

The Accounting Environment And The Development Of Financial Reports In Commercial Banks Of Pakistan

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Abstract

The accounting environment plays a vital role in the banking sector. The present paper explores the predictive power of the accounting environment in developing financial reports. The commercial banks of Pakistan are selected as the study context. The study employs a deductive approach which is handled through a path analysis. The findings of the study show a significant and positive effect of the accounting environment's constructs like liquidity, financial leverage (FL), profitability, earnings management (EM), corporate governance (CG) and company life cycle (CLC) on the accounting environment (AE) in the commercial banks of Pakistan. The findings of a study would further provide the guidelines to policymakers and planners in developing the conducive AE, which would increase the profitability and CLC. Moreover, the study outcomes would contribute to the domain literature, i.e. finance, management and banking in the context of financial reports development.

Keywords: Accounting environment, liquidity, financial leverage, earning management, corporate governance, company life cycle.

Introduction

At present, the demand for financial reports is increased enormously. This increase is noted due to an upsurge in global business activity and the more extensive involvement in financial markets globally. In the business, the selection of international accounting policies fulfils the companies' to meet the global standards (Soomro & Shah, 2019). Accounting offers the quantitative information of the economic units. It provides good platforms and knowledge to rationalize financial decisions (Bhatti et al, 2021). In earlier years, it was famous as the business language as an official information system. These familiarity developed the attitudes and values of accounting, and the organizations considered it a robust and valuable degree. According to Azadeh (2011), AE works as a principal-agent, which raised the values of professional accountants and academic lecturers through academic connections and professional relationships to solve organizational issues. The AE offers the three main used friendly groups, accounting experts and reporter units. Every segment is developed to provide legal and financial information in the shape of reports. Such information proposes a statement to deliver the essential standard for the credentials of public sector objects that must make and approve financial reports for the determination of satisfying their accountability duty. Several reporter units stipulate events, exchanges, subsets, and happenings that would reproduce in its financial report. It must be determined in such a mode that the financial reports extant a good picture of its financial situation and performance (Liu et al, 2018). One of them is the significant way to use financial analysts and financial statements in assessing companies. Predictors observe the financial statement of the company and analyze them with proportional methods. The analysts try to investigate the production and sales channels, debt matters, financial risk and profitability. Owners of the company examine that when the company's financial risk is high, owners may sell their creditors or stocks and attempt to get less credit or returns against their lending. In Pakistan, commercial banks are regarded as significant pillars and service providers accepting deposits and offering commercial loans. The accounting department provides direct investment facilities and provides financial reports as a function of their momentous accounting practices. Therefore, the present paper aims to explore AE through liquidity, FL, profitability, EM, CG and CLC in the commercial banks of Pakistan. This article is consisting of four sections. Second section presents literature review and hypotheses derivation of study. Third section presents the research methodology. Last section presents the discussion and conclusion.

Literature review and hypotheses derivation

Profitability and liquidity are considered significant factors in the banking sector. A study was conducted by Doana and Buia (2021) in the commercial banks of Vietnam. The findings of a survey demonstrate a negative impact of profitability on the liquid asset ratio. The study further

shows the positive association of profitability with the loan-to-deposit ratio. However, the profitability of commercial banks is also suffered by several economic elements, i.e. inflation and economic growth. Likewise, in Indonesia, the ratios of leverage, profitability, activity and liquidity are essential for the value of the firms. Corporate Social Responsibility (CSR) also has a substantial role in controlling the company size and financial ratios in terms of profitability, leverage, liquidity and activity of firm value (Jihadi et al, 2021). Similarly, Saha (2021) reveals a significant and positive effect of liquidity decision constructs such current ratio on managerial performance.

On the other hand, liquidity decisions can negatively affect the networking capital ratio and positively with return on investment of the sample banks. However, Kalantonis et al. (2021) estimate the adverse effects of short-run beliefs of economic agents on leverage in both external and internal financing debt. The factors such as growth, financial stability and control for firm size negatively significantly affect market performance and accounting among non-financial firms (Roychowdhury, 2006; Silva et al, 2021). In commercial banks, loans net profit, assets, interest income and deposits are meaningfully correlated. Contrary to it, the net loans to total deposits ratio and net profit are unrelated. Besides, lending operations are the protagonist sources of profitability of the banks (Nisar et al, 2021). In the present existing situation of the COVID-19 pandemic, working capital management works as the driving force for SME performance. The empirical investigation of Rey-Ares et al. (2021) finds a convex association between economic profitability and investment. Lakhan et al. (2021a) underline finance as the significant barrier for entrepreneurs in Pakistan. According to Soomro et al. (2019), a demographic factor predicts the success of SMEs. The scholars like Soomro and Shah (2020) and Lakhan et al. (2021b) found a positive role in financial development in developing social entrepreneurship intention and financial performance. Consequently, the relevant literature underlines the different predictors that play an influential role in the development of AE. Based on relationships, we suggest the model (figure 1) for investigation.

