the challenges posed by the advancements in information technology and the globalization of the world economy particularly with regard to the new medium of disseminating corporate reports through the web and to reflect on the new requirements in terms of its contents which include intellectual capital and knowledge based assets.

THE NEW MEDIUM OF CORPORATE FINANCIAL REPORTING AND ITS CHALLENGES.

Nowadays, more businesses are shifting their operations to the web or e-commerce and we have seen the rapid emergence of brick and click companies as well as the dot coms. As these companies serve the global business, their operations involve reaching customers worldwide and this at the same time, gives the opportunities to attract investors worldwide. Realizing the need to serve the information needs of global investors, more businesses are shifting from the traditional medium of disseminating corporate reports to web-based reporting in order to reach the global investors quicker and in a timely manner. This has posed several challenges with regard to web-based reporting as discussed below.

First, we will examine the impact of information technology (IT) on corporate financial reporting. Several authors speculate that the impact of IT on corporate financial reporting includes the expectation of multiple measures reporting, database reporting, and online reporting (Dodgson, Sangster and Xiao, 1997). The Securities and Exchange Commission (SEC) in the United States, for example, now requires online companies to submit all information (quarterly and annual reports) electronically.

Companies that use web-based reporting will encourage the establishment of a one-to-one relationship with the stakeholders/investors or users. This feature is not available in the traditional annual report and it enables users to make any query immediately upon receiving the information. The reports will be made available to various users anywhere in the world, and this will pose a challenge in terms of reporting security and possible intruders in the system that could alter the information presented to the users. An effective internal control system should be established in order to keep track of the possible alterations to the financial reports. The security issues with regard to web-based reporting are discussed next.

THE SECURITY ISSUES OF WEB BASED REPORTING

Web based reporting opens the possibility for manipulations of the accounting information presented over the web. This includes: (a) access by illegitimate users to the computer network and the possible alterations of the data, (b) invasions by unauthorized employees of data and transmission of files over the communication lines which involves theft or destruction of data files, and (c) the threats of computer viruses with potential great damages to data files and the computer system itself.

Misstatement arising from fraudulent financial report is one of the issues that should be taken into consideration. The misstatement and fraud arising from the information system may be categorized as "input tampering", and "throughput/ output tampering" (Pessini, 1999). Input tampering involves entering false or fraudulent data into an information system. Throughput tampering involves the alteration of computer program codes. One example is programming the computer to round all dollar-and-cent amounts down and accumulate fractions of cents in an account to which the fraudster has access to. Output tampering is stealing data from an information system such as customer lists, merger plans, trade secrets, etc. Here, the internal control system should ensure that there are regular physical controls over equipment and files in order to protect the system. Any intentional misstatements or omissions of amounts of disclosure in the financial statements would likely be deceiving users of accounting information.

Internal auditors should also ensure that only legitimate users have access to the computer network and associated data. Data stored in files and transmitted over communication lines are subject to invasions by unauthorized employees or other parties. Also at stake is the security of all electronic commerce conducted via websites. One control that addresses this problem is encryption. Any process of encryption endeavours to create a ciphertext (an encoded, unreadable string of characters from a plaintext (the original character of the message) (Banarjee, 1999). This is the process of encoding information, and security software is available to perform this function. The most popular encryption scheme for web-based transactions is the secure sockets layer (SSL) (Lyold, 1999).

Internal auditors should also assure proper virus protection. Once a computer is infected by a virus, many types and levels of damage can result. Some viruses might destroy all the files on a computer's hard drive. Thus, the most difficult to recover from are virus infections, which gradually corrupt data over a period of time without ever revealing their presence. The internal control should ensure that an effective control is incorporated with regard to the information stored in the computer system in order to avoid the threats from computer viruses.

Besides trying to overcome the security problems with regard to web-based reporting, managers also need to consider the breadth of the new information that should be included in the corporate financial report in this new era. It includes the need to account for the intellectual capital, and to reflect on the multiple perspectives on performance measures for the managers. The following discussion will elaborate on these issues.

THE NEW REQUIREMENTS FOR CORPORATE FINANCIAL REPORTING

Some parties argue that the shift to the new economy presents some challenges to the existing accounting system and that the requirements for external financial statements impede the financing of knowledge-based companies that produce high value-added goods and services through the application of science and technology. They argue that the statements do not reflect the real value of these companies. These issues have been highlighted the most in the growth of the new economy, in which the crucial aspects in defining wealth-creating characteristics of companies are knowledge, technology, information and intangible assets.

Brennan argues that attention should be paid to the 'invisible capital' of knowledge-based enterprises. Financial statements do not recognize the knowledge and skill levels of the employees, training, technological development, and technology licensing agreements or marketing and distribution investments as assets. All of these, however, are valuable to the company and necessary for its future success as they are its 'invisible capital'.

