THE IRRELEVANCE OF FINANCIAL STATEMENTS FROM PARASTATALS IN TANZANIA

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Abstract: The use of financial statement information has been well documented. It is expected to facilitate decision making pertinent to the user. However, financial statement information is useful only if it is available on time. This study sought to establish whether financial statements from Tanzania parastatals were availed on time, and if not, whether the delay was significant. Using the Normal Approximation Rule to test for significance in mean time difference, it was found that parastatals delayed in releasing financial statements. The difference in mean time for their release was found to be significant at the 1 percent significance level. It is thus concluded that information provided by financial statements from Tanzanian parastatals was no longer relevant at the time it was available. Decisions made on the basis of that information, it is argued, were misguided.

INTRODUCTION

Financial statements contain information about the business prospects of an enterprise. Through their publication and release, this information is conveyed to present and potential investors, as well as to other interested parties. Generally, users of financial statements include investors, creditors, employees, customers, governments and the general public. Among the uses this information provides is the facilitation of investment decision-making, assessment of the quantity, timing and risk on returns on investments, and the evaluation of the economic resources of enterprises and results of operations of the enterprise.

Parastatals, basically state-owned enterprises, are affected by what has been referred to in the literature as agency problems. It has been argued, for example, that state-owned enterprises have a soft budget constraint, and the fact that the government often assured the survival of a state-owned enterprise dented creativity on the part of management [Kornai (1992)]. It was thus interesting to establish whether financial statements from parastatals had any significance for the major stakeholders. This study sought to establish whether financial information relating to Tanzanian parastatals was disclosed within a time that ensured usefulness, or if not, whether the delay in disclosure was significant.

LITERATURE REVIEW

Usefulness of Accounting Information

Scholarly interest has focused on the usefulness of annual and interim accounting reports, considered separately, with respect to whether more use could be derived from one than from the other. An earlier study showed that investors do not have any preference between the two types of reports [May (1971)].

The ability to inform is an important aspect of accounting information usefulness. An important use to which financial accounting information is put is in predicting results of events occurring in the past, present and future. Predictive ability is therefore one of the basic properties of accounting numbers, and predictive value is one of the qualities expected of financial statements. Studies on information content have therefore been simultaneously undertaken with those on predictive value. Predictive ability is indeed a key component of information relevance, and generally accounting numbers which are regarded as good predictors of the future and thereby facilitating better decision-making are preferable to those which do not predict equally well [Beaver, Kennelly and Voss (1968)]. Accounting information usefulness has also been suggested in relation to ability to predict share prices, through the prediction of expected future cash flows and risk [Giner, Laffarga and Larran (1996)]. Subsequent studies have generally supported the argument for usefulness of interim reports for predictive purposes. However, arguments have cropped up, that accounting information apparently has no predictive advantage over non-accounting information [Brenner and Watkins].

Similar studies have taken place during the past three decades with the focus being

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on earnings, although some have considered other aspects of financial reporting. Interest has been on information content [Beaver (1968), May (1971), Brown and Kennelly (1972), Morck, Yeung and Yu (1997)], and predictive value [Reilly, Morgenson and West (1972), Coates (1972), Abdel-Khalik and Espejo (1978), Swaminathan and Weintrop (1991) and Turmel and Elloumi (1995)].

Usefulness of accounting information has also been examined in relation to the prediction of corporate failure. Bankruptcy is an indication of the improper allocation of resources, which adversely affects society, and which causes personal loss to investors. Studies in this area have aimed at determining the usefulness of financial accounting data in the prediction of bankruptcy. Pioneering work by Beaver (1966, 1968) concluded that accounting data, in the form of financial ratios, can be used to forecast business failure. Similar findings were made by Libby (1975). It has also been found that cash flow information play an important role in the prediction of bankruptcy [Charalambous, Liatsos and Charitou]. Interpretation of the findings of these studies is however subject to the realisation of the self-fulfilling prophecy inherent in the reliance on ratio analysis. Preventive action by, for example, providers of loan capital in an attempt to pre-empt loss from insolvency may itself be an ingredient to failure of the business, which would not have occurred if loan capital was provided.

QUALITIES OF FINANCIAL INFORMATION

The usefulness of financial statements cannot be questioned, but whether the statements are of a quality high enough to justify or maintain usefulness is questionable. The usefulness of financial statement information is dependent on the needs of the user. Users as individuals or groups, will interpret such information according to their objective functions, which will vary a lot. It is unlikely and very difficult therefore, to produce information that will match the user objectives and the general objectives of financial reporting. Nevertheless, the provision of information of a general nature is expected to benefit users of financial statements in various ways. Users likely to benefit are those who have an interest in: (a) assessing the financial performance and position of the enterprise, (b) assessing the performance of management, and (c) making a number of decisions, including decisions on investment, credit, trade and employment [Solomons (1989)].

