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REVIEW OF COMPLIANCE WITH DISCLOSURE REQUIREMENTS OF IAS 1 – CASE OF ALBANIA

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Abstract

The purpose of this paper is to verify the level of compliance with the International Accounting Standard (IAS) 1 disclosures requirements of notes in financial statements (hereinafter FS), providing an empirical evidence. In order to fulfill the aim of this study, 41 large companies that meet the criteria for applying IFRSs according to the Accounting Law of Albania, are considered. The level of compliance with disclosure requirements is measured by a self-constructed disclosure index (DI).The paper reveals through empirical analysis that only one of the entities taken into consideration does not present the basis of preparation and does not make a summary of significant accounting policies applied. All the entities give supporting information for the items presented in the FS. 26% of the entities do not present information related to commitments and contingent liabilities. 6 entities out 41 do not present information about risk management. 5 entities out 41 do not cross-reference the notes with the respective items presented in the FS. The updating terminology is made by more than 70% of the entities. The average overall compliance is 92%, which is considered as a satisfactory level for our country.

Keywords: Financial Statements, IAS 1, Mandatory Disclosures, Notes, Self-Constructed Disclosure Index (DI)

INTRODUCTION

International Financial Reporting Standards (IFRS) is that set of standards that enables obtaining better information, as a result of using recognition and measurement criteria that better reflect the economic reality of companies and providing a wide range of information in the notes (Lourenço & Branco, 2015).

The implementation of IFRS in Albania, started with the adoption of the Law No. 9928 "On accounting and financial statements", in 2004, approved by the Albanian Parliament. The law defined which entities have to present FSs using full IFRSs or the Accounting National Standards (NAS -prepared by the National Accounting Council in compliance with the IFRSs). Since the year 2008, bank and insurance companies, and some other large private companies (which were important for the public interest, due to the nature of the business, the size or the number of their employees, determined by decision of the Council of Ministers) in Albania, prepare Financial Statements, including notes, in accordance to the IFRS. During the preparation of this paper, that law was superseded by Law No. 25/2018 “On accounting and financial statements” (“New Law”),with effect as of 1 January 2019. The New Law is partly harmonized with the European Union legislation on financial statements and other reports of economic entities.

The implementation of the IFRS/NAS determined the transition of our country from *Plan Comptable Général* (known as French accounting model) based on accounting rules, fiscal – oriented system, to the IFRS system (the Anglo-Saxon accounting model) which is known as investor-oriented system. The implementation of the IFRS resulted in a qualitative improvement of the Albanian financial reporting of banks, insurance companies, and other large companies.

It is generally recognized that IFRS contain so many requirements relating to the information to provide in the notes to financial statements that they result in information overload and increased complexity (Blanchette et al., 2013). The Notes to the Financial Statements are components of a complete set of FSs that provide important disclosures and details related to the information reported in them. They make up an integral part of the financial reporting, prepared at the end of the reporting period. The demand for financial reporting and disclosure arises from information asymmetry and agency conflicts between managers and outside investors (Healy & Palepu, 2001).

A lot of the information that needs to be presented in the notes is specifically described in the requirements of mandatory disclosures by accounting standards. But IFRSs only prescribe the format and order of the notes to a limited degree.Other aspects of the notes depends from management’s assessment in what is important for a user to understand FSs.

Healy & Palepu (2001) point out that managers' presentation decisions within the financial statements reflect informational motivations (that is, revealing the underlying economics of the firm) or opportunistic motivations (that is, attempts to bias perceptions of firm performance). Riedl & Srinivasan (2008) suggest managers to use income statement presentation as a mechanism to assist users in better identifying and understanding the firm's underlying performance. On the other hand, in order to process financial statement information appropriately, users must understand that information which is relevant, discover that information in the financial statements and asses the implications of that information for Judegments and decisions, both alone and in conjunction with other information (Hodge et al., 2004).