The new economy is forward-looking and changes rapidly. Accounting systems are poor at dealing with the main characteristics of the creative modern economy - volatile, uncertain and always changing. They also suffer for being able to only record a company's historical performance, and are unable to shed any light on the potential future returns on a company's assets. This is particularly troublesome because in today's fast changing economy, a company's historical performance often has little bearing on how the company will perform in the future. Some people argue that traditional financial statements focus on the entity's ability to realize value from existing assets and liabilities and that financial statements are largely backward-looking (Business and Financial Reporting). Therefore, a new financial reporting paradigm is needed to capture and report on the entity's creation of value especially in this new era.

These problems have been recognized for many years. However, the accounting profession has generally taken a view that the benefit of additional accounting recognition of intangible assets would be offset by the precisions involved in measuring those assets.

The next discussion will explain the issue of intellectual assets, which are a large portion of these intangible assets.

INTELLECTUAL CAPITAL

Intellectual capital is the economic value of two categories of intangible assets of a company, which are organizational/structural capital and human capital. Structural capital refers to things like proprietary software systems, distribution networks and supply chains. Human capital includes human resources within the organization (i.e. staff resources) and resources external to the organization, namely customers and suppliers. The most important issues are how to measure people skills, how to differentiate between valuable and worthless knowledge, whether to treat intellectual capital as an intangible asset, and how to treat it in the financial statement.

One reason for the lack of intellectual capital reporting in the financial statement is the lack of an established and generally accepted framework for reporting. The biggest challenges in intellectual capital are determining the need to report, knowing what to report, and knowing how to report it. It is clear that the importance of this intellectual capital would necessitate the development of a consistent accounting standard on how to treat and record these assets in the financial report. The FASB in particular has given several guidelines with regard to the issues.

The next section will discuss the management reporting issues, which emphasize the use of multiple measures of performance. The use of the balanced scorecard approach is also explored.

MANAGEMENT REPORTING ISSUES

Beaver (in Crowther, 1996) has identified some changing trends in reporting and has highlighted the rapid growth in reporting and the changes in existing requirements, in which less emphasis is given on earnings and more on soft data and disclosure. He claims that there has been a shift from an economic point of view of income to an informational perspective with a recognition of social implications of an organization's activities.

Many executives have recognized the shortcomings of financially-oriented reporting and understood that a well-designed performance measurement system is essential to achieve strategic objectives. This has given rise to the 'balanced scorecard' system of organizational performance reporting. Kaplan and Norton published 'The Balanced Scorecard- Measures That Drive Performance' and the method is believed to be a suitable model for many of the reporting systems which are now labelled as 'intellectual capital' (Walker, 1996).

The balanced scorecard technique utilizes a broad set of performance measures that support current management initiatives such as customers, quality, profit, innovation, human resources, flexibility and learning. Several advantages of the balanced scorecard over the traditional financial reporting include greater flexibility, inclusion of more non-financial information, ability to communicate key factors that drive performance, customer-based reporting, and innovation/ organizational learning.

The balanced scorecard perspective on performance evaluation argues that traditional measurement systems are based on the finance functions and so have a control bias, but the balanced scorecard puts strategy and vision at the centre. They identify four components of the balanced scorecard, each having associated goals and measures, which are the financial perspective - how the firm looks at shareholders; the customer perspective - how customers perceive the firm; the internal business perspective - what the firm must excel at; and the innovation and learning perspective - can the firm continue to improve and create values.

According to Walker (1996), many limitations of financial-only performance measures are overcome in the balanced scorecard system. Management actions such as dysfunctional decisions to avoid unfavourable variances such as attempts to accelerate customer orders, and other decisions to manipulate reported revenues and expenses are difficult to hide when a broad range of performance measures are used. Moreover, corporate efforts to decentralize decision making through worker empowerment, improved efficiency and competitiveness, increased co-operation and execution strategy are consistent with the balanced scorecard approach. It forces the organization to recognize explicitly those activities that contribute to the company's success and develop suitable performance measures. However, as most businesses operate in dynamic environments, the performance measures selected need to be dynamic as well.

CONCLUSION

The globalization and advancements in information technology have changed the way the medium of corporate report is presented and have posed a new requirement for companies to account for the intangibles such as knowledge assets. However, the lack of directives and guidelines with regard to which standard and what measurement to be adopted for the intangibles such as the intellectual assets make its adoption difficult to materialize. This is due to the fact that it is difficult to measure and it is very costly to implement a system that needs to be continuously updated to reflect the changing value of the intellectual assets. Thus, it is important that an international consensus is reached towards the treatment of intellectual capital in corporate reports. Things such as what to measure, how to measure, and how to account for it in the corporate report need to be addressed if the full potential of businesses in the knowledge economy is to be realized.

As knowledge is an important asset that drives competition, it is also important to reflect this and other non-financial aspects in the managers' performance evaluation by incorporating multiple measures in evaluating their performance without depending too much on the financial figures. A system such as the balanced scorecard is one of the alternatives that could be used for that purpose. Moreover, the security threats of presenting the corporate financial report over the web need to be addressed by tightening the internal control system. All these need to be addressed carefully if businesses are to realize their full potential and opportunities in this new economy.

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