

THE IMPACT OF VOLUNTARY RELATED-PARTY DISCLOSURE IN CHINA OVER THE YEARS 2001–2005: A PERIOD OF CHANGING REGULATION

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Abstract

Changes in the regulatory environment in China since 2002 with respect to related-party disclosure were a sign that China wished to make its corporate sector more transparent and accountable. It was expected that the introduction of mandatory disclosure might also lead to higher levels of voluntary disclosure than had previously been the case. Our investigation of a large sample of listed Chinese companies finds that a significant increase in the extent of related-party disclosure occurred after the introduction of *The Code of Corporate Governance for Listed Companies in China (The Code)*. This suggests that *The Code* issued by the China Securities Regulatory Commission have worked as 'soft' corporate directives as well as insisting on legally enforceable mandatory disclosure requirements, to effectively improve the extent of corporate disclosure in the sensitive area of related-party transactions.

Keywords: Related-Party, Voluntary Disclosure, China

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1. Introduction

China is in transition from a centrally planned to a market-oriented economy with a major aim being to introduce efficiency into its economy and to establish a business partnership with the world. Since its economic reforms in the 1980s China has emerged as one of the economic giants in the world. The pace of economic growth has averaged 10 per cent over the past two decades and this trend is expected to continue for some time. China continues to adopt an open-door policy for the international investment community and to assure its trading partners that appropriate steps will be taken to develop and foster business institutions.

In China financial market development and reform started as a by-product of state-owned enterprise (SOE) reform. Its financial market development and corporate governance became entwined with the establishment of the Chinese stock market in the 1990s. The Shanghai and Shenzhen Stock Exchanges (SHSE and SZSE) were launched in 1990 and 1992, respectively. The appearance of the stock markets was a novelty for the Chinese people. Subsequently, agency problems have arisen, generating conflicts of interest between the management and shareholders of listed firms, and have emerged in relation to ownership structure and

corporate governance in China. These problems include evidence of opaqueness in related-party transactions. A major source of agency conflict may arise from transactions and relationships entered into by directors and top management with parties that are, or are deemed to be, related to the reporting entity. The two parties are defined as being related if there exists a direct or indirect control or significant influence of one party over the other party in making financial and operating decisions. Significant influence can be exercised over a reporting entity by representation on its board of directors, participation in its policy-making process, material inter-company transactions, interchange of key management personnel, and statute or other agreement.

According to International Accounting Standard (IAS) 24, related-parties can be classified into three categories: corporate shareholders (e.g., subsidiaries, joint ventures and associated companies), individual shareholders (e.g., a major shareholder, close members of the families of these major shareholders, companies owned by major shareholders or their close family members), and key management personnel (e.g., directors and top managers, close family members of these individuals, enterprises owned by these individuals and their close family members). Related-party disclosures are expected to include a description of the company's relationship with each

related party and a description of various transactions with them, including the pricing policy and amount involved in purchases, sales, rendering of services, write-offs, guarantees, management contracts, leases and license agreements.

Stakeholders cannot evaluate the quality of corporate governance undertaken by a company unless management chooses to disclose relevant information. Therefore, an improved understanding of incentives for management to provide more rather than less disclosure is important to both regulators and investors. In the area of corporate financial reporting it is important to understand what motivates managers to voluntarily disclose corporate information to external shareholders. Such an understanding will lead to policy implications regarding the formulation and subsequent refinement of accounting standards and codes of corporate governance.

The objective of this study is to identify the extent to which listed companies in China disclose information about their relationships, and their direct and indirect transactions, with their subsidiaries, directors, key management personnel and shareholders, and to assess whether such related-party disclosures have significantly increased in the period following the introduction of *The Code of Corporate Governance for Listed Companies in China (The Code)* in 2002. Such an analysis can indicate whether *The Code*, issued by the China Securities Regulatory Commission (CSRC) as a directive, has been an effective means of increasing the comprehensiveness of corporate disclosure in a culture known for its secrecy (Hofstede, 1984), and in a disclosure area that is highly sensitive for corporate directors, top management and large shareholders.

The structure of the paper proceeds as follows. Section 2 provides a brief review of institutional background on China's corporate governance framework. Section 3 outlines the literature and establishes the hypothesis. We describe the research methodology Section 4. Results of the analysis and their discussion are presented in Section 5. Section 6 provides a brief conclusion to the paper.

2. Institutional Background

The rapid development of China's securities markets inevitably demands the establishment of centralised market regulatory bodies. In particular, the scandals in 1992, 1995, and late 1996 to early 1997 involving poor regulation by local government officials destabilised the securities market and undermined the broader financial system. As a result, the Central Government actively enhanced its control and supervision. In late 1992, the State Council Securities Commission (SCSC) and its executive organ, the CSRC, were established. The SCSC, chaired by former Premier Zhu Rongji, is the macro policy-making body of the Chinese securities industry. The CSRC, headed by Zhou Zhengqing, is the SCSC's

executive branch responsible for conducting daily supervision and regulation of the securities markets in accordance with the law. Practically, the SCSC and the CSRC took over most of the functions of the former regulatory body.

