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A holistic model for measuring financial reporting quality in Sri Lanka

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ABSTRACT

High-quality financial reporting ensures that disclosed financial information is reliable, relevant, timely, and unbiased, enabling informed stakeholder decisions. The Qualitative Characteristics (QCs) approach, derived from the Conceptual Framework of Financial Reporting, is widely recognized as the most appropriate method to evaluate Financial Reporting Quality (FRQ). Accordingly, this study develops a context-specific FRQ measurement model based on QCs within the Sri Lankan context. The proposed model integrates fundamental (Relevance, Faithful Representation) and enhancing (Comparability, Verifiability, Timeliness, Understandability) characteristics. Data were collected through a questionnaire survey of 397 Sri Lankan investors with accounting knowledge. Partial Least Squares Structural Equation Modeling (PLS-SEM) was used to construct the model, supported by Exploratory and Confirmatory Factor Analyses for validation. Reliability and validity were assessed using indicator reliability, Average Variance Extracted (AVE), Cronbach's alpha, composite reliability, Fornell–Larcker, and HTMT criteria. All QCs significantly influence FRQ, with relevance and faithful representation identified as primary drivers. The resulting model provides a holistic, IASB-aligned tool for assessing FRQ, supporting stakeholders in evaluating the decision usefulness of financial information. The findings are limited to investors with accounting knowledge, which may constrain generalizability. Future research could extend the model to diverse stakeholder groups.

Contribution/Originality: This study develops a context-specific FRQ measurement model grounded in the IASB Conceptual Framework and based on Qualitative Characteristics (QCs). Using primary investor data, it introduces a novel QC-based FRQ index for the Sri Lankan context, bridging theory and practice to offer a localized tool that enhances reporting transparency and credibility.

1. INTRODUCTION

Providing accurate and reliable financial reports has become essential, serving a crucial role for users of financial information in making informed economic decisions. This is due to the high-quality financial reports' notable and significant impact on all stakeholders (Muraina & Dandago, 2020). According to ElBannan and Farooq (2019), research within accounting and finance indicates that there is an inverse correlation between the quality of financial reporting and the presence of agency problems. As the quality of financial reports improves, the likelihood and severity of agency problems tend to decrease. It proves that the quality of information minimizes the impact of

information asymmetry, which is growing and provides essential information for stakeholders (Lambert, 2001). Therefore, it is expected that the quality of financial reports will lead to increased relevance and reliability of accounting and financial information, as well as the expansion of transparent accounting and financial information (Pitenoei, Gholamrezapoor, Kazemi, & Amirniya, 2021).

Ensuring high-quality financial reports is crucial for preserving public trust. Primarily, it upholds accountability and transparency regarding public funds, while also supporting informed and effective decision-making processes. The high-quality financial reports enable stakeholders to use such information in evaluating economic performance and expect that such information will assist them in measuring the soundness of the reporting entity and in making valid financial decisions (Kantudu & Alhassan, 2022). For decision-making to be accurate and reliable, the information in financial statements must be presented properly, embodying qualities such as relevance, clarity, comparability, timeliness, and verifiability. Therefore, the quality of financial reporting is beneficial in making decisions regarding the allocation of resources in organizations (Sabauri & Kvatashidze, 2018).

When considering the measurement of FRQ, Beest, Braam, and Boelens (2009) and Mbobo and Ekpo (2016) recognized four (04) proxies as: (i) accrual methods, (ii) value relevance methods, (iii) focusing on specific elements in the annual reports, and (iv) qualitative characteristics (QCs) based methods. The QC-based approach, also referred to as the operationalization of these characteristics, aims to assess the quality of financial information across multiple dimensions or concepts simultaneously. To provide a more comprehensive, transparent, and current framework of these concepts, the International Accounting Standards Board (IASB) periodically updates the Conceptual Framework for Financial Reporting. The latest and revised Conceptual Framework was published on March 29, 2018 (IASB, 2018). These qualitative characteristics demonstrate how the information in financial reports supports the decision-making process. Furthermore, this approach considers all components and statements within the annual reports, encompassing both financial and non-financial information.

As the most appropriate method of assessing the information quality in the literature, the QCs-based method is suggested (Bandara, 2020; Chmielowiec-Lewczuk, Lament, Bauer, & Spigarska, 2023; Karim & Bahabbaz, 2023; Mechta, Szeles, & Siklosi, 2023).

In line with this, the present study is dedicated to designing an FRQ measurement index utilizing QCs. Building upon this overarching aim, a series of specific research objectives (RO) and related sub-research objectives (SRO) have been established.

RO 01: Creation of an FRQ measurement index grounded in the qualitative characteristics of financial information outlined in the Conceptual Framework published by the IASB.

This research aims to construct the FRQ measurement model grounded on the six (06) QCs outlined in the IASB's Conceptual Framework for Financial Reporting. Consequently, six (06) Sub-Research Objectives (SROs) have been formulated to guide this development.

- *SRO 01a: Determine the relevant information dimensions and sub-components necessary to assess the 'Relevance' of information, which plays a crucial role in forming the FRQ measurement model.*
- *SRO 01b: Determine the relevant information dimensions and sub-components essential for measuring the 'Faithful Representation' of information, contributing significantly to the development of the FRQ measurement framework.*
- *SRO 01c: Identify the appropriate information dimensions and sub-components to evaluate the 'Comparability' of information, which is vital for the FRQ measurement model's development.*
- *SRO 01d: Determine the relevant information dimensions and sub-components needed to assess the 'Timeliness' of information, supporting the construction of the FRQ measurement model.*
- *SRO 01e: Identify the appropriate information dimensions and sub-components to measure the 'Understandability' of information, which is key to developing the FRQ measurement approach.*
- *SRO 01f: Determine the relevant information dimensions and sub-components necessary to evaluate the verifiability of information, contributing to the overall development of the FRQ measurement model.*

Further, the study's findings aim to highlight how enhancing FRQ contributes directly to corporate sustainability by strengthening governance, transparency, and accountability. The proposed QC-based FRQ model promotes ethical reporting practices, reduces information asymmetry, and supports responsible decision-making. By ensuring faithful representation and comparability, it fosters stakeholder trust and long-term confidence in financial systems. In the Sri Lankan context, the model provides a localized tool to align corporate reporting with sustainability principles, reinforcing the integrity and resilience of financial institutions and markets.

2. LITERATURE REVIEW

2.1. Definition of Financial Reporting Quality

Scholars have diverse interpretations and methods for defining and assessing FRQ, with Achim and Chiş (2014) observing that the definition varies significantly among individuals, projects, companies, and organizations, depending on their specific objectives for utilizing financial information. It is noted that the main reason for having a variety of definitions for FRQ is that different interested parties or users refer to the financial reports for different information needs. When observing the definitions, it is noticed that only a few definitions focus on the QCs as the measurement of decision-usefulness, which leads to FRQ, while some definitions talk about only financial information (Achim & Chiş, 2014; Asmar, Alia, & Ali, 2018; Dobija, Hryckiewicz, Zaman, & Puławska, 2022; Mohamed A Elbannan, 2011; Helfaya, Whittington, & Alawattage, 2019; Jonas & Blanchet, 2000; Nguyen, 2024; Nguyen & Dang, 2022; Nguyen & Dang, 2023; Ramachandran & Charumathi, 2011; Ud Din et al., 2021; Vargiya, 2015).

Annual reports typically include both financial and non-financial data, encompassing both qualitative and quantitative aspects. In making economic decisions, users (investors) require all these types of information. It is obvious that information provided through financial statements becomes more meaningful when read together with all the reports and other notes given in the annual reports. With these, it can be concluded that when developing the definitions of FRQ, it needs to be focused on both financial and non-financial information, and it will enhance the decision-usefulness. Scholars; Al-Ajmi (2009), De Zoysa and Rudkin (2010), Robinson and Munter (2004), Stainbank and Peebles (2006), Mitnick, Windsor, and Wood (2022), also pointed out the essentiality of having non-financial information and other narrative reports for decision-making by the users.

In summary, it is difficult to find a universally accepted definition for measuring FRQ. The main reason for the absence of a clear understanding of the quality is that different users expect different information when making decisions (Bandara, 2020).

Finally, it is important to analyze the QCs outlined in the IASB's Conceptual Framework, as they serve as quality assessment proxies from the investors' viewpoint, emphasizing both financial and non-financial information presented in the annual reports.

2.2. Measurement of Financial Reporting Quality

Due to the non-availability of a universally accepted concept for measuring the quality of accounting information within the scientific community, many authors and theoreticians have attempted to formulate valid definitions and indicators of measurement to assess the quality of accounting and financial information (Karim & Bahabbaz, 2023). By developing a conceptual framework, the IASB aims to define the qualitative characteristics that underpin accounting and financial information. Consequently, these characteristics are categorized into two groups: (i) fundamental qualitative qualities, namely relevance and faithful representation, and (ii) enhancing qualities, including comparability, verifiability, timeliness, and understandability. Building on these principles, the primary hypothesis is articulated as follows.

H_1: The Financial Reporting Quality (FRQ) measurement model is developed in accordance with the qualitative characteristics of financial information outlined in the Conceptual Framework issued by the IASB.

2.3. Qualitative Characteristics of Accounting Information

2.3.1. Relevance

Financial information is considered relevant if it has the potential to influence the decisions made by users of accounting information. The relevant information has *predictive value* (i.e., the ability to use the financial information to predict future outcomes), *confirmatory value* (i.e., the ability to provide feedback on previous evaluations and facilitate users in confirming or correcting previous decisions), or *both* (IASB, 2018). Relevant information is more useful to users when making sustainable economic decisions (Dima, 2013). Further, relevant information should be able to provide insight into business opportunities, risks, as well as possible future scenarios for the company (Jonas & Blanchet, 2000). If the omission or falsification of financial data impacts the economic decisions made by users, it is considered relevant information (Kieso, Weygandt, & Warfield, 2019). Accordingly, the concept of relevance is considered a proxy in the development of the FRQ index, and hence, the first sub-hypothesis of the research is developed as follows.