There remains however the problem of specifying those issues common to all users of financial statements. This is a research question. However, it is important in the present Circumstances to identify the qualities expected of financial statements for them to be useful.

Quality of financial information disclosure has been defined in reference to completeness, accuracy and reliability. That is, for financial statements to be useful, the information provided therein must be complete in itself, accurate as to the conveyance of the intended message, and reliable for the purpose intended [Singhvi and Desai (1971)]. In addition to the above, others include relevance, understandability, objectivity, timeliness and comparability [ICAEW (1975), Solomons (1989) and FASB (1980)]. SFAC 2 lists relevance, comprising of predictive value, feedback value and timeliness, and reliability, encompassing verifiability, neutrality and representational faithfulness as accounting qualities that make financial information a useful commodity. Further, comparability and consistency contribute to information usefulness. These all operate within cost-benefit and materiality considerations.

In both Singhvi and Desai (1971) and the SFAC 2, reliability is stated as being a desirable characteristic for financial statements. Reliability has to do with dependability or trustworthiness. Information is reliable if it can be depended upon and trusted for decision making. Trust is a function of verifiability. The more information can be verified, the more it can be trusted and depended upon. Hence, reliable information is verifiable, neutral and faithfully representational. In other words, there should be wide consensus among independent measures of accounting data using the same measurement methods, with no bias in information reporting, and the information should be trusted to represent the economic conditions or events it purports to represent. These are the components of reliability.

Second, accuracy in the case of Singhvi and Desai (1971) can be related to verifiability in the case of the SFAC 2. If accuracy is considered to imply conformity to a yardstick or standard, then it pre-supposes an ability to verify conformity. The purpose of verification is to assure oneself that accounting measures are correct. This assurance in turn contributes to the usefulness of accounting information.

Third, completeness can, albeit remotely, be likened to representational faithfulness. If information is complete and unqualified, then full representation can be assumed. Relevance and reliability affect the usefulness of accounting information for valuation purposes. Data that is gathered for one set of purposes in a particular environment may have little relevance in a different environment. The reliability of past data may be highly suspect if there are changes in type of accounting system, basic assumptions underlying accounting estimates and calculations, and lack of verifiability that is reasonably free of error and bias [UNCTAD (1993)].

The financial accounting and reporting systems of developing countries were once disqualified as being unreliable, inadequate, rudimentary and offering little or no vital information to management, and that they were irrelevant and deficient [Mahon (1965)]. It is argued that financial accounting information emanating from Tanzanian parastatals is likely to be viewed in a similar manner due to a number of reasons. One is that, there are significant weaknesses in the accounting function in Tanzania. Although efforts are being made in a number of areas, the shortage of professionally qualified accounting personnel appears to impact negatively on the period it takes to have financial statements ready for use by end-users. This affects relevance and reliability of the statements as evidenced by the opinion provided by statutory auditors. This study seeks to confirm the irrelevance and unreliability of parastatal financial statement information in Tanzania, as would be implied by suggestions from other studies.

Relevance

Relevance pertains to the extent to which financial information is useful for decision-making. It is the capability of influencing a decision-maker by changing his or her assessment of the likelihood of occurrence of some event relating to the attainment of a goal. Relevant information is particularly useful to investors, creditors and others for investment, credit and similar decisions. Such information must have the ability to impact on a decision by facilitating the formulation of predictions about the results of events occurring in the past, present or future. Relevant information must help the decision-maker to confirm or adjust expectations. Usually, information facilitates both functions simultaneously because the knowledge of the results of past actions will normally improve the decision-maker's ability to forecast the outcome of similar future actions. It is not easy to make a forecast without a sound historical background.

Financial information will only be useful, or relevant, to business decision-makers if it is available when required, i.e. at the time a decision is to be made and it has the capacity to influence decisions. Information that comes long after the reported events have taken place is superseded by events and has no value for a decision, and is therefore irrelevant.

Ideally, financial accounting information should be available soon after the end of the period to which it relates. The significance of timeliness depends a great deal on the nature of the information to be communicated to influence decision-making. For example, the measure of timeliness for release of routine information on annual results of an enterprise will not be the same as that for reporting such crucial information as a take over bid or the results of an internal investigation. Whereas in the former situation the usefulness may be retained for a relatively delayed period, in the latter cases, any delay may be extremely detrimental to enterprise survival.