The limits of the authority of the SCSC and the CSRC gradually expanded with the growth of the securities markets. In November 1993, the State Council gave the SCSC responsibility to test the operation of a futures market, to be carried out by the CSRC. In March 1995, the State Council officially approved *The Organisational Plan of the China Securities Regulatory Commission*. Under this the CSRC is validated as a deputy-ministry-level unit and is authorised to supervise and regulate both securities and futures markets in accordance with the law. In April 1998, pursuant to the State Council Reform Plan, the SCSC and the CSRC were merged to form one ministry-level unit directly under the State Council. Both the power and functions of the CSRC have been strengthened. Five months later, the State Council approved the provisions regarding the CSRC's function, international structure and personnel, further confirming the CSRC as an enterprise unit directly under the State Council, and as the authorised department governing the securities and futures markets in China. In November 1998 the Central Government held the National Finance Conference and decided to reform and restructure the national securities regulatory mechanism. The local securities regulatory departments and other organisations that engaged in securities formerly supervised by the Central Bank–People's Bank of China (PBOC) were placed directly under the centralised supervision of the CSRC.

In China, corporate governance developments involve a number of regulatory bodies, including the CSRC, the Ministry of Finance (MOF), the State Economic and Trade Commission (SETC) and the PBOC. The key legal framework for corporate governance consists of *The Company Law* promulgated in December 1993 and revised in 2005, *The Securities Law* promulgated in December 1998 and revised in 2005, and *The Code* issued by the CSRC and the SETC in January 2002. *The Code* is applicable to all listed companies in China, and is the major measuring standard for evaluating whether a listed company has good corporate governance or not. All listed companies are required to act in the spirit of *The Code* in their efforts to improve corporate governance.

3. Literature and Hypothesis

In Chinese companies, majority shareholders are typically very strong and individual minority shareholders are extremely weak and unable to counter the influence of the majority shareholders. Related-party transactions between controlling shareholders are often detrimental to minority shareholders, who are often regarded as speculators

expecting to gain a 'free ride' on the firm's performance (Lin, 2004). Thus, China's corporate governance is potentially relatively ineffective in the matter of protecting minority shareholders' rights (Cha, 2001; Lin, 2001; Schipani and Liu, 2001; Tam, 2002; Shan and Taylor, 2008).

One important aspect of protecting minority shareholders' rights is to disclose more information about related-party relationships and transactions (Shan and Taylor, 2008). While good board governance would expect both the corporate board and supervisory board to strongly monitor and support related-party disclosures by the company, such disclosures can be sensitive to those board members who directly or indirectly enter business transactions and relationships with the company.

Lin (2004) argues that *The Company Law*, *The Securities Law* and *The Criminal Law* are inclined to neglect civil liability and compensation, and have not provided a procedure and specific clauses for enforceable civil actions. In addition, there is no provision for a class action lawsuit under Chinese law and it is very cumbersome for an individual shareholder to sue for fraud of listed companies (Liu and Ren, 2003). Under this situation, it is no surprise that a series of corporate scandals were exposed in 2001. These scandals have helped fuel the drive for corporate governance reforms and led to the formulation of *The Code* became effective in January 2002.

The Code states three requirements for related-party transactions. First, written agreements shall be entered into for related-party transactions between a listed company and its connected parties. Such agreements shall observe principles of equality, voluntariness and fair value of compensation. Second, efficient measures shall be adopted by a listed company to prevent its connected parties from interfering with the operation of the firm and damaging the firm's interests by monopolising purchase or sales channels. Therefore, the company shall fully disclose the basis for pricing for related-party transactions. Third, the firm shall adopt efficient measures to prevent its shareholders and their affiliates from misappropriating or transferring the capital, assets or other resources of the firm through various means. On top of these requirements, the Chinese Accounting Standard for Business Enterprises, ASBE 36,⁹ prescribes requirements concerning related-party relationships and transactions disclosures.

3.1 Theory of the Regulatory Environment

In this study, the regulatory environment of changing corporate disclosure requirements is tested. We seek to determine whether the introduction of mandatory

disclosure regulations in relation to corporate financial reporting has inhibited or enhanced voluntary information disclosure. It is widely thought that an efficiently operating unregulated stock market offers enough incentives for businesses to voluntarily disclose information. When various incentives and market realities have the effect of forcing management to disclose information to markets, then voluntary corporate disclosures should produce adequate information for investors and other corporate stakeholders (Jovanovic, 1982). A wide range of relevant literature suggests strongly that voluntary disclosures are influenced by changes in mandatory disclosure requirements (Gonedes, 1980; Verrecchia, 1982; Dye, 1985, 1986; Chow *et al.*, 1996; Nagarajan and Sridhar, 1996; Taylor and Redpath, 2000; Berkman *et al.*, 2002; Aggarwal and Simkins, 2004; Chalmers and Godfrey, 2004).