H_{1a}: Selected main information dimensions and sub-information items significantly contribute to measuring the 'Relevance' of information when developing the FRQ measurement model.

To develop the FRQ measurement model, the key information dimensions and their respective sub-information items related to the variable 'Relevance' as presented in Table 1 were employed.

Table 1. Main information dimension and sub-information item under 'relevance'.

Main information dimension	Sub-information items		Literature
	Code	Item name	
Forward-looking Information (RFL)	RFL01	Projected revenue growth	Bandara (2020) and Celik, Ecer, and Karabacak (2006)
	RFL02	Projected profit growth	Bandara (2020) and Celik et al. (2006)
	RFL03	Projected earnings per share (EPS) growth	Alattar and Al-Khater (2008)
	RFL04	Projected increase in market price per share (MPS)	Bandara (2020); Joshi and Abdulla (1994); Mirshekary and Saudagaran (2005), and XRB (2016)
	RFL05	Potential business prospects	Bandara (2020)
	RFL06	Upcoming strategies will be implemented to attain either revenue or earnings objectives.	Bandara (2020) and Mirshekary and Saudagaran (2005)
	RFL07	Factors impacting the achievement of revenue or earnings targets.	Bandara (2020) and De Zoysa and Bhati (2011)
	RFL08	Expected increase in dividend per share.	Bandara (2020); Celik et al. (2006); De Zoysa and Bhati (2011), and Naser, Nuseibeh, and Al-Hussaini (2003)
	RFL09	Details regarding upcoming non-financial key performance indicators.	Bandara (2020) and CASL (2017)
	RFL10	Other factors (Company plans, projects, capital expenditure plans, etc.)	Celik et al. (2006)
	RCF01	Projected cash flows	Bandara (2020)
	RCF02	Historical cash, bank, and other cash equivalent details.	Bandara (2020)
	RCF03	Cash flow comparison data spanning multiple previous years.	Bandara (2020)
	RCF04	Reasons or justifications for changes in previous cash flows (operating, investing, or financing activities).	Bandara (2020)

Main information dimension	Sub-information items		Literature
	Code	Item name	
Cash flow information (RCF)	RCF05	Details of cash flows segmented by product, sector, or geographical classification.	Bandara (2020)
	RCF06	Other factors (Additional information, cash, bank, and other cash equivalent details, etc...)	Mirshekary and Saudagaran (2005)
Segmental information (RSI)	RSI01	Segmented information regarding revenue.	Bandara (2020); IASB (2013) and Mirshekary and Saudagaran (2005)
	RSI02	Comparative information on revenue by segment.	Bandara (2020); IASB (2013) and CASL (2017)
	RSI03	Segment-specific information on historical profit.	Bandara (2020); IASB (2013) and CASL (2017)
	RSI04	Projected profit by segment.	Aleksanyan and Danbolt (2015); Bandara (2020) and XRB (2016)
	RSI05	Segment-specific non-financial key performance indicators.	Bandara (2020) and PwC (2017)
	RSI06	Other factors (Providing non-mandatory information)	Aleksanyan and Danbolt (2015)
Information on measuring assets, liabilities, and equity at fair value (RFV)	RFV01	Assets, liabilities, and equity line items are valued at their original cost.	Bandara (2020)
	RFV02	Assets, liabilities, and equity line items are measured at fair value.	Bandara (2020); Beest et al. (2009); Braam and Beest (2013) and CASL (2017)
	RFV03	Explaining the valuation techniques utilized for assets, liabilities, and equity components.	Bandara (2020); Hooks, Coy, and Davey (2002) and IASB (2011)
	RFV04	Details regarding changes in the fair value.	Bandara (2020)
	RFV05	Other factors (Other non-financial information on valuation)	Braam and Beest (2013)
Capital structure information (RCS)	RCS01	Explanations of the gearing ratio (Debt-to-Equity) employed to finance assets.	Bandara (2020); Cascino et al. (2014) and XRB (2016)
	RCS02	Comparative information on changes in the capital structure.	Bandara (2020); Benjamin and Stanga (1977) and PAAinE (2009)
	RCS03	Details regarding the composition of non-current liabilities.	Bandara (2020)
	RCS04	Other factors (other related information such as dividend payments, finance costs, etc.)	Cascino et al. (2014)
Risk-related information (RRR)	RRR01	Details on the company's risk profiles for the current year.	Amran, Bin, and Hassan (2008) and Bandara (2020)
	RRR02	Information regarding risk mitigation strategies.	Bandara (2020); Botosan, Plumlee, and Xie (2004) and KPMG International (2014)
	RRR03	Comparative analysis of risk profiles against previous years.	Bandara (2020); Botosan et al. (2004); KPMG International (2014) and XRB (2016)
	RRR04	Other factors (Information related to predicting financial distress and credit ratings)	Cascino et al. (2014)

2.3.2. Faithful Representation

Economic phenomena involve presenting information about an entity's economic resources, the obligations or claims on those resources, and the impact of transactions and other events. They also include details about the circumstances that alter these resources and claims. An entity's financial report represents such economic phenomena

in words and numbers, and this representation is expected to be faithful (IASB, 2018). Qualities such as being free from material mistakes, completeness, naturality, and verifiability can be used as measures of faithful representation (Cohen, Dey, & Lys, 2008; Gaeremynck & Willekens, 2003; Jonas & Blanchet, 2000; Rezaee, 2003; Sloan, 2001). Therefore, in the construction of the FRQ measurement model, faithful representation is used as the second proxy, and hence the second sub-hypothesis is constructed as.

H_{1b}: The Faithful Representation of Information significantly contributes to the development of the FRQ measurement model.

To develop the FRQ measurement model, the primary information dimensions and their corresponding sub-items, outlined in Table 2, have been employed in relation to the variable 'Faithful Representation of Information'.

Table 2. Main information dimension and sub-information item under 'faithful representation'.

Main information dimension	Sub-information items		Literature
	Code	Item name	
Information on accounting estimates and policies (FRAEP)	FRAEP 01	The rationale behind the chosen accounting policies.	Bandara (2020) and Beest et al. (2009)
	FRAEP 02	The foundation for determining accounting estimates.	Bandara (2020)
	FRAEP 03	Describing the constraints associated with making accounting estimates and choosing accounting policies.	Bandara (2020)
	FRAEP 04	The elements influencing decisions regarding accounting estimates and the choice of accounting policies.	Bandara (2020)
	FRAEP 05	Explanations concerning the reasons behind changes in accounting estimates and policies.	Bandara (2020) and Cole, Branson, and Breesch (2012)
	FRAEP 06	Other factors (The annual report includes an unqualified auditor's report)	Beest et al. (2009)
Information on related party disclosure (FRRPD)	FRRPD 01	Providing a report or information from independent related-party transactions.	Bandara (2020)
	FRRPD 02	Other factors (Other related party disclosures under corporate governance)	Beest et al. (2009)
Information on self-reported events (FRSRE)	FRSRE 01	Details regarding previous negative events.	Bandara (2020)
	FRSRE 02	Details of previous positive events.	Bandara (2020)
	FRSRE 03	Expected future negative information.	Bandara (2020)
	FRSRE 04	Expected future positive information.	Clatworthy and Jones (2003) and Bandara (2020)
	FRSRE 05	Other Factors (Providing both positive and negative events in a balanced manner)	Beest et al. (2009)

2.3.3. Comparability

Providing comparable information is crucial for users, as it enables them to effectively evaluate and select between alternative options. For example, whether to sell or hold an investment in the shares of a company. Therefore, financial information is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or date (IASB, 2018). Cuong and Ly (2017) also emphasized the importance of the concept of comparability, and they assessed comparability through information on changes in accounting policies, information on changes in accounting estimates, relevant comparative information, and the impact of changes in accounting policies, financial indices, and reports, as well as information on shareholders'

investments, industry, and competition-related information. Therefore, comparability is selected as the third proxy of the FRQ measurement index, and the related sub-hypothesis is constructed accordingly.

H_{1c}: The comparability of information significantly contributes to the development of the FRQ measurement model.

The primary information dimensions and their associated sub-items, as detailed in Table 3, have been utilized in the development of the FRQ measurement model, specifically concerning the variable 'Comparability of Information'.

Table 3. Main information dimension and sub-information item under 'comparability of information'.

Main information dimension	Sub-information items		Literature
	Code	Item name	
Comparative information (CCI)	CCI 01	Analysis of comparative data concerning revenue and profit.	Bandara (2020)
	CCI 02	Comparison of the revenue of the current year with the budgeted revenue from the previous year.	Bandara (2020)
	CCI 03	Analysis of the company's information in relation to industry and economic data.	Cole et al. (2012), CASL (2017), and Bandara (2020)
	CCI 04	Analysis of non-financial key performance indicators in comparison to the previous year.	CASL (2017) and PwC (2017)
	CCI 05	Other factors (information in the annual report is comparable to information provided by other organizations).	Beest et al. (2009)
Financial ratios (CFR)	CFR 01	Information relating to an analysis of financial position and performance using ratios.	Arkan (2016) and Bandara (2020)
	CFR 02	Other Factors (Other ratios are shown under voluntary disclosures)	Hooks et al. (2002)

2.3.4. Understandability

Understandability represents the attribute that, by classifying, characterizing, and presenting information clearly and concisely, makes it understandable (IASB, 2018). Beest et al. (2009) it was also reported that understandability will increase when information is classified, characterized, and presented clearly and concisely, emphasizing the importance of understandability. With classification and characterization, the organization of information will improve, and users can easily comprehend the specific information they search for (Jonas & Blanchet, 2000). The presentation of disclosure information and notes to the financial statements will provide more insight into financial figures (Beretta & Bozzolan, 2008). Based on these facts, the concept of understandability is adopted as the fourth proxy in the development of the FRQ index. Consequently, the fourth sub-hypothesis is formulated as follows.