In recent years, the authors see that the financial statement presentation is one of considerable importance issue of those addressed by the IASB in the context of the Disclosure Initiative for better communication. "The Board has been clear that the Disclosure Initiative is not about reducing disclosures per se—it is about making disclosures more meaningful by improving their communication value while simplifying the preparation process" (Kabureck, 2016).

In the context of the most recent developments at international level as a reflection on Disclosure Initiative, the authors study the level of compliance with mandatory disclosures requirements as per IAS 1, of some Albanian large companies.Since IAS 1 includes the general disclosure requirements in the FS, the main purpose of this study is to provide evidence regarding the way that those companies are disclosing information in compliance with the overall requirements of that standard.

Considering the gap that exists in our country with regards to studies involving mandatory disclosure and more importantly on company disclosure levels, this paper intends to contribute to the topic by addressing some identified issues in this specific area of financial reporting.

LITERATURE REVIEW AND THEORETICAL BACKGROUND

Financial statements are a primary means for management to communicate financial information about an enterprise to the external parties.The basis for the presentation of the general-purpose financial statements in accordance with IFRS are prescribed in International Accounting Standard 1 (IAS 1) "Presentation of Financial Statements", which sets out the overall requirements for the presentation of financial statements, the guidelines for their structure and minimum requirements for their content.

The usefulness of financial statements is believed to be increased by explanations and details outside the body of the statements themselves. For this reason, financial statements are accompanied by notes and other additional disclosures when necessary providing a variety of information that would otherwise not be available. Through these disclosures, managers provide information that facilitates external users of financial reports to better understand the true economic picture of the business (Kothari & Short, 2003).

The key role of the notes in the financial statements is to provide further information explaining the amounts presented in the financial statements as well as the information about items that have not been recognized, aimed to be useful for decision-making. There is a degree of fluidity between showing information "on the face of the accounts" (i.e., directly in the statement of financial position or income statement) and in the notes: the main categories have to be preserved, but the detail underlying the reported amounts may be shown in the notes (Epstein & Jermakowicz, 2010).

In accordance with IAS 1, the notes should: (1) present information about the basis of preparation of the financial statements and the specific accounting policies used; (2) disclose the information required by IFRS that is not presented elsewhere in the financial statements, and (3) provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

IFRS are principle-based rather than rule-based, which are characterized by less precise guidance and fewer bright-line rules (Barth *et al*. 2008). The IASB's Conceptual Framework states that "To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions" and "The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable."This means that preparers and auditors would, therefore, need the courage to exercise and defend their professional Judegments in performing their roles in this simplified accounting world (Shields, 2006; Tweedie, 2007).

IAS 1 is not prescriptive in nature. Rather, IAS 1 confess that judgement is required in determining the best manner in which information is presented.The standard has two separate paragraphs regarding the requirements to present two types of Judegments made by management that have the most significant effect on the amounts recognised in the financial statements:

1. Judgements that management has made in the process of applying accounting policies (IAS1:122); and
2. Judgements that management makes about the future and estimations (IAS 1:125).

To be a key Judegment disclosed under IAS 1: 122, the subject matter must relate to something other than assumptions about the future or making estimates (Deloitte, 2017). The separation of generic from the specific accounting policies has been shown to be difficult to make. Disclosures of key Judegments do not usually address measurement although they may do when the issue relates to determining the appropriate measurement basis (e.g. fair value, amortized cost etc.) rather than what goes into arriving at the amounts recognized (Deloitte, 2017). It happens quite often that useful information is lost in technical disclosure, but in the same time it is accepted that making disclosures on recognition and measurement without being technical is challenging (IASB, 2013).

Second type judgements are considered as sources of estimations uncertainty.Actually, making such estimates is a difficult task as long as a subjective assessment of many things is required at the reporting date and in the future. For this reason, information about these Judegments is usually included in the form of a special note. These estimates include professional Judegments that are made to set amortization rates, as well as an assessment of whether the entity meet the assumption of going concern and will continue in operation for the foreseeable future. It is obvious that there is a risk of making "mistakes" when assumptions have a high degree of subjectivity and complex "guesswork" about uncertainties (e.g. the life of an asset, future selling prices, future costs, and future interest rates). There also needs to be a significant risk that a material adjustment to the carrying amount of assets or liabilities may be required as a result of changes in those assumptions or estimates in the next period, not just in any future period whenever that might be (Deloitte, 2017).