There are two opposite arguments regarding the impact of the regulatory environment on corporate disclosure. The first argument advocates that voluntary disclosures may decline as the mandatory reporting requirements become more detailed (Gonedes, 1980; Verrecchia, 1982; Dye, 1985; Nagarajan and Sridhar, 1996). The second argument suggests that the mandatory disclosure of non-proprietary information provides incentives for the voluntary disclosure of correlated proprietary information. This is because the increase in the mandatory disclosure of non-proprietary information reduces the benefits of withholding correlated proprietary information (Dye, 1986; Taylor and Redpath, 2000). Dye (1990) investigates a comparison between mandatory and voluntary disclosures in a simple market economy where disclosures by one firm can alter the perceptions about the distribution of other firms' cash flows as 'financial externalities' and possibly the actual distributions of other firms' cash flows as 'real externalities'. He further argues that any divergence between voluntary and mandatory disclosures is dependent upon which kinds of externalities a firm's disclosures generate. Externalities generated by increased mandatory disclosure requirements reflect that competitors are faced with the same expectation to disclose proprietary information.

3.2 Testing the Effects of Changes in Corporate Disclosure Requirements

To establish investor confidence in the stock market and to achieve better investment decisions, it is contended that corporate provision of information needs to be regulated so as to allow external stakeholders, particularly minority shareholders, to enjoy a certain minimum level of disclosure of both proprietary and non-proprietary information. Managers of a firm are assumed to have more information regarding the firm's present and future performance than outsiders have, and such information is not necessarily easily or freely

⁹ ASBE 36 'Disclosure of Related Party Relationships and Transactions' was issued by the Ministry of Finance with an operative date from 1 January 1997.

attainable by all the firm's stakeholders, even if they have legitimate interests in the business' activities. The public cannot rely on information disclosed by managers as it could be inaccurate, unstable or even misleading. Thus, accounting and other corporate information needs to be regulated in the public interest. By regulating accounting and other corporate information, the public, who are at an information disadvantage, can be protected from an inefficient market and unregulated information disclosure.

In accordance with the basic principles of *The Company Law*, *The Securities Law* and other relevant laws and regulations, as well as with commonly accepted standards in international corporate governance, *The Code* was issued in China in January 2002. It was formulated to promote the establishment and improvement of the modern enterprise system, to standardise the operations of listed firms, and to bring forward the healthy development of the securities market in China (Lin, 2004).

The aspect of the regulatory setting which is of concern in this study is whether the introduction of mandatory disclosure requirements relating to corporate financial reporting inhibits or enhances management's incentives to voluntarily disclose additional information. The literature on the voluntary disclosure strategy of firms indicates that voluntary disclosures are influenced by changes in mandatory disclosure requirements (Dye, 1986; Taylor and Redpath, 2000; Chalmers, 2001; Aggarwal and Simkins, 2004; Chalmers and Godfrey, 2004). The hypothesis that is tested in this study is largely based on the arguments presented in first three of these studies. Dye (1986) suggests that mandatory and voluntary information disclosures are complementary when mandatory disclosures consist of reporting a firm's non-proprietary information. He argues that an increase in mandatory disclosure of non-proprietary information will reduce the benefits of withholding correlated proprietary information. The effect is an increase in incentives to voluntarily disclose such correlated proprietary information. To test Dye's 1986 model, Taylor and Redpath (2000) investigate the relationship between mandatory and voluntary disclosures of financial instruments for a sample of Australian mining companies during 1996 and 1998. They discover that an increase in mandatory disclosure is paralleled by an increase in voluntary disclosure. Chalmers (2001) examines the derivative instrument disclosure practices of Australian companies during the period of voluntary disclosure between 1992 to 1997, and also in the year of 1998 the standard on financial instrument presentation and disclosure became mandatory in Australia. She concludes that there was a significant increase in voluntarily disclosure after the introduction of the standard. Thus, the hypothesis that we seek to test in this paper is:

Hypothesis: *There will happen significant increases in the voluntary disclosure of related-party*

relationships and transactions after the introduction of The Code in China in 2002.

4. Methodology

4.1 Sampling

This study focuses on non financial A-share¹⁰ firms listed on either the Shanghai Stock Exchange or the Shenzhen Stock Exchange. In order to test the effects of various types of ownership on disclosure—that is, high levels of state and foreign investor ownership—the sample of companies is divided into three groups: A-share, AB-share,¹¹ and AH-share¹² companies.

A sample of 120 companies was selected from the listed companies in China's Shanghai SSE180¹³ and Shenzhen SSE100¹⁴ indexes for the period 2001–2005. This was achieved by using a stratified random sampling method. As is shown in Figure 1, from the overlapping area for AB-shares, 42 companies were randomly selected from the AB-share group. Only 32 companies were listed on both the Hong Kong Stock Exchange and one of the two mainland Chinese stock exchanges (see the overlapping area for AH-shares). Therefore, all these AH-share companies were selected for our sample. Finally, 46 companies were randomly selected from the A-share group.