H_{1d}: The Understandability of Information significantly contributes to the development of the FRQ measurement model.

The primary information dimensions and their associated sub-items, as detailed in Table 4, have been utilized in the development of the FRQ measurement model, specifically concerning the variable 'Understandability of Information'.

Table 4. The main information dimension and sub-information item under 'understandability of information'.

Main information dimension	Sub-information items		Literature
	Code	Item name	
Readability of information (UR)	UR 01	Use of shorter sentences to explain information.	Biddle, Hilary, and Verdi (2009); Jang and Rho (2016), and Bandara (2020)
	UR 02	Use of non-technical terms (words) to explain information.	Lu and Beamish (2004), Financial Reporting Council (2017), and Bandara (2020)
	UR 03	Other Factors (the degree of organization and clarity of	Beest et al. (2009)

Main information dimension	Sub-information items		Literature
	Code	Item name	
		information presented in the annual report)	
Glossary of terms (UGT)	UGT 01	Providing a glossary of terms to accompany the annual reports .	Beest et al. (2009); Financial Reporting Council (2017), and Bandara (2020)
	UGT 02	Other Factors (how well-managed the technical jargon is and the industry-related jargon in the annual report)	Beest et al. (2009)
Graphical information (UGI)	UGI 01	Utilization of graphs, charts, or tables to illustrate information within the annual reports.	Beattie and Jones (2008), Jonas and Blanchet (2000), and Bandara (2020)
	UGI 02	Other Factors (The degree to which conciseness was ensured in the annual report)	Jonas and Blanchet (2000)
Notes to the financial statement (UNFS)	UNFS 01	Extent of information disclosed in the financial statement notes .	Lu and Beamish (2004), Beretta and Bozzolan (2008), and Bandara (2020)
	UNFS 02	Other factors (how well the narrative explanations are in the annual report)	Iu and Clowes (2004)

2.3.5. Timeliness

According to the IASB (2018) conceptual Framework, the more recent the information, the more useful it is. While certain types of information retain their relevance over an extended period, such as data used to identify and evaluate long-term trends, generally, more recent information holds greater value. This is because the business environment, market conditions, and financial circumstances frequently change, making up-to-date data crucial for accurate decision-making. When a financial statement is presented with information related to the closest period immediately after the end of a given financial year, it can be treated as a better financial statement El-Maude, Bawa, Dandago, and Abu-Saeed (2015). According to Dima (2013), timeliness refers to the fact that if there is undue delay in reporting the information, it may lose its relevance, and the management may need to choose between the relative value of the reporting at a certain time and providing reliable information. The above grounds provide a basis for the timeliness concept as the fifth proxy, and it leads to the development of the fifth sub-hypothesis.

H_{1e}: The Timeliness of Information significantly contributes to the development of the FRQ measurement model.

Table 5 presents the key information dimensions and corresponding sub-items used to develop the FRQ measurement model, specifically regarding the 'Timeliness of Information' variable.

Table 5. The main information dimension and the sub-information item under 'timeliness of information'.

Main information dimension	Sub-information items		Literature
	Code	Item name	
Information on the timely publishing of Financial Reports (TFR)	TFR 01	After ending the financial year, during the first three-month period, annual reports undergo an audit and are completed.	Özer, Merter, and Balcıoğlu (2023)
	TFR 02	Annual reports are released within three months after the end of the financial year.	Clatworthy and Peel (2016), Naser et al. (2003), and Bandara (2020)
	TFR 03	Interim financial statements are prepared and finalized within 45 days of the conclusion of each quarter.	Özer et al. (2023)
	TFR 04	Interim financial statements are released within 45 days following the conclusion of each quarter.	Dola and Mead (2019)
	TFR 05	Other Factors (firms with busy auditors)	Singh, Sultana, Islam, and Singh (2022)

2.3.6. Verifiability

When information can be verified, it provides assurance that the information faithfully represents the economic phenomena being depicted (IASB, 2018). The concept of verifiability aims to assure users of the provision of accurate financial information, and it represents the economic phenomena they intend to describe (Dima, 2013). According to ASBJ (2006), in measuring profits, estimates may vary significantly based on the person who makes the estimates. The usefulness of information increases if it is verifiable. Therefore, the expectation of the presentation of financial statements under this concept should be based on facts unaffected by the subjective judgment of the person making the measurement or evaluation of financial reports (Aifuwa, Embele, & Saidu, 2018). With this ground, the verifiability is used as the sixth proxy, and the sub-hypothesis is developed as.

H_{1f}: The Verifiability of Information significantly contributes to the development of the FRQ measurement model.

The primary information dimensions and their associated sub-items, as detailed in Table 6, have been utilized in the development of the FRQ measurement model, specifically concerning the variable 'Verifiability of Information'.

Table 6. Main information dimension and sub-information item under 'verifiability of information'.

Main information dimension	Sub-information items		Literature
	Code	Item name	
Information in the audit report (VAR)	VAR 01	A financial statement accompanied by an unqualified (unmodified) audit opinion, as opposed to one with a modified audit opinion.	Bandara (2020)
	VAR 02	Providing independent third-party verification for narrative reports.	Bandara (2020)
	VAR 03	Annual reports audited by the major global accounting firms (Big Four: EY, PWC, KPMG, Deloitte).	Robu and Robu (2015), Rusmin and Evans (2017) and Bandara (2020)
	VAR 04	The Audit Committee plays an oversight and advisory role on the financial statements.	KPMG (2001)
	VAR 05	The independence of the audit committee enhances the transparency of financial reports.	Babalola, Kokogho, Odio, Adeyanju, and Sikhakhane-Nwokediegwu (2025)
	VAR 06	Other Factors (ICFR – Internal Control over Financial Reporting)	KPMG (2001)

Building on the reviewed literature, FRQ can be theoretically positioned as a cornerstone of sustainable economic decision-making. High-quality financial information characterized by relevance, faithful representation, comparability, verifiability, timeliness, and understandability extends beyond short-term decision usefulness to underpin the long-term sustainability of organizations and markets. By reducing information asymmetry and strengthening accountability, FRQ fosters ethical management behavior, transparent governance, and efficient capital allocation, which are critical for corporate sustainability (Helfaya et al., 2019; Nguyen, 2024). Moreover, reliable financial reporting supports investors and policymakers in evaluating risks and opportunities with a long-term perspective, aligning corporate strategies with principles of economic resilience and sustainability. Hence, the FRQ framework does not merely improve financial decision-making but serves as an enabler of sustainable governance and market trust within emerging economies like Sri Lanka.

3. RESEARCH METHODOLOGY

This study primarily centers on developing the FRQ measurement model, utilizing a comprehensive QC-based approach. As outlined in the literature, this approach considers all QCs as proxies for the usefulness of information and aligns with the IASB Conceptual Framework. Consequently, six elements of the independent variable, namely

FRQ, are identified based on the QCs specified in the Framework: Relevance, Faithful Representation, Understandability, Comparability, Verifiability, and Timeliness.

A questionnaire-based survey was conducted to collect data from users of annual reports (i.e., investors) in the Sri Lankan stock market. The data collection process followed a mixed-mode approach, incorporating online surveys (via Google Forms and email distribution) and paper-based questionnaires. The survey included technically oriented questions related to the perceived importance and usefulness of annual reports, requiring respondents to possess a sound understanding of accounting and financial reporting principles. Prior literature has indicated that individuals with professional or academic expertise in accounting and finance, such as experts and graduate-level business students, are suitable participants for this type of study (Elliot, Maier, Moller, Friedman, & Meinhardt, 2007; Gassen & Schwedler, 2010). Accordingly, the sample comprised financial consultants, stockbrokers, audit firm partners, chartered accountants, accountants, and corporate managers.

A total of 387 valid responses were obtained. Participation in the study was entirely voluntary, and informed consent was obtained from all respondents before participation. Respondents were assured of anonymity and confidentiality, and all data were collected solely for academic and research purposes. No personally identifiable information was recorded, ensuring full compliance with ethical research standards for studies involving human participants.

3.1. Construction of FRQ Measurement Model

The construction of the FRQ Measurement model consists of 17 information dimensions, which have been constructed with 75 sub-information items, called 'indicators'. This is considered the latent construct/first-order construct of the model, and based on the 17 information dimensions, 06 QCs were developed as the second-order construct. Finally, FRQ has been assessed using the said 06 QCs at the third-order construct as portrayed in the model given under Figure 1;

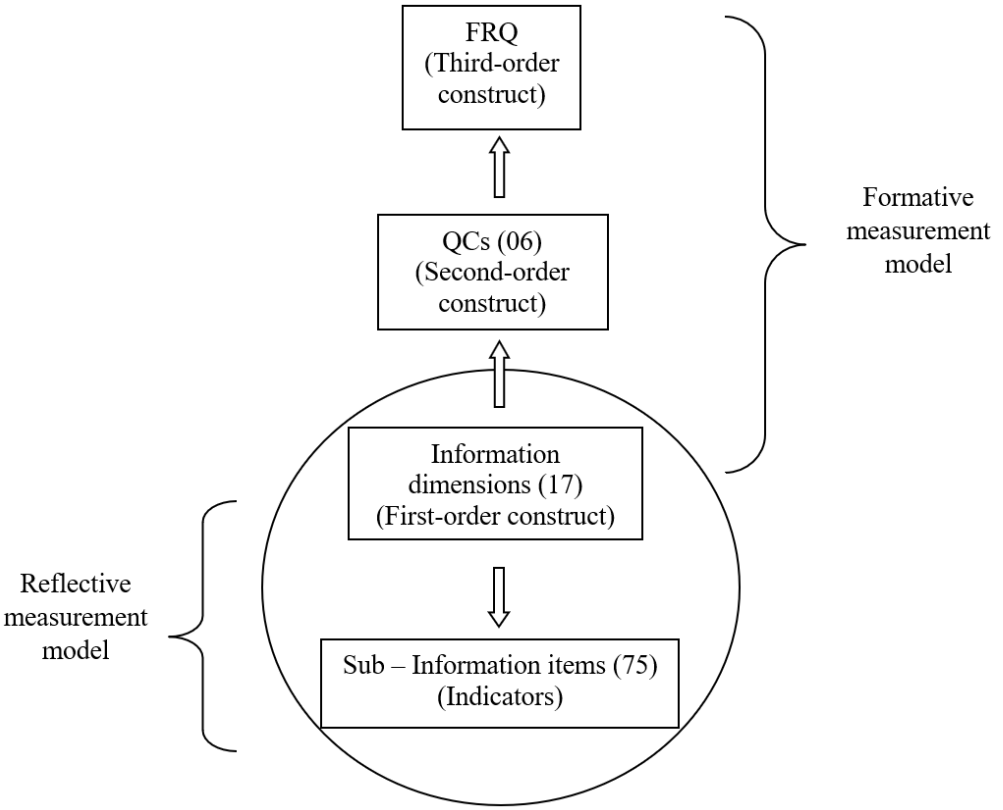

Figure 1. Structure of the FRQ measurement model.