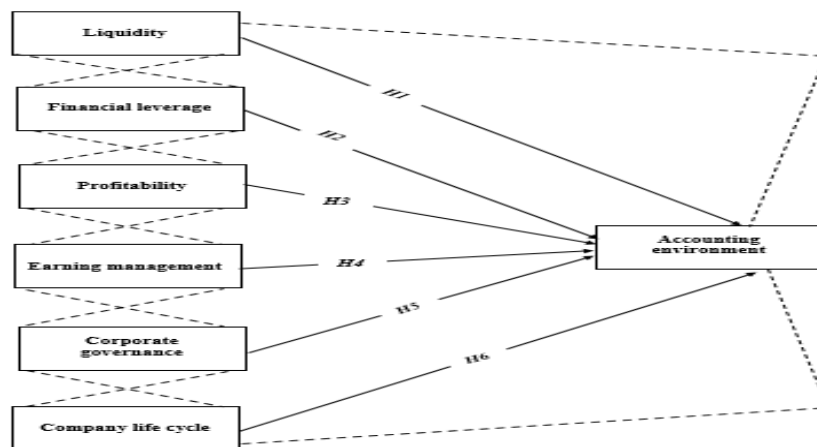


Figure (1) Conceptualized model

Accounting is a significant aspect that makes aware to financial decision-makers with the financial statement. It also provides the pinions to independent auditors and reporter units about all types of information: false, misrepresentative, and sufficient (Bachi et al, 2019). In this way, criteria of liquidity offer company's short term liquidity and are a pointer to assess the capability to pay required and urgent payments. Fundamentally, the more significant liquidity criteria offer more certainty regarding the cash assets availability for repaying a short-term debt. Thus, a prestige of such criteria has led to a threat to the steadiness of businesses and adjustment of auditors accounts (Haron et al, 2009; Valerian, 2016). According to Ye and Bai (2021), stock liquidity is not predicted through the high environmental performance of the firms.

On the contrary, low environmental firms experienced an outstanding contribution towards inverted-U shaped stock liquidity in the firms. In a similar aspect, Dahiyat et al. (2021) find a significant and powerful influence on company's size, solvency management and financial performance. Moreover, size negatively affects performance. Likewise, in manufacturing firms, a substantial and positive effect of leveraged corporate standards is observed to deliver conditional audit reports probability. In contrast, contingent audit opinion and leverage ratios have no positive connection with each other (Spathis, 2003). The scholars like Ireland (2003), Gaganis et al. (2007) and Mahd et al. (2013) claim the positive predictive power of debt ratio towards the FL. More recently, in the industrial firms of Bahrain, the empirical evidence underline the negative association between the percentage of financial performance such as earning per share and economic value-added capital restructuring with the various leverage ratios (Farooq et al, 2021). The study of Barakat (2014) highlights a statistically significant association of capital structure and return on equity with the market price.

On the other hand, there is no significant relationship found to be between sock value and FL. In the perception of numerous scholars like Kotsiantis et al. (2006) and Zureigat (2015), profitability ratios' ability is the robust predictor of both financial and economic companies' status. The findings also predict that a decrease in companies' profitability would increase the chances of a conditional audit report without considering the audit opinion as to the profitability analyst. Mahd et al. (2013) also demonstrate a meaningful and substantial association between the audit report condition clauses and profitability ratios. The Saudi Stock Exchange (Tadawul) explored EM of all firms (2014-2018) through short-term versus long-term discretionary accruals. The outcomes of the study reveal EM discretionary accruals impact the earnings for the long-term than the short-term. Generally, high-quality earnings experience for a high level of persistence. These are regarded as more timely, predictable and less volatile with a lower level of EM. However, Cug and Cugova (2021) claim a negative association between quality of earnings and EM. Issuance of a revised audit report and changes in the auditor positively and significantly related to each other (Lennox, 2000; Hudaib, 2005). In the investigation of Lin (2014), the type of audit opinion positively increases the probability. The finding of Vlashani et al. (2012) shows a significant and positive association between the likelihood of receiving audited accounts and the stock market life of registered companies. Nonetheless, the consequences of Bahman (2011)

underline a significant negative connection between the type of audit opinion and the company's business life.

Consequently, the above literature confirms the predictive power of the factors such as liquidity, FL, profitability, EM, CG and CLC towards AE (Vlashani et al, 2012; Valerian, 2016; Cug and Cugova, 2021; Farooq et al, 2021). However, these association needs confirmation in Pakistan's central banks. Based on such need, we expect:

H1. Liquidity positively and significantly predicts AE.

H2. FL positively and significantly predicts AE.

H3. Profitability positively and significantly predicts AE.