¹⁰ A-shares are common stock issued by mainland China firms, subscribed and traded in RMB, listed on the mainland stock exchanges, and are reserved for trading by Chinese citizens. The A-share market was launched in 1990 in Shanghai.

¹¹ B-shares are issued by mainland China firms, traded in foreign currencies, and listed on the mainland stock exchanges. The B-share market was launched in 1992 and was restricted to foreign investors before 19 February 2001. AB-share companies are those that have issued both A-shares and B-shares, with an initial A-share offering.

¹² H-shares are securities of companies incorporated in mainland China and nominated by the Chinese Government for listing and trading on the Hong Kong Stock Exchange, being quoted and traded in HKD. There are no restrictions on holdings by international investors. AH-share companies are those that have issued both A-shares and H-shares, and have floated their shares simultaneously on the Hong Kong Stock Exchange and one of China's two mainland stock exchanges.

¹³ Shanghai SSE180 Index was created by restructuring and renaming the SSE30 Index. Through scientific and objective methods it selects constituents that best represent the market. The SSE is a benchmark index reflecting the Shanghai market and serves as a performance benchmark for investment and a basis for financial innovation.

¹⁴ The Shenzhen SSE100 is a benchmark index reflecting performance in the Shenzhen market and serves as a performance benchmark for investment and as a basis for development of financial innovations.

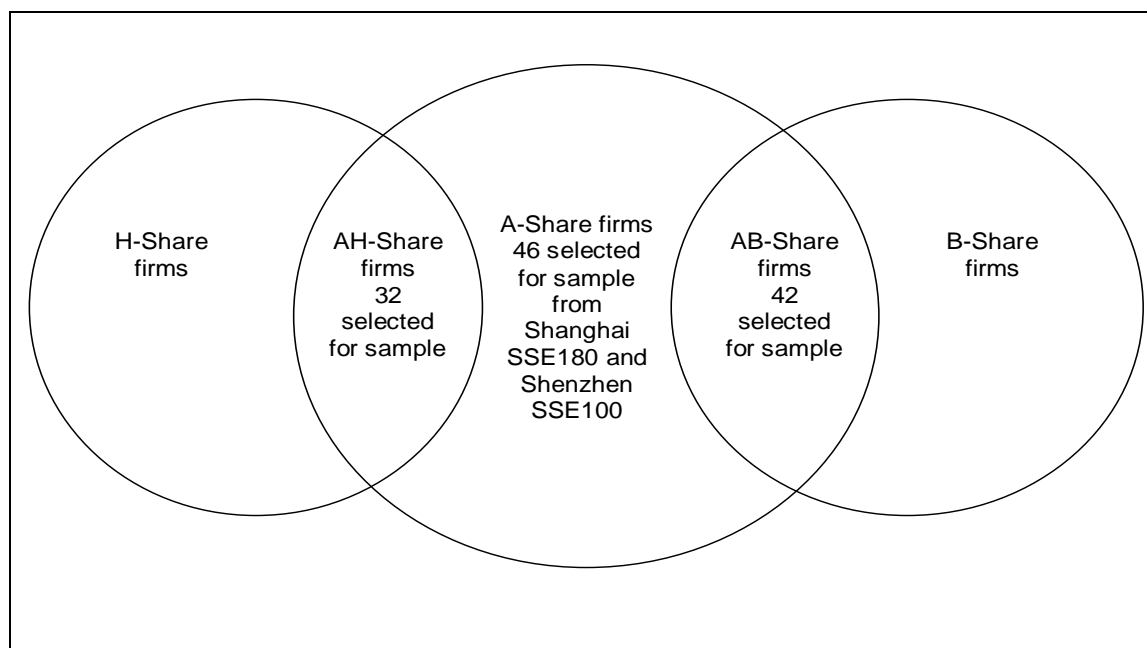


Figure 1. Sampling Frame

Table 1 presents the composition of the sample. It comprises 118 non-financial companies because two AH-share companies listed after 2005 have been removed. The final sample consists of 46 A-share, 42

AB-share and 30 AH-share companies, which represent 39.0 per cent, 35.6 per cent and 25.4 per cent of the sample, respectively.

Table 1. Composition of Sample

Share Type	Size of Sample	Percentage of Sample	No. of observations	Percentage of observations
A	46	39.0	196	36.0
AB	42	35.6	210	38.5
AH	30	25.4	139	25.5
Total	118	100.00	545	100.00

4.2 Content Analysis

Content analysis is the major method used in collecting the data for this study. The sources for the content analysis were 545 annual reports of the 118 sampled companies for the period 2001–2005. The disclosure of information can be quantified in three steps. First, all items disclosed in the annual report of a firm that accord to the disclosure categories of ABSE 36 is extracted. Second, to overcome the disadvantage of manifest content in content analysis, a blending of manifest and latent analysis strategies¹⁵

is used in this study. Third, the number of words for each item of disclosure is counted.