In the first-order construct, the arrows point from the construct toward the indicator variables since the connection between the construct and its indicators is reflective. Conversely, the second and third-order constructs are treated as formative measurement models, with arrows directed from the indicators to the construct. A reflective measurement model assumes that the construct causes the indicators, whereas in a formative measurement model, the indicators are viewed as causing the latent construct. Therefore, the FRQ measurement model developed here combines both reflective and formative approaches. This hybrid FRQ measurement model serves as the foundation for the conceptual framework of the study, which is outlined in Figure 2.

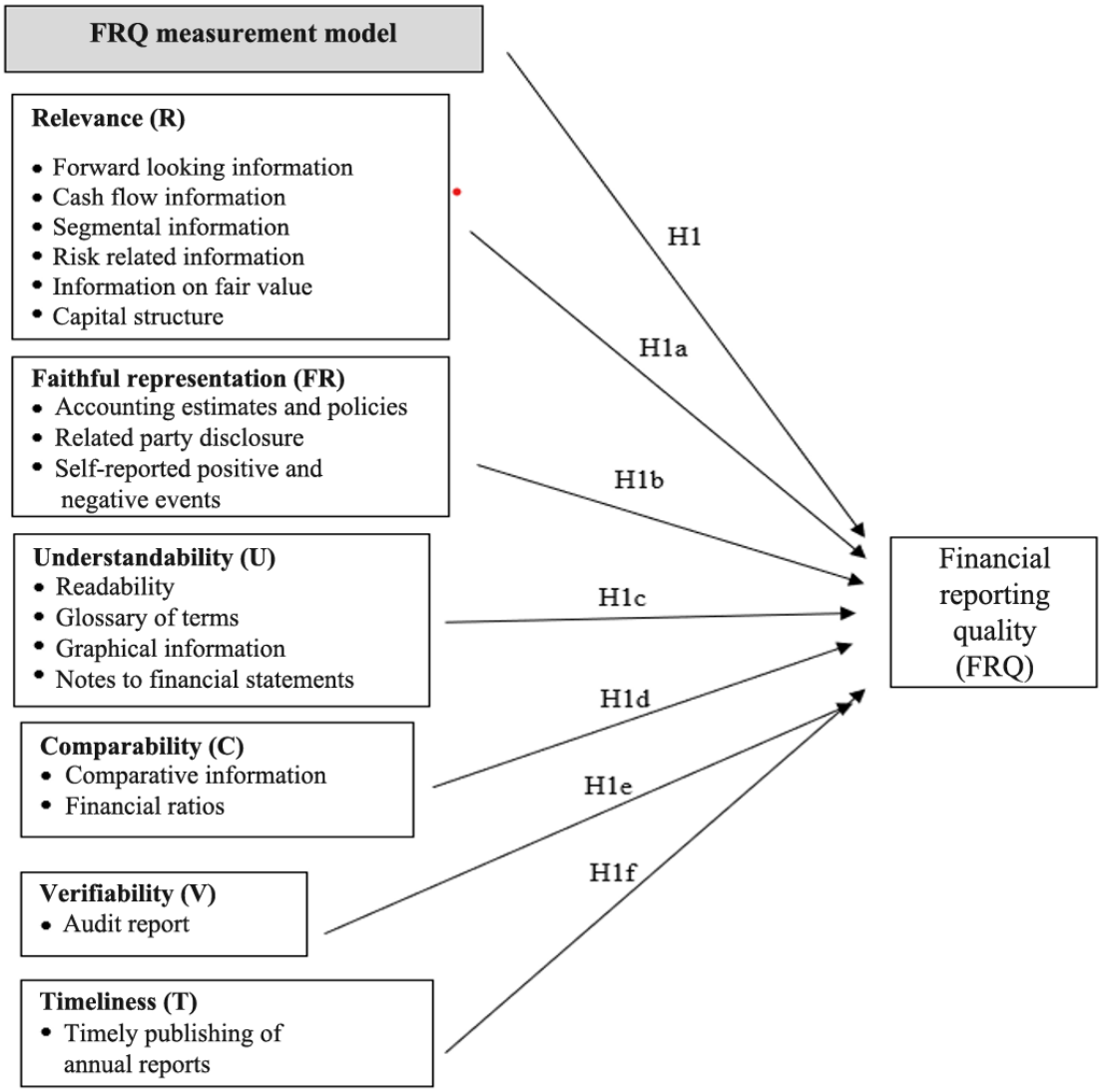

Figure 2. Conceptual framework.

Data was gathered through a questionnaire survey. In total, 408 questionnaires were collected and subsequently subjected to data screening, resulting in 397 questionnaires being selected as the final sample dataset.

Exploratory Factor Analysis (EFA) was conducted using IBM SPSS Statistical Software (Version 20) as the initial step. Since the FRQ measurement model comprises 75 sub-information items (indicators), representing 17 information dimensions under six independent variables (as shown in Figure 01), each variable was analyzed separately for factor analysis. Variables were selected based on the IASB Conceptual Framework and the adopted questionnaire; each variable was considered independently for the factor analysis (Bandara, 2020; Hair, Black, Babin, & Anderson, 2010; Hair, Hult, Ringle, & Sarstedt, 2016). With the KMO and Bartlett's tests, factor loadings, and

reliability analysis, the FRQ measurement model is limited to 65 sub-information items across 15 information dimensions.

The second step involved conducting a Confirmatory Factor Analysis (CFA). Based on the results, the FRQ measurement model was refined to include 63 sub-information items across 14 information dimensions. To ensure a more robust evaluation of the measurement model, three statistical measures, as recommended by Hair et al. (2016) and Bandara (2020) were performed: (i) convergent validity (assessed through indicator reliability and Average Variance Extracted), (ii) internal consistency (evaluated using Cronbach's alpha and composite reliability), and (iii) discriminant validity (measured using the Fornell-Larcker criterion and HTMT ratios).

To confirm the validity of the second-order model, the Variance Inflation Factor (VIF) is employed to detect potential multicollinearity, alongside an analysis of the outer weights' significance, consistent with the guidelines proposed by Hair et al. (2016). Similarly, the examination of the relationships and contributions of the six Qualitative Characteristics (as second-order constructs) to the FRQ (a third-order construct) adheres to the same methodology, involving both the assessment of VIF values and significance testing of the outer weights, as conducted for the second-order formative model.

4. RESULT AND DISCUSSION

4.1. Exploratory Factor Analysis (EFA)

To identify how variables group into underlying factors, reduce many variables into fewer summary factors, help develop and validate measurement instruments, suggest new theoretical constructs or relationships, evaluate consistency among items in a scale, and identify redundant or irrelevant variables, the EFA analysis is carried out.

4.2. Relevance

EFA analysis is carried out for the variable of "Relevance" with three iterations, and at the first iteration, there were six (06) information dimensions and 35 sub-information items. However, due to cross-loading situations, some of the information items have been deleted, and finally, the Kaiser-Meyer-Olkin measure (KMO value) is reported as 0.930. The outcome is reported in Table 7, with 28 information items under six (06) dimensions.

Table 7. Results of the EFA Analysis of the variable – Relevance.

Variable	Information dimension	Sub-information item recognized in conceptual framework	Items deleted during the process of EFA	Items finalized through EFA
Relevance	Forward-looking information (RFL)	RFL01, RFL02, RFL03, RFL04, RFL05, RFL06, RFL07, RFL08, RFL09, RFL10.	RFL04, RFL05, RFL09, RFL10	RFL01, RFL02, RFL03, RFL06, RFL07, RFL08.
	Cash flow information (RCF)	RCF01, RCF02, RCF03, RCF04, RCF05, RCF06	RCF06.	RCF01, RCF02, RCF03, RCF04, RCF05.
	Segmental information (RSI)	RSI01, RSI02, RSI03, RSI04, RSI05, RSI06.	-	RSI01, RSI02, RSI03, RSI04, RSI05, RSI06.
	Information on measuring assets, liabilities, and equity at fair value (RFV)	RFV01, RFV02, RFV03, RFV04, RFV05.	RFV05	RFV01, RFV02, RFV03, RFV04.
	Capital structure information (RCS)	RCS01, RCS02, RCS03, RCS04	RCS04	RCS01, RCS02, RCS03
	Risk-related information (RRR)	RRR01, RRR02, RRR03, RRR04	-	RRR01, RRR02, RRR03, RRR04

4.3. Faithful Representation

The variable of Faithful Representation was initially constructed with three (03) dimensions and 13 information items. After considering cross-loadings, the outcome of the second iteration of this variable is finalized with two factors, which are Accounting Estimates and Self-reported Events. The KMO value is reported as 0.880 in the final iteration, as shown in Table 8.