According paragraph 113 in IAS 1, an entity should, as far as practicable, present notes in a systematic manner and should cross-reference each item in the statements of the financial position and the comprehensive income, in the separate income statement (if presented), and in the statements of changes in equity and of cash flows to any related information in the notes.

Up to 2016, an entity is required by paragraph 114 to present notes in the following order, to help users understand the financial statements and to compare them with financial statements of other entities:

1. Statement of compliance with IFRS;
2. Summary of significant accounting policies applied;
3. Supporting information for items presented in the financial statements;
4. Other disclosures, including contingent liabilities and unrecognized contractual commitments; and nonfinancial disclosures.

Now, in the context of the Disclosure Initiative, this order is only an example of how notes can be ordered. It is required by the revised standard that the notes be ranked based on the qualitative characteristics of understandability and the comparability of information.

The way in which some Standards are designed hint the perception that specific requirements of those Standards override the general statement in IAS 1:31 that an entity need not provide information that is not material. Materiality has been and remains an important concept in the centre of attention of the IASB itself, closely related to the importance of information that is useful for user decision-making. However materiality is very important in practice for its implications for the preparers of financial statements and auditors.

One of the underlying requirements for financial statement preparation in compliance with the IFRSs is that an entity should make an explicit and unreserved statement of such compliance in the notes. This means that financial statements and the notes and other supplemental information accompanying them must include all available relevant information to keep them from being misleading (Carmichael & Graham, 2007). There is a risk that a immaterial information that is not deemed necessary to be present in primary statements, can be found unnecessarily in notes. The presence of immaterial information and the omission of material information results in a decrease of the decision-usefulness of the financial statements. The inappropriate application of “materiality” from entities is considered to be one of the reasons of disclosure ineffectiveness. As a consequence, the IASB has addressed materiality as part of the Disclosure Initiative. The amendments to the definition of material in IAS 1 must be applied prospectively for annual periods beginning on or after 1 January 2020.

METHODOLOGY

The main purpose of this paper is to verify the level of compliance with the disclosures requirements of financial statements made in accordance with IAS 1, providing an empirical evidence for this specific area of financial reporting in our country.

This study is carried out using primary as well as secondary data sources which are available on World Wide Web. The authors have primarily worked with secondary data, i.e. papers published by foreign authors, IAS 1 disclosure requirements, and discussions done related to Disclosure Initiative.

Based on Law No. 9228 dated 29.04.2004 (superseded by the New Law that came into force from the beginning of 2019), the financial reporting structure in our country is organized in three levels. Only those entities categorized as first level are required to apply IFRSs issued by IASB and translated into Albanian without any changes to the original text in English. This category includes:

a) the entities listed on an official stock exchange and their subsidiaries, subject to the consolidation of the accounts; and

b) of important general interest (second level banks, financial institutions, similar to banks, insurance and reinsurance companies, securities funds and all companies licensed to carry out investment activities in securities, even when they are not listed on an official stock exchange;) and

c) other large unlisted entities when they meet the last two years these both criteria set by the Council of Ministers: 1) annual income over 1,250,000,000 ALL; 2) average annual number of employees over 100.

In selecting the sample the authors referred only to the entities of group (c). There are no listed entities in our country as predicted in category (a). Since the drafting of the Law on Accounting, the creation of the stock exchange in our country was made possible after 13 years, in July 2017, when it was licensed "Albanian Stock Exchange (Albanian Stock Exchange)- ALSE" as the first Albanian stock exchange with private capital licensed in the country. The stock exchange ALSE started its activity, officially, in February 2018 with a limited activity only in the trading of government securities, but with the aim of further expansion of the financial market as a whole in the future. On the other hand there is no published information about any Albanian entities listed on any international stock exchange. Entities included in category (b), in addition to reporting under IFRSs, also have specific reporting requirements set by the supervisory boards of the respective markets, which are likely to impact the level of disclosures.