The first step in measuring the quantity of comprehensive disclosure involves the segregation of items relevant to related parties. According to ABSE 36, related-party disclosure can be divided into two categories, with three items to be disclosed under each category, as displayed in Table 2.

¹⁵ Royse (2008) suggests that the greatest disadvantage in using content analysis is the manifest content, which means that the manifest content is directly related to the methodology of counting individual words, expressions or events, and thus is comparable to what is seen on the surface of a message unlike latent content which refers to the deep structural meaning (Berg, 2004). In this study, a blending of manifest and latent analysis strategies is used to overcome the disadvantage of content analysis, and is perhaps the best solution to solve this issue.

Table 2. Related-Party Disclosure Requirements by ABSE 36

Relationships	Transactions
(1) The nature or type of business entity, the name, the legal representative and the place of registration of the related enterprise, and its registered capital and changes therein	(1) The amounts of the transactions, or the appropriate proportions
(2) The principal business of the related enterprise	(2) The amounts of outstanding items, or the appropriate proportions
(3) The proportions of shares or equity interest held and changes therein	(3) Pricing policies, including those transactions where no amount or only nominal amounts have been charged

Regarding the definition of related parties, Article 4 of ABSE 36 states that if a party has the power to directly or indirectly control, jointly control or exercise significant influence over the financial and operating policy decisions of another party, those parties are regarded as related parties; and if two or more parties are subject to control from the same party, they are also regarded as related parties.

The related-party relationships dealt with by Article 5 of ABSE 36 principally refer to:

- Enterprises that directly or indirectly control, or are controlled by, the reporting enterprises; and two or more enterprises subject to control from the same enterprise (such as parent companies, subsidiaries and fellow subsidiaries);
 - Joint ventures;
 - Associated enterprises;
 - Principal individual investors, key management personnel, or the close family members of such individuals;
 - Other enterprises directly controlled by principal individual investors, or key management personnel, or the close family members of such individuals.

According to Article 6 of ABSE 36, related parties do not including the following:

- Providers of finance, public utilities, government departments and agencies that only have normal dealings with an enterprise, although they may participate in the financial and operating policy decisions of the enterprise, or circumscribe the freedom of action of the enterprise to a certain extent;

- A single customer, supplier or agent with whom an enterprise transacts a significant volume of business by virtue only of the resulting economic dependence.

In dealing with related-party transactions, Article 8 of ABSE 36 defines a related-party transaction as ‘an event whereby a transfer of resources or obligations takes place between related parties, regardless of whether a price is charged.’ The standard also provides examples of related-party transactions such as:

- Purchases or sales of trading goods or of assets other than trading goods;
- Rendering or receiving of services;
- Agency arrangements;
- Leasing arrangements;
- Provision of finance (including loans or equity contribution, made in cash or in kind);
- Guarantees and collaterals;
- Management contracts;
- Transfer of research and development;
- License agreements;
- Emoluments for key management personnel

As shown in Figure 2, the disclosure of relevant items of related-party relationships and transactions stems from separate sections (i.e., the subsection ‘Related-Party Relationships and Transactions’ under the section ‘Notes to Financial Statements’, and the subsection ‘Substantial Related Transactions in Reporting Period of the Company’), and non-dedicated sections (i.e., the section ‘Report of Board Directors’) in a company’s annual report.