Table 8. Results of the EFA analysis of the variable – faithful representation.

Variable	Information dimension	Sub-information item recognized in the conceptual framework	Items deleted during the process of EFA	Items finalized through EFA
Faithful representation	Information on accounting estimates and policies (FRAEP)	FRAEP01, FRAEP02, FRAEP03, FRAEP04, FRAEP05, FRAEP06.	-	FRAEP01, FRAEP02, FRAEP03, FRAEP04, FRAEP05, FRAEP06.
	Information on related party disclosure (FRRPD)	FRRPD01, FRRPD02.	FRRPD01 FRRPD02	Both items were deleted, and hence, no item remains.
	Information on self-reported events (FRSRE)	FRSRE01, FRSRE02, FRSRE03, FRSRE04, FRSRE05.	-	FRSRE01, FRSRE02, FRSRE03, FRSRE04, FRSRE05.

4.4. Understandability

The initial development of the variable, understandability, is constructed with four (04) information dimensions/factors and nine (09) sub-information items. However, the rotated component matrix results show three (03) factors/components. UNSF01 is cross-loaded; hence, it has to be deleted and the factor analysis rerun. In the second iteration, the variable "Understandability" is finalized with a 0.789 KMO value and three (03) components. Furthermore, information items UGI01, UGI02, and UNSF02 have been loaded as one component, as per the analysis in Table 9.

Table 9. Results of the EFA analysis of the variable – understandability.

Variable	Information dimension	Sub-information item recognized in the conceptual framework	Items deleted during the process of EFA	Items finalized through EFA
Understandability	Readability of information (UR)	UR01, UR02, UR03.	–	UR01, UR02, UR03.
	Glossary of terms (UGT)	UGT01, UGT02	–	UGT01, UGT02
	Graphical information (UGI)	UGI01, UGI02	–	Items UGI01, UGI02, and UNFS02 have been combined as one component*.
	Notes to the financial statement (UNFS)	UNFS01, UNFS02	UNFS01	

4.5. Comparability

The factor analysis results of the first iteration provided the final results for the variable "Comparability," as shown in Table 10, with a KMO value of 0.770. Two (02) components are reported, containing five (05) and two (02) information items, respectively, as shown in Table 10.

Table 10. Results of the EFA analysis of the variable – comparability.

Variable	Information dimension	Sub-information Item recognized in the conceptual framework	Items deleted during the process of EFA	Items finalized through EFA
Comparability	Comparative information (CCI)	CCI01, CCI 02, CCI03, CCI04, CCI05.	–	CCI01, CCI 02, CCI03, CCI04, CCI05.
	Financial ratios (CFR)	CFR01, CFR02	–	CFR01, CFR02

4.6. Verifiability

As per the conceptual framework of this research, the variable – Verifiability has only one factor/component, and it suggests that all of the sub-information items fit onto a single theoretical construct. That means, operationally, this variable has one information dimension, and no more factors to potentially correlate with; hence, there is no need to rotate to reduce correlation. Therefore, EFA for this variable was not carried out. The KMO results are reported as 0.887, and the final combination of items of the variable verifiability is presented in Table 11.

Table 11. Results of the EFA analysis of the variable – verifiability.

Variable	Information dimension	Sub-information item recognized in conceptual framework
Verifiability	Information in the audit report (VAR)	VAR01, VAR02, VAR03, VAR04, VAR05, VAR06.

4.7. Timeliness

The variable, Timeliness, also has only one factor/component, and here all of the sub-information items are considered as a single theoretical construct, as depicted in the conceptual framework. Since the variable has one information dimension, it shows no additional factors that potentially correlate with it; therefore, there is no requirement to run a rotated component matrix to reduce correlation. Accordingly, EFA for this variable was not conducted. The KMO results indicate a value of 0.866, and the final combination of items is provided in Table 12.

Table 12. Results of the EFA analysis of the variable – timeliness.

Variable	Information dimension	Sub-information item recognized in the conceptual framework
Timeliness	Information on the timely publishing of financial reports (TFR)	TFR01, TFR02, TFR03, TFR04, TFR05.

4.8. Reliability Analysis

To evaluate the reliability of the questionnaire, Cronbach's Alpha was tested, and the results for all the information dimensions are provided in Table 13.

Table 13. Reliability analysis results table of all the variables.

Serial number	Variable	Information dimensions	Cronbach's alpha
1	Relevance	Forward-looking information	0.920
		Cash flow information	0.936
		Segmental information	0.916
		Risk-related information	0.868
		Information on fair value	0.918
		Capital structure information	0.875
2	Faithful Representation	Accounting estimates and policies	0.956
		Related-party disclosure	0.769
		Self-reported positive and negative events	0.927
3		Readability	0.843

Serial number	Variable	Information dimensions	Cronbach's alpha
	Understandability	Glossary of terms	0.818
		Graphical information	0.777
		Notes to the financial statements	0.770
4	Comparability	Comparative information	0.908
		Financial ratios	0.789
5	Verifiability	Audit reports	0.942
6	Timeliness	Timely publishing of financial reports	0.920

4.9. Confirmatory Factor Analysis (CFA) via Individual Measurement Model

Confirmatory Factor Analysis (CFA) is a specialized form of factor analysis used to assess whether the measures of a particular construct align with the researcher's conceptual understanding of that construct. It has replaced older methods for establishing construct validity. CFA serves as a statistical tool to verify the factor structure among observed variables. It enables researchers to test the hypothesis that certain observed variables are related to underlying latent factors. Using theoretical insights, empirical findings, or both, the researcher proposes a specific relationship pattern beforehand and then evaluates this hypothesis through statistical analysis.

Therefore, following the development of the PLS path model, the PLS algorithm is executed. The measurement model involves evaluating the quality of the constructs, specifically their reliability and validity. This section emphasizes how to report these aspects for the constructs within the study. When presenting the measurement model, researchers should begin by examining the factor loadings, which indicate how effectively each item reflects the underlying construct.

There are many studies that reported that factor loadings should be greater than 0.5 for better results (Hulland, 1999; Truong & McColl, 2011), whereas in the tourism context, Chen and Tsai (2007) also considered 0.5 as a cut-off for acceptable loadings. Additionally, while exploring pro-environmental consumer behaviour, Ertz, Karakas, and Sarigöllü (2016) have considered the factor loadings of 0.4 and above for their confirmatory factor analysis. Based on these prior studies, it is decided that the factor loadings should be greater than 0.50 as proposed by Hair, Money, Samouel, and Page (2007) for this research study. The factor loading of 65 sub-information items to 15 information dimensions is given below in Table 14.

Table 14. Factor Loadings of 65 sub-information items to 15 information dimensions.

Serial number	Variable	Information dimensions	Factor loadings			
			Indicator	Loading	Indicator	Loading
01	Relevance	Forward-looking information (RFL)	RFL01	0.754	RFL06	0.884
			RFL02	0.692	RFL07	0.843
			RFL03	0.621	RFL08	0.763
02		Cash flow information (RCF)	RCF01	0.899	RCF04	0.898
			RCF02	0.856	RCF05	0.889
			RCF03	0.804		
03		Segmental information (RSI)	RSI01	0.876	RSI04	0.785
			RSI02	0.808	RSI05	0.870
			RSI03	0.818	RSI06	0.661
04		Risk-related information (RRR)	RRR01	0.932	RRR03	0.812
			RRR02	0.877	RRR04	0.511
05		Fair value measurement information on assets, liabilities, and equity (RFV)	RFV01	0.777	RFV03	0.886
			RFV02	0.868	RFV04	0.894
06		Capital structure information (RCS)	RCS01	0.888	RCS03	0.838
			RCS02	0.866		
07	Faithful representation	Information on accounting estimates and policies (FRAEP)	FRAEP01	0.874	FRAEP04	0.897
			FRAEP02	0.936	FRAEP05	0.900
			FRAEP03	0.947	FRAEP06	0.763
08		Information on self-reported events (FRSRE)	FRSRE01	0.897	FRSRE04	0.889
			FRSRE02	0.905	FRSRE05	0.675
			FRSRE03	0.869		
09	Understandability		UR01	0.848	UR03	0.790

Serial number	Variable	Information dimensions	Factor loadings			
			Indicator	Loading	Indicator	Loading
		Readability of Information (UR)	UR02	0.782		
10		Graphical information and notes to the financial statement (UGINFS)	UGINFS01	0.751	UGINFS03	0.604
			UGINFS02	0.669		
11		Glossary of terms (UGT)	UGTS01	0.854	UGT02	0.813
12	Comparability	Comparative information (CCI)	CCI01	0.885	CCI04	0.884
			CCI02	0.886	CCI05	0.545
			CCI03	0.893		
13		Financial ratios (CFR)	CFR01	0.442	CFR02	1.472
14	Verifiability	Information in the audit report (VAR)	VAR01	0.892	VAR04	0.918
			VAR02	0.853	VAR05	0.947
			VAR03	0.831	VAR06	0.675
15	Timeliness	Information on the timely publishing of financial reports (TFR)	TFR01	0.963	TFR04	0.835
			TFR02	0.796	TFR05	0.603
			TFR03	0.874		

As per the factor loading results, the information item CFR01 reported an amount of less than 0.5, and CFR02 reported an abnormally high value. Hence, those items are removed for re-drawing the model. The results generated by re-running the consistent PLS algorithms are provided in Table 15.

Table 15. Factor Loadings of 63 sub-information items to 14 information dimensions.