Information providers, however, need to strike a balance between accurate information and timely information. The value of financial statements is, apparently, inversely related to the time taken to prepare it. Promptness, though of paramount importance, may compromise on the usefulness of the information reported. Occasionally, economic events may reasonably be presented as estimates without compromising on usefulness, and the information made available quickly. Gains in both cases will again depend on the nature of the information and its materiality. In this regard, timeliness alone does not make information relevant, but relevance may be diminished if information is not timely, leading to information decay [Givoly and Palmon (1982)].

Both timeliness of information release and predictive ability of financial statement numbers affect relevance. Interim reports provide information for periods less than one year. These provide users with timely information about enterprises to avoid the time lag between the annual reports. This has important implications for monitoring and control. If accounting information is not made available early enough, it is not possible to monitor the performance of management and to detect other financial misconduct by employees of the enterprise. Indeed, information can be delayed deliberately for that very purpose (Patell and Wolfson 1982), Givoly and Palmon 1982; Whittred and Zimmer 1984). It is thus imperative that delayed information should be analysed more carefully.

THE EMPIRICAL STUDY

The Problem

In Tanzania, amendments to the Companies Ordinance (Cap. 212) and other laws required parastatals to submit their accounts for examination by the TAC *immediately* after the close of the financial year. The maximum period specified by the Public Corporations Act was three months. The examination of the accounts was required to be completed within three months after receipt from the parastatal. The minister responsible was to receive a copy of these statements together with the auditors' report within one month after completion of the examination. The accounts were to be tabled before the National Assembly within one month of their receipt.

The Treasury Registrar requires, however, that copies of duly audited annual financial statements, among others, be submitted to his office one hundred and eighty days, i.e. six months, after the close of the financial year in question. This applies especially to specified companies, which are companies so specified by the Companies (Regulation of Dividends and Surpluses and Miscellaneous Provisions) Act of 1972. No explanation is available as to why this should not apply equally to the non-specified companies. However, since in both cases audited statements are required to be ready six months after the year, this is considered the maximum delay provided by law. This period is longer than that required elsewhere. In the USA, for example, the law requires that US corporations file their financial statements with the Securities and Exchange Commission (SEC) within ninety days after their year-end. But even there, delays sometimes arise in the receipt of foreign financial statements in the case of corporations with subsidiaries abroad [Mueller, Gernon and Meek (1994)].

There is no financial statement user in Tanzania who requires financial reports of enterprises with such an urgency as would a stock exchange[1]. Institutions that receive parastatal financial statements on a statutory basis have no influence on the timing of the supply of accounting information from parastatals. Even though the law stipulates the period for provision, this is not enforced, and in any case, no specific date is mentioned in the laws. It is thus assumed that parastatals resort to the normal means used in dispatching letters and the like. There is no way therefore in which the time of information release can be determined as would be in the case of developed economies with stock exchanges. Further, if indeed the information contained in the reports is not good, there would be reasons for the parastatals to delay such reports to the extent possible (Whittred 1980; Patell and Wolfson 1982).

Objectives

The study intended to determine whether financial information from Tanzanian parastatals was indeed not disclosed within a time that ensured usefulness, as per observations made by the external auditors of parastatals in Tanzania that parastatals released their financial statements in arrears. If that was the case, interest was on whether the delay in disclosure was significant. This objective is met by determining whether the delay in financial statement release is significantly greater than the time legally prescribed. The following section describes the approach used in the study, and thereafter the results of the study are presented and analysed, and conclusions made therefrom.

Methodology

Sources of Parastatal Financial Statements

Data was obtained from financial statements of parastatals in Tanzania. The sampling frame comprised a list of parastatals earmarked for

[1] The Dar es Salaam Stock Exchange in Tanzania, began its operations in 1998. At the time of study none was existent.

privatisation between 1994 and 1995 by the Presidential Parastatal Sector Reform Commission (PSRC). An array of the enterprises was prepared and 142 parastatals were initially selected using a random numbergenerator. From the resultant sample, enterprises from Dar es Salaam and Mwanza regions were identified and selected. The final sample therefore consisted of 60 parastatals from these two areas, and data was obtained from 54 of these. Dar es Salaam was a natural choice due to its economic significance; besides being the capital, it is the largest city and the main commercial and industrial centre.

Mwanza was considered suitable due to its increasing industrial and commercial importance, and other logistical considerations, including accessibility and the feasibility of data collection were considered in arriving to this choice.

Collection of Financial Statement Data

Data was extracted from financial statements collected from the sampled parastatals. Additional financial statement data were obtained from the Tanzania Audit Corporation in Dar es Salaam and Mwanza, and from other private sources. In sum, data was extracted from financial statements of fifty-four of the sixty parastatals, i.e. ninety per cent of the final sample selected. The statements were for financial years ending any time between January and December 1990.