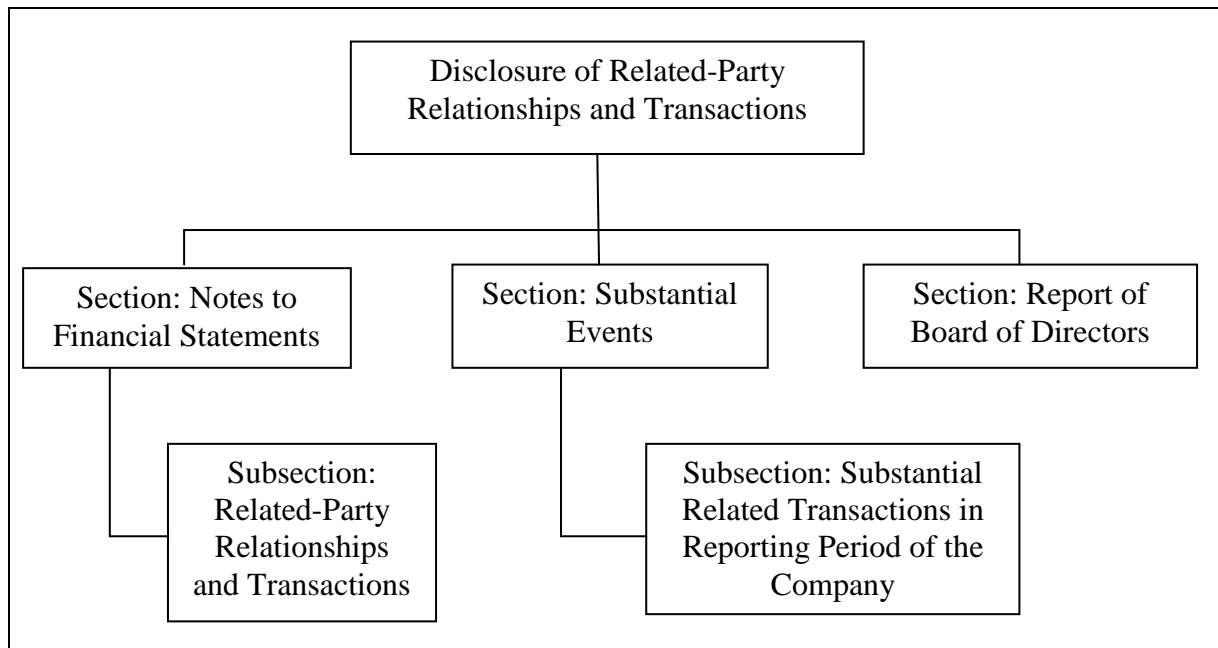


Figure 2. Map for Disclosure of Related-Party Relationships and Transactions in Annual Reports

The second step in measuring the quantity of comprehensive disclosure involves using a blending of manifest and latent content analysis strategies. One of the arguments concerning the use of content analysis is whether the analysis should be limited to manifest content (those elements that are physically present and countable) or extended to more latent content. In the latter case, the analysis is extended to an interpretive reading of the symbolism underlying the physical data (Berg, 2004). As mentioned earlier, Berg (2004) suggests that the best solution to the dilemma about whether to use manifest or latent content is to use both whenever possible. In this case, a given unit of content would receive the same attention from both methods. For example, the key words 'related party', 'related-party relationships' or 'related-party transactions' may appear in the section 'Notes to Financial Statements' by mandatory requirement or in the section 'Substantial Events' voluntarily, but may appear only in the section 'Report of Board of Directors' by using words such as 'subsidiaries', 'son company', 'parent company', etc. All these words will be counted as disclosures for related-party relationships and transactions. To avoid double counting, if identical or close meanings in disclosure appear in both the sections 'Substantial Events' and 'Report of Board Directors', only one occurrence of disclosure would be counted. The last step is to count the number of words to be disclosed as the unit of analysis. Content analysis requires the selection of a unit of analysis (Guthrie *et al.*, 2004). Holsti (1969, p.116) defines a recording unit as "the specific segment of content that is characterised by placing it into a given category". In the accounting literature, Gray *et al.* (1995) discussed various units

of measurement, for example, the use of words, sentences or portions of pages as the basis for the coding.

Various recording units have been adopted by previous studies using content analysis to measure the extent of corporate disclosures. The examples include:

- Word count (Deegan and Rankin, 1996; Lemon and Cahan, 1997; Brown and Deegan, 1998; Wilmshurst and Frost, 2000; Liu and Taylor, 2008; Shan and Taylor, 2008);
- Sentence count (Buhr, 1998; Tsang, 1998; Deegan *et al.*, 2000; Deegan *et al.*, 2002);
- Page count (Guthrie and Parker, 1989)

In this study, to measure the extent of disclosure relevant to related-party relationships and transactions within annual reports, the number of words relating to specified disclosure items is selected as the unit of measurement. We follow the approach suggested by Brown and Deegan (1998), and sum the words, and numbers that are counted as equivalent to a number of words, as our measure the extent of disclosure.

5. Result and Discussion

5.1 Descriptive Analysis

Table 3 presents a comparison of means by year for the disclosure items. A one-way ANOVA test analyses the variances between the years over the period 2001–2005. The analysis can provide a test of our null hypothesis that each group (year) sample is drawn from the same underlying probability distribution against the alternative hypothesis that the underlying probability distributions are not the same for all group samples.

Table 3. Disclosure Items: Comparison of Mean by Year

Disclosure Items	2001	2002	2003	2004	2005	F-stat	p-value
Mandatory Disclosure Items of Related-Party Relationships in ABSE 36:							
The nature or type of business entity, the name, the legal representative and the place of registration of the related enterprise, and its registered capital and changes therein	451.97	516.01	557.19	569.83	584.82	1.4500	0.2162
The principal business of the related enterprise	89.49	121.38	130.54	123.22	131.00	1.3275	0.2584
The proportions of shares or equity interest held and changes therein	317.80	385.49	382.16	401.14	411.91	0.9288	0.4468
Overall Mandatory Disclosure for Related-Party Relationships	859.26	1022.87	1069.89	1094.18	1127.73	1.5247	0.1936
Mandatory Disclosure Items of Related-Party Transactions in ABSE 36:							
The amounts of the transactions, or the appropriate proportions	573.71	638.29	740.65	831.79	924.78	3.9066	0.0039
The amounts of outstanding items, or the appropriate proportions	246.99	283.88	295.89	309.61	346.87	1.7544	0.1367
Pricing policies, including those transactions where no amount or only nominal amounts have been charged	48.82	62.54	69.45	77.92	78.88	1.0403	0.3857
Overall Mandatory Disclosure for Related-Party Transactions	869.52	985.09	1105.99	1219.33	1348.17	4.4752	0.0014
<i>Summary of Disclosure Totals</i>							
Overall Mandatory Disclosure for Related-Party Relationships and Transactions	1728.78	2007.96	2137.03	2313.51	2475.90	4.4307	0.0016
Total Voluntary Disclosure for Related-Party Relationships and Transactions	422.07	571.41	768.96	918.02	1148.06	13.6467	0.0000
Comprehensiveness of Disclosure for Related-Party Relationships and Transactions (RPDISC)	2150.85	2579.37	2944.85	3231.53	3623.96	10.3301	0.0000