The authors provided the annual reports and relevant data of the entities of category (c) referring to the National Business Center (NBC) web site. NBC is the institution where entities have the legal obligation to publish valuable financial information for use by the general public. So, the primary data are provided on official way from the only source where the Certified Financial Statements can be found.

The authors have manually downloaded notes of the FS, from NBC, for 41 Albanian large non-listed companies using IFRS, for the year ended 31 December 2016. To measure the level of the compliance with the disclosure mandatory requirements, as per IAS 1, the authors have used a self-constructed unweight disclosure index:

Disclosure index (DI) $=\sum_{i=1}^{n} \mathrm{di}$ /n

If the item i is disclosed, di=1,

If the item i is not disclosed di=0.

n=number of items which might be disclosed by a sample company.

Referring to the specific paragraphs on notes, authors have determined that the disclosure index should include the following 8 items of information:

1. *Reference number* – The authors have verified if the entities have the column reference in the FSs, as well as, if the items are cross-referenced with the information given into

the notes. If the entities cross reference the information in the notes with the respective item in the FSs the authors put 1, otherwise 0. Except of being a mandatory element of FSs, the reference number enables the realization of the enhancing sub characteristic of understandability.

2. *Basis of preparation* – Do the entities make an explicit and unreserved statement of compliance with IFRS?
3. *A summary of significant accounting policies applied* – Do the entities make a summary of significant policies applied, for example, do they specify the method used to depreciate the intangible assets, the method used to evaluate the inventory, etc.
4. *Judgements and estimates*– Do the entities make judgements in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements?
5. *Supporting information for the items presented in the FS* – Do the entities provide breakdown of line items in FSs into the notes?
6. *Commitments and contingencies* – Do the entities disclose in *other disclosure* section, commitments or contingent liabilities?
7. *Comparative information* – Do the entities provide comparative figures in the notes, i.e. the notes of the previous year?Providing comparative information enables the fulfillment of the enhancing sub-characteristic of comparability.
8. *Business risk information*– Do the entities disclose in *other disclosure* section, nonfinancial risk management?

In addition to the items included in the DI, the authors have verified some other items in the Notes in the FSs. This verification is done through the compilation of a list of questions which represent the chosen disclosure requirements assessed in our research. The compiled questions are as follows:

- In how many pages are the notes disclosed? – In some studies, the number of pages of notes has been taken as a factor that may affect the quality of them, although it mainly measures the quantity of disclosures (Beretta & Bozzolan, 2008).
- Does the entity use an updated/partially updated/old terminology? – The terminology is updated if the companies use the new terminology introduced by IASB in 2007. Regarding the terminology the authors have verified whether the entities have been updated with the new terminology announced by the National Accounting Council, which is based on that published by IASB in 2007. The authors have verified if the companies use terms like:
  - Balance Sheet or Statement of Financial Position

- Income Statement or Financial Performance Statement
- Passive or Liabilities and Equity

- Does the entity recognize a provision? – The authors have verified if the entities describe provision in the summary of significant accounting policy applied and applies it, i.e. recognize a provision, or just describe it.
- Does the entity recognize an allowance for doubtful accounts? –The authors have verified if the entities describe impairment of receivables in the summary of significant accounting policy applied and applies it, i.e. recognize an allowance for doubtful accounts, or just describe it.
- Does the entity present disclosures in the same order as prescribed by IAS 1:114? – The authors have verified if entities present disclosure in the same order as have been prescribed by the updated version of IAS 1:114. The update of the disclosure order presentation has been made in the context of the Disclosure Initiative.

ANALYSİS

The primary data were elaborated through excel spreadsheets. Our sample comprise 41 large companies.

General characteristics of the sample

Through descriptive analysis the authors will describe the main characteristics of the sample selected (Table 1, Table 2 and Table 3).