Analysis

Financial statements were analysed with the purpose of obtaining information related to the time it took for financial statements to be ready for distribution or collection. The time at which the financial statements were available for interested users was taken to be the later of the date of signing by either the auditors or the directors. As in the case of Abayo and Roberts (1993), it is assumed in this study that financial statements can be collected immediately after they have been signed.

The mean time in months that parastatals took to make financial statements available as well as the standard deviation was determined. The Normal Approximation Rule was then invoked to test for significance of the difference between the mean time determined for parastatals and the legal time. The following expression for the Student's t was used:

$$t = (X_m - \mu_o)/(s/\sqrt{n})$$

where,

X_m represents the mean time to avail financial statements on the basis of the sample;

μ_o is the time required for financial statements to be ready for distribution/collection; and $s/\sqrt{n}$ is the standard error.

The model above is used to test the significance of the difference in months taken to prepare financial statements. The significance level was set at 1 percent.

If the difference is not significant then it implies that the time parastatal financial statements are ready is the same as the prescribed time period, and that any difference is attributable to the sample selected. The null hypothesis was thus set out as follows:

Null hypothesis: $H_o: \mu = 6$ months.

The null hypothesis is accepted if the time difference is not significantly different, and we will conclude that the financial statements are released on a timely basis.

The argument that parastatal financial statements are delayed in their release is represented by the alternative hypothesis set out as follows:

Alternative hypothesis: $H_1: \mu > 6$ months.

This represents the argument that it takes longer than six months to have parastatal financial statements ready, which would be the case if the two mean times were significantly different. We would thus accept the alternative hypothesis and reject the null hypothesis of no difference in the timing of accounting information disclosure.

The Empirical Results

The results of the analysis are summarised in the following table:

Table 1: *Summary results on the time it takes for financial statements from parastatals to be available*

Number of Parastatals	54
Mean time (months)	12.04
Standard deviation	5.29
Median (months)	10.00
Mode (months)	9.00
Range	23
t – statistic	8.39
p-value	< 0.0005

The sample mean time of availing financial statements was 12.04 months. The resulting *t* statistic was 8.39, which gives a p-value far less than 0.0005. The difference in mean time is significant, implying that the chance that the difference in mean time for releasing financial statements is attributable only to the sample selected is much less than 1 percent.

DISCUSSION OF THE FINDINGS

The results of the study suggest that the time parastatals took to have financial statements ready for collection is significantly longer that that prescribed by law. This is a clear indication that the parastatals could not heed to the requirements of the law in terms of financial information release and dissemination. On the basis of the findings important implications for decision making by both external users and internal users can be inferred. The results suggest that those who relied on parastatal financial statements for decision-making actually based their decisions on information that had been overtaken by events. The financial statements were no longer relevant at the time they were released. The results further confirm observations made by the Tanzania Audit Corporation, that a large number of the parastatals in Tanzania had their accounts in arrears.

It is thus difficult to understand how management were able to plan, make decisions and control their organisations throughout the year without financial information that was current. It is therefore possible to link some of the problems that parastatals have experienced as having their origin in the absence of up-to-date financial statements. It would be interesting, however, to establish whether this absence of current information was a cause or effect of the various problems facing the profession. Among the problems cited was a dearth in the supply of accounting personnel. If indeed there was a great shortage of accountants in parastatals, this could be one of the results of that shortage. However, this does not explain the presence of a large number of expatriate accountants in the parastatals. Another explanation could be related to the agency problem. It will be argued that the interest of Government as a stakeholder in enterprises is not the same as that of individuals.

CONCLUSIONS

This study sought to establish whether financial information associated with Tanzanian parastatals was disclosed within a time that ensured usefulness, or if not, whether the delay in disclosure was significant. It was found that parastatals took a significantly long time to have their financial statements available to the various users.

It can be concluded therefore that financial statements from parastatals were not useful at the time they were received. This means that decisions made on the basis of the financial statements were misguided, and the statements did not provide an appropriate basis for control of organisational operations. Consequently, the failure of the parastatal sector in the country can be looked at in the context of an absence of an effective monitoring device for their operations.

Recommendation

The study focused on parastatals, most of which have, or are in the process of being privatised. Parastatals therefore may not constitute an item of interest at the moment. However, the legal framework as regards financial information disclosure needs to be re-visited, especially in the present circumstances with the establishment of a stock exchange. It is opined that the time frame stipulated by the relevant statutes for financial information reporting is probably long. This would particularly be true for enterprises trading in the stock exchange. Whereas the parastatal sector has crumbled, the statutes have not been revised. It is recommended that a revision with a view to shortening the legally required reporting period should seriously be considered by the relevant authorities. A shorter reporting time frame will pose a challenge to the enterprises to improve efficiency and effectiveness in the collection and summarisation of accounting information. Timely provision of financial information will in turn facilitate timely economic decision-making.

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