Table 3 indicates that there are no significant increases in the means of all disclosure items, including overall disclosures for related-party relationships. The *F*-statistics are small. The expected large jump in mandatory disclosure items of related-party relationships between 2001 and 2002, the years pre- and post-introduction of *The Code*, is not found. However, for the overall mandatory disclosure items regarding related-party transactions, Table 3 shows that there is a significant increase in the mean for overall disclosure over the period 2001–2005, with a large *F*-statistic of 4.4752 and a small *p*-value of 0.0014. As expected, the greatest jump of 13.29 per cent occurred between 2001 and 2002. Specifically, the mandated item on the amounts of the transactions, or the appropriate proportions, reveals a significant increase in the mean over the five-year period, but the differences in the means of *the amounts of outstanding items, or the appropriate proportions, and pricing policies, including those transactions where no amount or only nominal amounts have been charged* are not significant.

For voluntary disclosure, the results show a significant increase in the mean over the period 2001–

2005, with a large *F*-statistic of 13.6467 and a very small *p*-value. As expected, the greatest increase in voluntary disclosure of 35.38 per cent occurred between 2001 and 2002. More importantly, the results in Table 3 also indicate that there is a significant increase in the mean for the comprehensiveness of disclosure for related-party relationships and transactions (RPDISC), with a large *F*-statistic of 10.3301 and a *p*-value of zero. Thus, the null hypothesis is rejected. It is concluded that the underlying probability distributions of means are not the same for all group samples (i.e., years) over the five-year period from 2001–2005.

Table 4 presents a comparison of means by share-type over the period 2001–2005. The results indicate that there were significant increases in the means of all disclosure items, including overall disclosure for related-party relationships. Furthermore, as expected, the average overall disclosures for related-party relationships for AB- and AH-shares are greater than the disclosure for A-shares. For the disclosure items of related-party transactions, Table 4 shows that there is a significant increase in the mean for overall disclosure, with an *F*-statistic of 3.0527

and a small p -value of 0.0480. In fact, all items in this category show a significant increase over the three types of share except for the item on *the amounts of outstanding items, or the appropriate proportions*. For voluntary disclosure, there is a significant increase in the mean across the three types of share, as indicated by a large F -statistic of 28.5691 and a p -value of zero. The results also show that there is a significant increase in the mean for the

comprehensiveness of disclosures for related-party relationships and transactions (RPDISC), as revealed by a large F -statistic of 14.8128 and a p -value of zero. Therefore, according to the F -statistics in this one-way ANOVA analysis, the null hypothesis is rejected. It is concluded that the underlying probability distributions of means are not the same for all group samples across A-, AB- and AH-shares.

Table 4. Disclosure Items: Comparison of Mean by Share Type

Disclosure Items	A-Share	AB-Share	AH-Share	F -stat	p -value
Disclosure Items of Related-Party Relationships in ABSE 36:					
The nature or type of business entity, the name, the legal representative and the place of registration of the related enterprise, and its registered capital and changes therein	439.07	570.16	633.46	8.4811	0.0002
The principal business of the related enterprise	108.30	106.04	157.46	5.9507	0.0028
The proportions of shares or equity interest held and changes therein	321.19	484.24	312.09	12.6076	0.0000
Overall Disclosure for Related-Party Relationships	868.57	1160.43	1103.01	6.3303	0.0019
Disclosure Items of Related-Party Transactions in ABSE 36:					
The amounts of the transactions, or the appropriate proportions	724.04	696.88	869.02	2.3746	0.0940
The amounts of outstanding items, or the appropriate proportions	226.99	345.92	328.81	10.0804	0.0001
Pricing policies, including those transactions where no amount or only nominal amounts have been charged	86.40	39.16	86.73	9.6085	0.0001
Overall Disclosure for Related-Party Transactions	1037.43	1081.96	1282.83	3.0527	0.0480
<i>Summary of Disclosure Totals</i>					
Overall Mandatory Disclosure for Related-Party Relationships and Transactions	1905.99	2242.40	2385.84	5.3157	0.0052
Total Voluntary Disclosure for Related-Party Relationships and Transactions	578.95	686.24	1217.12	28.5691	0.0000
Comprehensive Disclosure for Related-Party Relationships and Transactions (RPDISC)	2484.95	2928.64	3602.96	14.8128	0.0000

5.2 Univariate Analysis

Univariate analysis refers to the analysis of one variable at a time. An independent two-sample t -test is used to test the hypothesis that there are significant differences in the voluntary disclosure of related-party relationships and transactions before and after the introduction of *The Code* in 2002.