H4. EM positively and significantly predicts AE.

H5. CG positively and significantly predicts AE.

H6. CLC positively and significantly predicts AE.

Methodology

The study is based on the deductive approach that has an excellent reputation in terms of validity of facts and authentic knowledge about the situations (Soomro & Shah, 2015; Shah & Soomro, 2017). The study collected cross-sectional data through a survey questionnaire. The items of the scale are derived from the existing literature. We targeted the supervisors to study the context of commercial banks of Pakistan. We employed a random sampling strategy to target the participants. The questionnaires were distributed by personal visits and somewhere sent through emails and postal services. We applied one dependent (AE) and liquidity, FL, profitability, EM, CG and CLC as the independent variables. Before gaining the response, we have taken care of the ethical values of the respondents. They were kept confident about the usage of their reactions in keeping confidential and private. In total, we collected the 280 valid cases and proceeded to infer the results.

Data analysis and findings

We applied the AMOS version 26.0 to infer the results. We tried to conduct the relevant tests, i.e., descriptive statistics, reliability, correlations and hypotheses assessments.

Reliability insurance

We ensured the internal consistency among the items and the factor wise. By employing Cronbach's alpha, in total or overall reliability is found to be 0.878. Besides, the internal consistency for individuals' factors is noted above the suggested values of 0.70 (Hair et al, 2017; Shah et al, 2020; Soomro & Shah, 2021) (Table 1). The highest constancy is found for the AE factors (0.892) while the lowest for EM (0.789) (Table 1).

Table (1) Alpha reliability

S.No	Variables	Alpha (α)
1	AE	0.892

2	Liquidity	0.832
3	FL	0.790
4	Profitability	0.802
5	EM	0.789
6	CG	0.812
7	CLC	0.872

Note(s): α =Cronbach's alpha reliability; FL=financial leverage; EM=earning management; CG=corporate governance; CLC=company life cycle; AE=accounting environment

Descriptive statistics and correlation

We examine descriptive statistics and correlations among all constructs (dependent and independent). We looked the descriptive statistics to perceive the demographic trend of participants. About the mean, we found a high range for the liquidity variable (3.832), while lower scores are noted for EM (3.030) (Table 2). Likewise, standard deviation (1.290) is found for EM and minimum (0.012) for profitability (Table 2). Concerning Pearson's correlation, we found a significant correlation of independent constructs with dependent variables (Table 2). In this way, the preliminary data analysis ensures the meaningful and desirable relationship among all constructs. There is no multicollinearity is observed.

Table (2) Descriptive statistics and correlation

Variables	Mean	Std. deviation	1	2	3	4	5	6	7
AE	3.458	0.234	---						
Liquidity	3.832	0.623	0.453**	---					
FL	3.224	0.369	0.332**	0.360**	---				
Profitability	3.761	1.012	0.410**	0.293*	0.342**	---			
EM	3.030	1.290	0.392**	0.475**	0.149*	0.234*	---		
CG	3.092	1.210	0.320**	0.432**	0.239*	0.223*	0.398**	---	
CLC	3.283	0.882	0.398**	0.328**	0.346**	0.349**	0.459**	0.249*	---

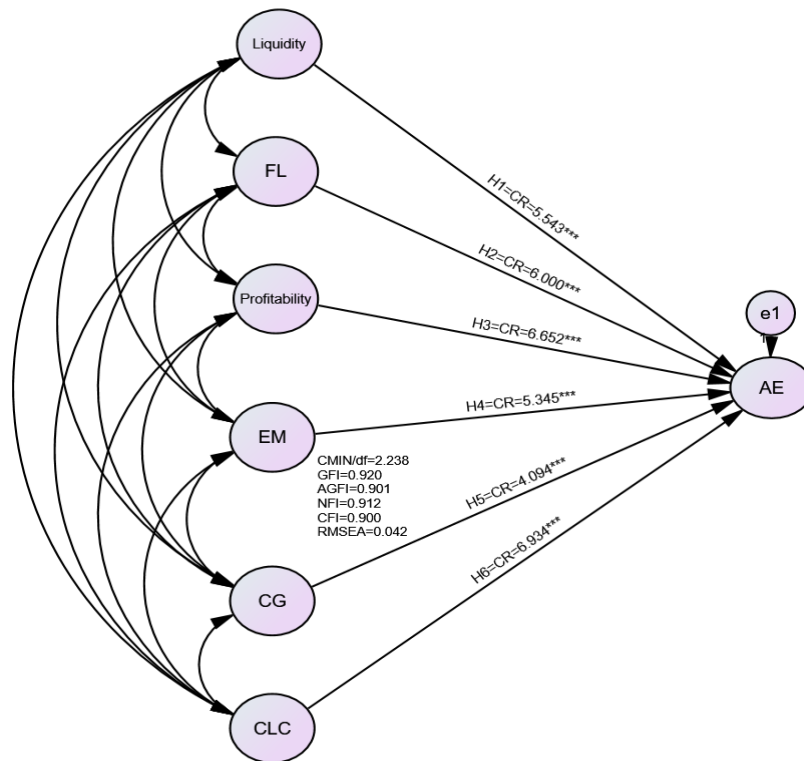
****,*Correlations are significant at 0.01 and 0.05 levels, respectively (two-tailed)**