Serial number	Variable	Information dimensions	Factor loadings			
			Indicator	Loading	Indicator	Loading
01	Relevance	Forward-looking Information (RFL)	RFL01	0.754	RFL06	0.884
			RFL02	0.692	RFL07	0.843
			RFL03	0.621	RFL08	0.763
02		Cash flow information (RCF)	RCF01	0.899	RCF04	0.898
			RCF02	0.856	RCF05	0.889
			RCF03	0.804		
03		Segmental information (RSI)	RSI01	0.876	RSI04	0.785
			RSI02	0.808	RSI05	0.870
			RSI03	0.818	RSI06	0.661
04		Risk-related information (RRR)	RRR01	0.932	RRR03	0.812
			RRR02	0.877	RRR04	0.511
05		Fair value measurement information on assets, liabilities, and equity (RFV)	RFV01	0.777	RFV03	0.886
			RFV02	0.868	RFV04	0.894
06		Capital structure information (RCS)	RCS01	0.888	RCS03	0.838
			RCS02	0.866		
07	Faithful representation	Information on accounting estimates and policies (FRAEP)	FRAEP01	0.874	FRAEP04	0.897
			FRAEP02	0.936	FRAEP05	0.900
			FRAEP03	0.947	FRAEP06	0.763
08		Information on self-reported events (FRSRE)	FRSRE01	0.897	FRSRE04	0.889
			FRSRE02	0.905	FRSRE05	0.675
			FRSRE03	0.869		
09	Understandability	Readability of information (UR)	UR01	0.848	UR03	0.790
			UR02	0.782		
10		Graphical information and notes to the financial statement (UGINFS)	UGINFS01	0.751	UGINFS03	0.604
			UGINFS02	0.669		
11		Glossary of terms (UGT)	UGTS01	0.854	UGT02	0.813
12	Comparability	Comparative information (CCI)	CCI01	0.861	CCI04	0.926
			CCI02	0.874	CCI05	0.590
			CCI03	0.843		
13	Verifiability	Information in the audit Report (VAR)	VAR01	0.892	VAR04	0.918
			VAR02	0.853	VAR05	0.947
			VAR03	0.831	VAR06	0.675
14	Timeliness	Information on the timely publishing of financial reports (TFR)	TFR01	0.963	TFR04	0.835
			TFR02	0.796	TFR05	0.603
			TFR03	0.874		

4.10. Unidimensionality, Validity, and Reliability

4.10.1. First-Order Constructs

This section aims to discuss a more robust evaluation of the measurement models at each level. An in-depth evaluation is carried out for the reflective measurement model (First-order construct). For this, the following three statistical measures are used, as suggested by Hair et al. (2016) and Bandara (2020).

i. *Convergent validity* (Using indicator reliability and Average Variance Extracted).
ii. *Internal consistency* (Using Cronbach's alpha and composite reliability).
iii. *Discriminant validity* (Fornell-Larker and HTMT creation).

The factor loading results (indicator reliability) are already given in Table 14. The results of Table 16 presented below show the AVE, CR, and CA results.

Table 16. AVE, CR and CA results at the first-order level.

Serial number	First-order construct	Convergent validity (AVE)	Internal validity CR	Internal validity CA
01	Forward-looking information (RFL)	0.651	0.918	0.892
02	Cash flow information (RCF)	0.805	0.954	0.939
03	Segmental information (RSI)	0.707	0.935	0.916
04	Risk-related information (RRR)	0.716	0.909	0.866
05	Fair value measurement information on assets, liabilities, and equity (RFV)	0.800	0.941	0.916
06	Capital structure information (RCS)	0.831	0.898	0.937
07	Information on accounting estimates and policies (FRAEP)	0.823	0.960	0.955
08	Information on self-reported events (FRSRE)	0.775	0.945	0.924
09	Readability of Information (UR)	0.766	0.908	0.847
10	Graphical information and notes to the financial statement (UGINFS)	0.635	0.838	0.707
11	Glossary of terms (UGT)	0.847	0.917	0.819
12	Comparative information (CCI)	0.740	0.933	0.904
13	Information in the audit report (VAR)	0.776	0.954	0.940
14	Information on the timely publishing of financial reports (TFR)	0.760	0.940	0.919

Based on the AVE analysis results, all first-order constructs have AVE values exceeding the commonly accepted threshold of 0.50. This suggests that both the researcher and survey respondents concur on the set of items used to measure each construct (Kock & Lynn, 2012). Additionally, the table indicates that the Composite Reliability (CR) and Cronbach's Alpha (CA) statistics are above the 0.70 cutoff. Overall, the CA and CR values demonstrate that survey respondents agree that each of the 63 sub-information items corresponds appropriately to the 14 information dimensions.

4.11. Discriminant Validity

As the next assessment criterion, discriminant validity is applied. It shows the extent to which a construct is distinct from other constructs using heuristic standards, implying that a construct is unique and captures phenomena not represented by other constructs in the model (Hair et al., 2016; Wasko & Faraj, 2005). In other words, it shows the extent to which the researcher and the survey respondents agree regarding the items that are associated with one particular construct, not with another construct (Kock & Lynn, 2012). Most commonly used methods for assessing discriminant validity are the cross-loadings results and the Fornell-Larcker criterion (Fornell & Larcker, 1981; Hair et al., 2016; Henseler, Ringle, & Sarstedt, 2015).

To fulfill the Fornell-Larcker criterion requirements, the square root of the AVE of any construct must be larger than the correlations shared between the construct and other constructs (Barclay, Higgins, & Thompson, 1995; Fornell & Larcker, 1981; Hair et al., 2016). The following Table 17 shows the Fornell-Larcker Creation.

According to the Fornell-Larcker criterion, the values along the diagonal in the table above, which represent the square roots of the Average Variance Extracted (AVE) for each construct, exceed the corresponding off-diagonal values that indicate the correlations between constructs Fornell and Larcker (1981). This confirms that the model meets the heuristic guideline for the Fornell-Larcker criterion. However, as noted by Henseler et al. (2015) and Hair et al. (2016), both the Fornell-Larcker criterion and cross-loading analyses can sometimes inadequately assess discriminant validity. Therefore, they recommend using the Heterotrait-Monotrait Ratio (HTMT) of correlations as a more reliable method for evaluating discriminant validity in variance-based Structural Equation Modeling (SEM). Hair et al. (2016) describe HTMT as the ratio of correlations between traits to correlations within traits, estimating the true correlation between two constructs if they were measured without error. Table 18 presents the outcomes of the HTMT ratio analysis.

Table 17. Fornell-Larcker Creation results at the first-order level.

	FRAEP	RCS	RCF	CCI	RFL	UGT	UGINSF	RFV	UR	RRR	RSI	FRSRE	TFR	VAR
FRAEP	0.907													
RCS	0.655	0.912												
RCF	0.579	0.606	0.897											
CCI	0.459	0.517	0.640	0.860										
RFL	0.475	0.587	0.620	0.552	0.807									
UGT	0.477	0.343	0.355	0.315	0.263	0.920								
UGINSF	0.492	0.434	0.376	0.533	0.331	0.432	0.797							
RFV	0.638	0.625	0.588	0.588	0.617	0.331	0.448	0.894						
UR	0.472	0.605	0.518	0.603	0.558	0.418	0.461	0.503	0.875					
RRR	0.587	0.620	0.544	0.498	0.515	0.317	0.395	0.586	0.519	0.846				
RSI	0.472	0.510	0.650	0.603	0.558	0.307	0.423	0.532	0.495	0.498	0.841			
FRSRE	0.573	0.634	0.518	0.713	0.598	0.435	0.526	0.560	0.667	0.555	0.605	0.881		
TFR	0.456	0.574	0.637	0.778	0.657	0.276	0.517	0.638	0.643	0.518	0.636	0.684	0.872	
VAR	0.686	0.655	0.506	0.569	0.508	0.451	0.552	0.686	0.576	0.621	0.519	0.690	0.579	0.881

Table 18. HTMT ratio analysis results at the first-order level.

	FRAEP	RCS	RCF	CCI	RFL	UGT	UGINSF	RFV	UR	RRR	RSI	FRSRE	TFR	VAR
RCS	0.706													
RCF	0.609	0.657												
CCI	0.497	0.570	0.684											
RFL	0.510	0.651	0.665	0.603										
UGT	0.540	0.399	0.405	0.376	0.305									
UGINSF	0.601	0.548	0.464	0.680	0.420	0.564								
RFV	0.683	0.686	0.634	0.651	0.676	0.384	0.552							
UR	0.525	0.692	0.578	0.680	0.633	0.500	0.594	0.571						
RRR	0.640	0.684	0.591	0.549	0.557	0.378	0.502	0.634	0.586					
RSI	0.500	0.559	0.700	0.655	0.609	0.352	0.527	0.577	0.557	0.535				
FRSRE	0.611	0.693	0.553	0.777	0.651	0.504	0.655	0.607	0.751	0.609	0.651			
TFR	0.485	0.625	0.676	0.850	0.715	0.318	0.641	0.692	0.721	0.558	0.683	0.732		
VAR	0.725	0.705	0.536	0.626	0.551	0.520	0.682	0.736	0.643	0.676	0.559	0.740	0.622	0.763

The HTMT criterion recognizes that discriminant validity is achieved when the true correlation between two constructs approaches 1. However, when the constructs are conceptually different, a more relaxed threshold of 0.90 is recommended. As shown in the table, all HTMT values are below this conservative cutoff of 0.90, indicating that the proposed FRQ measurement model adequately satisfies the discriminant validity requirements. In summary, the relationships between the 63 sub-information items (indicators) and the 14 information dimensions (first-order constructs) meet all necessary standards for convergent validity, internal consistency, and discriminant validity. With the validity of the first-order constructs confirmed, the next step is to evaluate the measurement model at the second-order level, which incorporates six (06) Qualitative Characteristics (QCs).