This t -statistic can provide a test of the null hypothesis that the means of two normally distributed populations are equal against the alternative hypothesis that these means are not equal. Because of the character of unbalanced panel data, the independent two-sample t -test assuming unequal sample sizes and unequal variances is the most appropriate choice.

In testing the hypothesis, which predicts a significant increase in the voluntary disclosures of related-party over the period 2001–2005, a comparison is made in Table 5 between the means of the disclosure items for the pre- and post-regulation years with the means of the same items for the same

period. In relation to disclosure of related-party relationships, the results indicate that there are statistically significant increases in the means for all disclosure items including overall disclosure for related-party relationships, as $|t| > t_c$ or $p < 0.05$. Thus, the null hypothesis is rejected. In relation to disclosure of related-party transactions, Table 5 shows statistically significant increases in the means for all disclosure items for the periods pre- and post-introduction of *The Code*, except the item on *pricing policies, including those transactions where no amount or only nominal amounts have been charged* ($|t| < 1.9782$, $p > 0.05$). But the overall disclosure for related-party transactions has increased, and is statistically significant. Thus, the null hypothesis can be rejected.

Table 5 also indicates that the voluntary disclosure has a statistically significant increase after the introduction of *The Code*, with a large absolute value of the t -statistic ($|t| > 1.9709$) and a p -value of zero. More importantly, the results reveal that the

comprehensiveness of disclosure (RPDISC) has increased significantly ($|t| = -6.5566$, $p = 0.0000$) for all sampled companies between the two time periods, with the average number of words increasing

from 2150.85 to 3114.30. In conclusion, the results support the hypothesis and indicate that a statistically significant increase in RPDISC occurred after the introduction of *The Code*.

Table 5. Disclosure Items: Comparison of Mean between Pre- and Post-Introduction of *The Code*

Disclosure Items	Pre-Intro	Post-Intro	t-stat	p-value (2-tailed)	t _c (2-tailed)
Relationships					
Mandatory Disclosure Items of Related-Party Relationships in ABSE 36:					
The nature or type of business entity, the name, the legal representative and the place of registration of the related enterprise, and its registered capital and changes therein	451.97	558.28	-2.6455	0.0088	1.9721
The principal business of the related enterprise	89.49	126.65	-2.6768	0.0081	1.9731
The proportions of shares or equity interest held and changes therein	317.80	395.70	-2.2180	0.0278	1.9727
Overall Mandatory Disclosure for Related-Party Relationships	859.26	1080.63	-2.8074	0.0055	1.9727
Transactions					
Mandatory Disclosure Items of Related-Party Transactions in ABSE 36:					
The amounts of the transactions, or the appropriate proportions	573.71	789.32	-3.8009	0.0002	1.9684
The amounts of outstanding items, or the appropriate proportions	246.99	310.14	-2.4557	0.0149	1.9724
Pricing policies, including those transactions where no amount or only nominal amounts have been charged	48.82	72.55	-1.5684	0.1192	1.9782
Overall Disclosure for Related-Party Transactions	869.52	1171.47	-4.1404	0.0000	1.9693
Summary of Disclosure Totals					
Overall Mandatory Disclosure for Related-Party Relationships and Transactions	1728.76	2252.10	-4.5303	0.0000	1.9703
Voluntary Disclosure for Related-Party Relationships and Transactions	422.07	862.20	-6.3869	0.0000	1.9709
Comprehensive Disclosure for Related-Party Relationships and Transactions (RPDISC)	2150.85	3114.30	-6.5566	0.0000	1.9694

6. Conclusion

These findings establish that the CSRC's strategy of issuing *The Code* as 'soft' corporate disclosure directives, rather than as legally enforceable disclosure requirements, has been effective in increasing the extent of corporate disclosure in a sensitive area. The area is sensitive because such

disclosure concerns information about transactions that transfer resources, services or obligations between the reporting company and directors, key executives and large shareholders, and especially governments. Other than the introduction of *The Code*, the regulatory environment affecting related-party disclosure in China did not change during the period 2001–2005. The relevant accounting standard, ASBE

36 *Disclosure of Related Party Relationships and Transactions* was issued by the Ministry of Finance with an operative date from 1 January 1997 and was not revised through to 2005. ASBE 36 is based on IAS 24 *Related Party Disclosures* issued by the International Accounting Standards Committee in 1986. Since then, the only revisions to IAS 24 became operative after 2005.

Accordingly, we are confident that our results support the notion that the introduction of mandatory disclosure rules with respect to certain types of corporate information has the effect of not only providing more information of this type to shareholders and to those who are not related in some way to the firm's management, but also there appears to take place at the same time a greater willingness to voluntarily provide other kinds of information, all of which will provide the underpinnings of a better informed and therefore more efficient stock market.

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