FL=financial leverage; EM=earning management; CG=corporate governance;

CLC=company life cycle; AE=accounting environment

Initially, we confirmed the fitness of the model by ensuring the different model fit indicators. We found all indicators, i.e. CFI, GFI, AGFI, NFI, CFI and RMSEA, within the scores of acceptable ranges (see caption figure 2). The structural equation model (SEM) was applied to test the hypotheses. With regard to H1, the findings suggest a predictive power of liquidity on AE (SE=0.040; CR=5.543***; $p < 0.01$) (figure 2 and Table 3), which accepted the H1. Likewise, the analysis ensures a positive impact of FL on AE (SE=0.055; CR=6.000***; $p < 0.01$). These scores accepted the H2. Further, we found the significant effect of profitability and EM on AE (H3=SE=0.064; CR=6.652***; H4=SE=0.071; CR=5.345***; $p < 0.01$). As a result, H3 and H4 are accepted. We found predictive outcomes of CG towards AE (SE=0.079; CR=4.094***; $p < 0.01$) that accepts the H5. Concerning the final hypotheses, we found a significant positive influence of CLC on AE (SE=0.682; CR=6.934***; $p < 0.01$) (figure 2 and Table 3). Consequently, H6 is also supported by the data.

Figure (2) Path analysis



Note: FL=financial leverage; EM=earning management; CG=corporate governance; CLC=company life cycle; AE=accounting environment

Table (3) Path analysis

H.No.	IVs	Path	DV	Estimate	SE	CR	P	Decision
H1	Liquidity	→	AE	0.223	0.040	5.543	***	Accepted
H2	FL	→	AE	0.222	0.055	6.000	***	Accepted
H3	Profitability	→	AE	0.347	0.064	6.652	***	Accepted
H4	EM	→	AE	0.423	0.071	5.345	***	Accepted
H5	CG	→	AE	0.304	0.079	4.094	***	Accepted
H6	CLC	→	AE	0.453	0.682	6.934	***	Accepted

Note: SE=standard error; CR=critical ratio; p=significance level ***p<0.05 IVs= independent variables; DV=dependent variable; FL=financial leverage; EM=earning management; CG=corporate governance; CLC=company life cycle; AE=accounting environment

Discussion and conclusion

The study has purposed to investigate the factors that predict the accounting environment regarding the formation of financial reports. We selected the commercial banks of Pakistan as a study area, where we contacted supervisors for participation to serve the aim and objectives of the study. The survey questionnaire was used as an effective tool for getting responses from the respondents. We employed the different channels of survey distribution in this regard. AMOS software was used to infer the results.

With regard to hypothesis 1 (H1), the path analysis confirmed the significant association between liquidity and AE (H1 accepted). In the literature, these outcomes are accorded with numerous studies like Haron et al. (2009), Valerian (2016), Bachi et al. (2019) and Ye and Bai (2021), who confirmed the same relationship between liquidity and AE. These results reflect the importance of liquidity towards accounting in making rational decisions through a financial statement in the banks. Moreover, the study demonstrated a positive association between FL and AE (H2 accepted). Like other studies, these findings are also supported by the literature (Ireland, 2003; Gaganis et al, 2007; Mahd et al, 2013; Ye and Bai, 2021) and shows the positivity between FL and AE. Further, we found a significant association of profitability and EM with AE (H3 and H4 supported). These results are also in line with previous studies, i.e. Spathis (2003), Dahiyat et al. (2021) and Farooq et al. (2021), which are conducted in the different regions. The findings

reflect the significant role of both profitability and EM towards the formation of financial reports and then earning profit in the light of such financial statements. Finally, the results also support the positive connection of CG and CLC with AE. These outcomes are not strange but existed previously in the literature (Vlashani et al, 2012; Valerian, 2016; Cug and Cugova, 2021; Farooq et al, 2021).

In conclusion, the study's findings confirmed a significant positive impact of the factors such as liquidity, FL, profitability, EM, CG and CLC on the AE in the commercial banks of Pakistan. The study's findings would open new avenues to policymakers and planners in creating the advantageous AE to enhance profitability and CLC. Besides, the conclusions would enrich the researches on factors of stock liquidity and is also supportive for firms to inclusive evaluate their environmental-related decision making. Finally, the outcomes would improve the depth of related literature.

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