4.11.1. Second-Order Constructs

In this second phase, the statistical relationship between the 14 dimensions (first-order constructs) and the six Quality Criteria (QCs) (second-order constructs) is examined. Since the hierarchical model represents the second-order constructs through all items of the first-order constructs, reliability and validity assessments are not performed at this level. Instead, validation of the second-order model is based on evaluating the Variance Inflation Factor (VIF) to detect multicollinearity and assessing the significance of the outer weights, following the guidelines of Hair et al. (2016). Multicollinearity, or collinearity, arises when two formative indicators exhibit a strong correlation. While such correlations are typical in reflective measurement models, they are generally unexpected in formative models (Petter, Straub, & Rai, 2007). Therefore, VIF is an essential statistic for identifying collinearity issues in PLS-SEM. Table 19 below shows the VIF values, outer weights, and their corresponding significance levels for the second-order construct.

Table 19. VIF values, Outer weights, and significance value for Second-order construct.

Serial number	Variable	Information dimensions	Variance inflation factor (VIF)	Outer weights	*p*-value	Significance ($p < 0.05$)
01	Relevance	RFL	2.031	0.137	0.000	Yes
		RCF	2.338	0.089	0.000	Yes
		RSI	1.921	0.261	0.000	Yes
		RRR	1.834	0.174	0.000	Yes
		RFV	2.141	0.262	0.000	Yes
		RCS	2.789	0.320	0.000	Yes
02	Faithful representation	FRAEP	1.485	0.433	0.000	Yes
		FRSRE	1.485	0.687	0.000	Yes
03	Understandability	UR	1.375	0.690	0.000	Yes
		UGINFS	1.391	0.385	0.000	Yes
		UGT	1.327	0.126	0.000	Yes
04	Comparability	CCI	1.000	1.000	0.000	Yes
05	Verifiability	VAR	1.000	1.000	0.000	Yes
06	Timeliness	TFR	1.000	1.000	0.000	Yes

As noted by Hair et al. (2016), VIF values at or above 5 may indicate potential collinearity issues. In the current study, all VIF values for the second-order constructs are below this limit, suggesting that collinearity among the dimensions is not a concern. The second formative model validation criterion from Hair et al. (2016) requires assessing the significance of the outer weights of formative indicators. To test this, bootstrapping was performed using SmartPLS 3. An outer weight significantly different from zero signifies that the corresponding information dimension makes a meaningful contribution to the construct. The summarized results demonstrate that all outer weights are positive and statistically significant. In conclusion, the PLS path-model findings confirm that the 14 first-order information dimensions, measured through 63 sub-information items, adequately represent the six second-order QCs. The subsequent step is to assess how these six QCs collectively form the third-order construct, FRQ.

4.11.2. Third-Order Construct

This section focuses on connecting the six QCs as second-order constructs to the overall FRQ, represented as the third-order construct. To evaluate the contribution of each QC to the FRQ, a method consistent with that used for the second-order formative model is applied, involving the assessment of multicollinearity through VIF values and the analysis of the significance of outer weights, as presented in Table 20.

Table 20. VIF values, outer weights, and significance values for the third-order construct.

Serial number	Variable	Variance inflation factor (VIF)	Outer weights	*p*-value	Significance ($p < 0.05$)
01	Comparability	2.920	0.190	0.000	Yes
02	Faithful representation	3.949	0.200	0.000	Yes
03	Relevance	4.021	0.204	0.000	Yes
04	Timeliness	3.272	0.191	0.000	Yes
05	Understandability	2.550	0.190	0.000	Yes
06	Verifiability	2.774	0.189	0.000	Yes

According to Hair et al. (2016), VIF values of 5 or higher suggest possible collinearity issues. In this research, all VIF values are below 5, and the outer weights of each QC are statistically significant, indicating that each QC contributes meaningfully to the FRQ.

4.12. Structural Models

To develop the FRQ measurement model, Partial Least Squares-Structural Equation Modeling (PLS-SEM) in the SmartPLS software package has been used (Henseler et al., 2015). As mentioned by Nascimento and Macedo (2016) and Lee, Petter, Fayard, and Robinson (2011), PLS-SEM has been extensively used in the social sciences to analyze quantitative data. As discussed by previous scholars, there are many advantages to the use of PLS-SEM as a second-generation statistical technique.

One aspect is that the initial structural model developed using QCs involves a multi-item construct. The PLS-SEM allows analyzing multi-item constructs, which consist of direct, indirect, and interaction effects (Kim, Chan, & Kankanhalli, 2012; Wasko & Faraj, 2005).

Another key advantage of PLS-SEM lies in its non-reliance on data normality assumptions. This characteristic makes it suitable for analyzing research models with both normally and non-normally distributed data (Hair et al., 2016; Lee et al., 2011). Given that the questionnaire data in this study exhibited a non-normal distribution, PLS-SEM offered an appropriate analytical framework. Furthermore, PLS-SEM provides greater flexibility regarding sample size compared to other structural equation modeling techniques (Hair et al., 2016; Kim et al., 2012). Its ability to readily accommodate both reflective and formative measurement models also makes it particularly well-suited for this research, as the developed FRQ measurement model incorporates a blend of these features.

4.13. PLS Path Model Development

The figure 03 represents the first-order construct, with the model following a reflective development approach. Consequently, the arrows are directed from the information dimension constructs toward their corresponding indicators. In constructing this path model, 63 indicators (depicted as rectangles representing sub-information items) are initially connected to 14 information dimensions (shown as small circles), forming the first-order construct. Following the Hierarchical Component Model (HCM) framework applied here, these 14 information dimensions are then linked to 6 Qualitative Characteristics (QCs) represented by medium circles, constituting the second-order construct. To build the third-order construct, the 6 QCs are connected to the overall FRQ (depicted as a large circle). The second and third-order constructs are modeled formatively, with arrows pointing from the 14 dimensions to the 6 QCs, and subsequently to the FRQ. Additionally, the 'repeated indicator approach' is implemented during the

development of the second and third-order constructs. Presented below is the FRQ measurement model at the first-order level. Table 3 explains the primary information dimensions and their associated sub-items, which are used in the development of the FRQ measurement model, specifically concerning the variable 'Comparability of Information'.

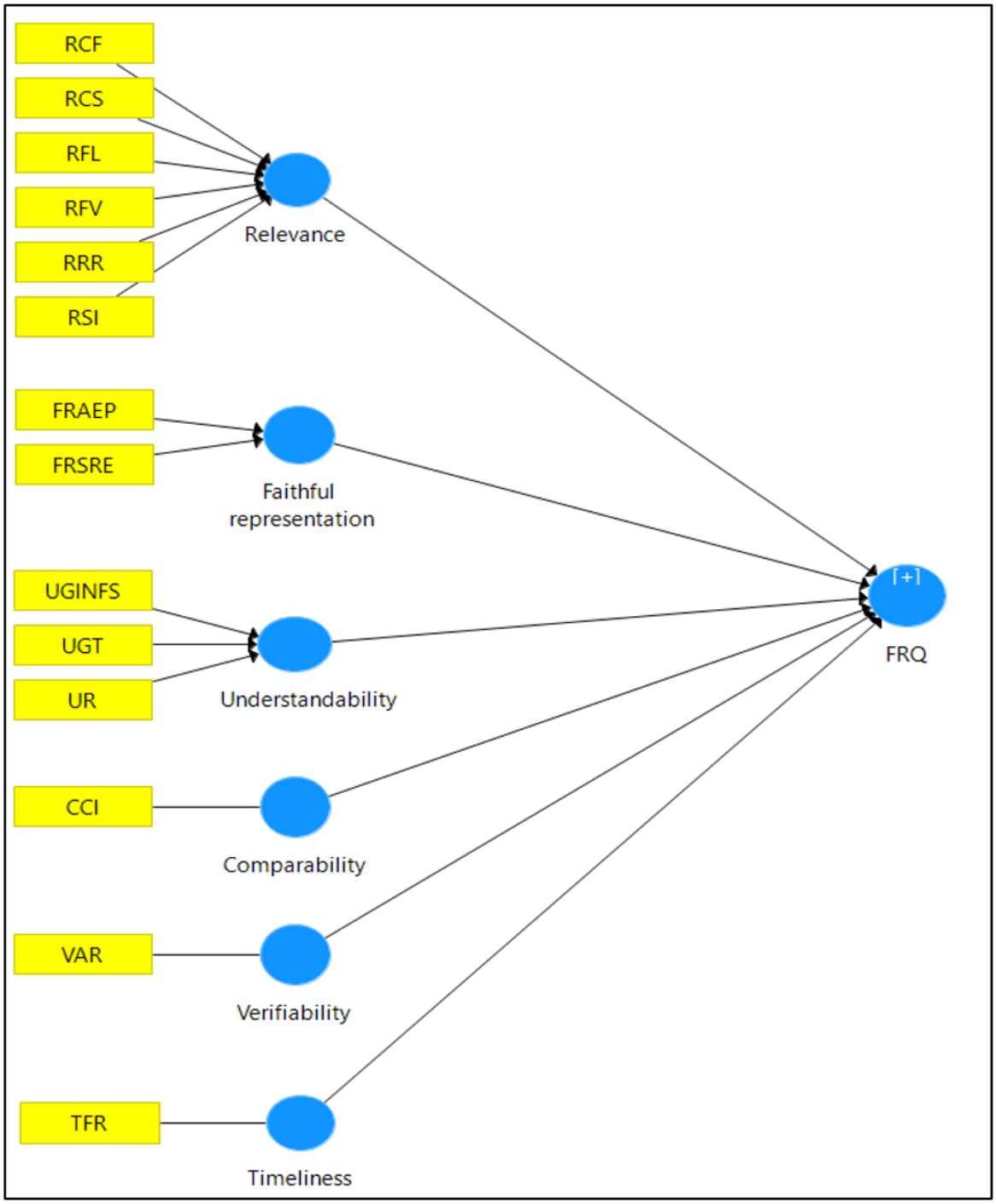

Figure 3. PLS path model development.

The proposed FRQ measurement model was evaluated using Partial Least Squares Structural Equation Modeling (PLS-SEM), supported by Exploratory Factor Analysis (EFA) and Confirmatory Factor Analysis (CFA) to validate construct reliability and dimensionality. All six Qualitative Characteristics (QCs): Relevance, Faithful Representation, Comparability, Understandability, Timeliness, and Verifiability, were found to significantly contribute to the measurement of FRQ. Indicator reliability, Average Variance Extracted (AVE), Cronbach's alpha,

composite reliability, Fornell–Larcker, and HTMT criteria confirmed the robustness and validity of the model. When considering the managerial, policy, and regulatory implications of this study.

- For Firms: The model provides a structured framework for enhancing internal reporting processes. Firms can use the FRQ index to evaluate their annual reports and identify areas needing improvement, such as ensuring more forward-looking information, timely disclosures, or better narrative explanations. This can enhance investor confidence, improve access to capital, and support long-term strategic decision-making.
- For Investors: Investors and analysts can apply the FRQ index as a diagnostic tool to compare firms' reporting quality, aiding in investment selection and risk assessment. Reliable and transparent reporting improves their ability to make informed, sustainable economic decisions.
- For Regulators: The model provides a benchmark for assessing reporting quality across firms in emerging markets such as Sri Lanka. Regulators can incorporate the FRQ framework into disclosure guidelines, enforce reporting standards more effectively, and monitor compliance to strengthen corporate governance.
- For Standard-Setters: Standard-setting bodies, including the IASB or local regulators, can leverage the model to refine qualitative reporting requirements, particularly in areas such as forward-looking information, fair value disclosures, and narrative reporting, promoting both transparency and long-term economic sustainability.
- For Auditors and Governance Committees: Audit committees and external auditors can use the model to identify key quality indicators, verify the accuracy of reported information, and ensure adherence to established qualitative standards, thereby enhancing market trust and accountability.

5. CONCLUSION AND SUGGESTIONS

To maintain public trust by protecting the accountability and transparency of public money, and to facilitate effective and efficient decision-making, the quality of financial reports plays a crucial role. The high-quality financial reports facilitate the use of quality information in evaluating economic performance by stakeholders, and they expect that such information will assist them in measuring the soundness of the reporting entity and in making valid financial decisions (Kantudu & Alhassan, 2022).

When measuring Financial Reporting Quality (FRQ), the Qualitative Characteristics (QCs) outlined in the IASB's Conceptual Framework serve as foundational principles. Previous research predominantly relied on secondary data, employing approaches such as accrual models and value relevance to infer FRQ. Bandara (2020) made a notable contribution by developing an FRQ measurement index grounded directly in the IASB Conceptual Framework and applied it to assess the FRQ of Sri Lankan companies' annual reports before and after IFRS adoption. Despite these efforts, existing studies have yet to produce a comprehensive, holistic index based on fundamental QCs for assessing FRQ. Moreover, most prior research has focused on secondary data extracted from financial reports rather than directly operationalizing the QCs themselves. Addressing this gap, the present study aims to develop an index that explicitly utilizes the Qualitative Characteristics as a basis for measuring FRQ, thereby enhancing the evaluation of financial reporting's decision-usefulness for capital providers.

As the first step, based on the literature and the Conceptual Framework of financial reporting, the FRQ measurement index was constructed with 17 information dimensions, which consist of 75 sub-information items, called "indicators." This is developed as a first-order construct. Based on the 17 information dimensions, six (06) QCs were developed as the second-order construct. Finally, FRQ has been assessed using the said 06 QCs at the third-order construct, as appeared in Figure 1.

Secondly, Exploratory Factor Analysis (EFA) was conducted after considering the factor loadings; information dimensions were reduced to 15, and sub-information items were reduced to 65. Thirdly, the Partial Least Squares – Structural Equation Modeling (PLS – SEM) method was used, and through that, Confirmatory Factor Analysis (CFA) was performed. Two information items were removed since the factor loadings were less than the threshold of

0.50. Accordingly, after the CFA, the FRQ measurement model was developed with 63 sub-information items across 15 information dimensions.

As the fourth step, for in-depth evaluation, three (3) statistical measures are carried out as suggested by Hair et al. (2016) and Bandara (2020). They are: *Convergent validity* (using Average Variance Extracted), *Internal consistency* (using Cronbach's alpha and composite reliability), and *Discriminant validity* (using Fornell-Larcker and HTMT criteria). According to the results of the AVE analysis, all the first-order constructs have AVE values above the rule of thumb of 0.50. This result indicates that both the researcher and the survey respondents agree on the set of items that measure each construct (Kock & Lynn, 2012). Further, this table shows that the CA and CR statistics are above the threshold of 0.70. Overall, CA and CR values indicate that the survey respondents agree that each set of the 6 and 3 sub-information items relates to the respective 14 information dimensions.

The following Table 21 showcases dimensions and information items for developing an FRQ (Financial Reporting Quality) measurement model in the Sri Lankan context.

Table 21. Composition of the Finalized FRQ model.

Variable	Information dimensions, which significantly contribute to developing the FRQ model	Sub-information items, which significantly contribute to developing the FRQ model		Sub-hypothesis	Acceptance of the hypothesis
Relevance	Forward-looking Information (RFL)	RFL01	RFL06		Accepted other than the information items: RFL 04, REL05,
		RFL02	RFL07		REL09, RFL10
		RFL03	RFL08		RCF06
	Cash Flow Information (RCF)	RCF01	RCF04		RFV05
		RCF02	RCF05		RCS04
		RCF03			
	Segmental Information (RSI)	RSI01	RSI04		
		RSI02	RSI05		
		RSI03	RSI06		
	Risk-Related Information (RRR)	RRR01	RRR03	H1a	
		RRR02	RRR04		
	Information on Measuring Assets, Liabilities, and Equity at Fair Value (RFV)	RFV01	RFV03		
		RFV02	RFV04		
	Capital Structure Information (RCS)	RCS01	RCS03		
		RCS02	-		
Faithful representation	Information on Accounting Estimates and Policies (FRAEP)	FRAEP01	FRAEP04		Accepted other than the dimension, 'Information on Related Party Disclosure', and information items: FRRPD01, FRRPD02
		FRAEP02	FRAEP05		
		FRAEP03	FRAEP06		
	Information on Self-Reported Events (FRSRE)	FRSRE01	FRSRE04		
		FRSRE02	FRSRE05		
		FRSRE03	-	H1b	
	Information on Related Party Disclosure (FRRPD)	-	-		
Understandability	Readability of Information (UR)	UR01	UR03		Accepted, however, dimensions UGI and UNFS have been combined as one dimension called 'Graphical Information and Notes to the Financial Statement (UGINFS)
		UR02			
	Graphical Information (UGI)	UGINF01	-		
	Notes to the Financial Statements (UNFS)	UGINF01	-		

Variable	Information dimensions, which significantly contribute to developing the FRQ model	Sub-information items, which significantly contribute to developing the FRQ model		Sub-hypothesis	Acceptance of the hypothesis
		UGINF02	-		
	Glossary of Terms (UGT)	UGT01	UGT02	H1c	
Comparability	Comparative Information (CCI)	CCI01	CCI04	H1d	Accepted, other than the dimension 'Financial Ratios'
		CCI02	CCI05		
		CCI03	-		
Timeliness	Information on the timely publishing of Financial Reports (TFR)	TFR01	TFR04	H1e	Accepted
		TFR02	TFR05		
		TFR03	-		
Verifiability	Information in the audit report (VAR)	VAR01	VAR04	H1f	Accepted
		VAR02	VAR05		
		VAR03	VAR06		

Finally, this study successfully developed a Financial Reporting Quality (FRQ) measurement model aligned with the qualitative characteristics of financial information as outlined in the Conceptual Framework issued by the International Accounting Standards Board (IASB). The model incorporates key dimensions such as relevance, faithful representation, comparability, verifiability, timeliness, and understandability, ensuring a comprehensive evaluation of financial reporting quality. Consequently, the hypothesis H1, which posited that an FRQ measurement model can be constructed based on the IASB's qualitative characteristics, is accepted. While this study offers valuable insights into Financial Reporting Quality (FRQ) measurement within the Sri Lankan context, its findings are primarily based on data from a single emerging market, which may limit generalizability to other jurisdictions with differing institutional, cultural, and regulatory environments. Future research could extend the application of the proposed FRQ model to other developing and developed economies to test its cross-country robustness and adaptability. Despite this contextual limitation, the study provides practical implications for enhancing sustainable reporting practices globally. The FRQ model, grounded in the qualitative characteristics of financial information, offers a structured framework that regulators, policymakers, and organizations in other countries can adopt to strengthen corporate governance, improve transparency, and align reporting standards with long-term sustainability objectives. Such adaptation can foster comparability, build investor confidence, and support sustainable financial ecosystems beyond the Sri Lankan context. In summary, the model developed throughout this research study can be used for future research studies in measuring FRQ. The developed FRQ measurement model is treated as a holistic, qualitative, characteristic-based approach since it was based on the Conceptual Framework for Financial Reporting issued by the International Accounting Standards Board (IASB). The IASB finalized an update to the Conceptual Framework for Financial Reporting on March 29, 2018, to provide a more complete, clear, and updated set of concepts to use. These qualitative characteristics exhibit how the information in financial reports assists the process of decision-making. Further, this approach considers all the components and statements in the annual reports, and it refers to financial information, as well as non-financial information. Accordingly, this research will fill the gap in the requirement of the Financial Reporting Quality measurement model in Sri Lanka.

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Institutional Review Board Statement: This study was approved by the MSU University Ethics Committee – Human, Management and Science University (MSU), Malaysia, under protocol number (EA-L1-PGC-2025-11-0001), dated 19 November 2025. Informed verbal consent was obtained from all participants, and all data were anonymized to protect participant confidentiality.
Transparency: The authors state that the manuscript is honest, truthful, and transparent, that no key aspects of the investigation have been omitted, and that any differences from the study as planned have been clarified. This study followed all writing ethics.
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