Table 1: Sample by industry

Industry	Number of companies	Percentage
Petroleum	3	7%
Gaming industry	3	7%
Mining industry	2	5%
Construction	8	20%
Production	5	12%
Service	7	17%
Telecommunication	5	12%
Trade	8	20%
Total	41	100%

The major part of the companies studied (56%) operate in the construction, service and trade sector while the other 44% operate in petroleum, gaming, mining, production and telecommunication industry.

Table 2: Sample by legal form

Legal form	Number of companies	Percentage
Corporation	21	51%
Limited liability company	20	49%

According to the legal form, 51% of the companies are limited liability companies, and the other 49% are corporations.

Table 3: Sample by company size

Company size (measured by total assets)	Number of companies	Percentage
500 million-5 billion	28	68%
5 billion-10 billion	6	15%
over 10 billion	7	17%

The total assets of the major part of the companies studied (68%) are in the interval 500 million ALL – 5 billion ALL.

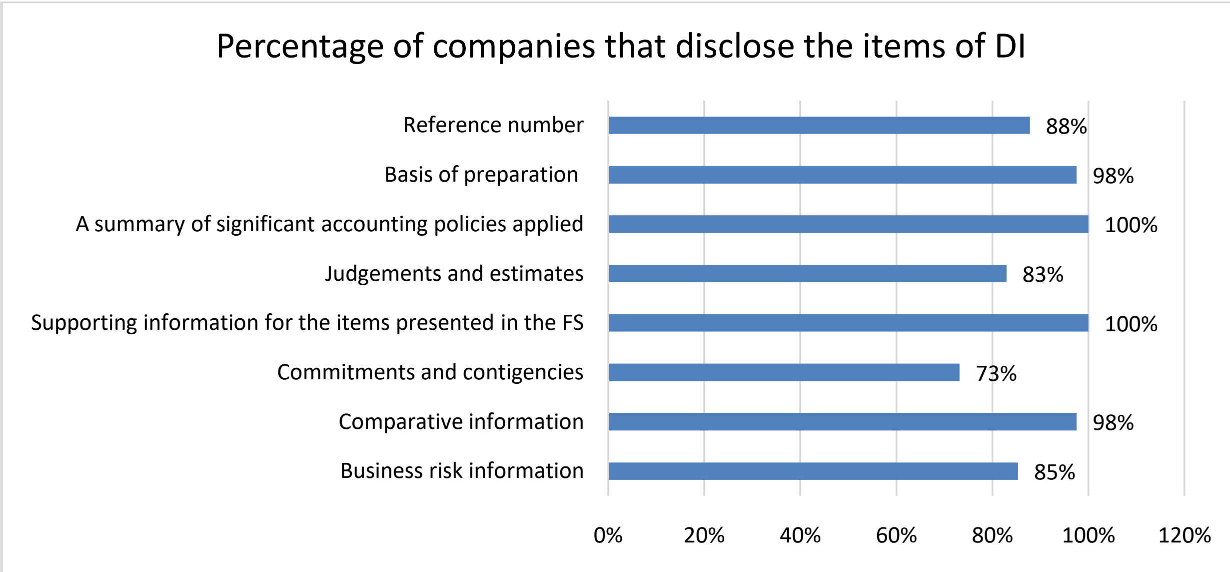
Analysis of the items included in the Disclosure Index

After the verification of each item included in the Disclosure Index with the notes of each company, the authors reveals that:

- 36 out of 41 entities comprise cross-references with Notes, 5 out of 41 do not have a column of reference in their FSs.
- 40 out of 41 entities make an explicit and unreserved statement of compliance with IFRS in the notes.
- 40 out of 41 entities make a summary of significant accounting policies applied.
- 34 out 41 entities apply their judgements and make estimates for the preparation of FS.
- All the entities present supporting information for the line items presented in the FS.
- Commitments and contingencies have the lowest level of compliance, only 30 entities present notes according to this requirement by IAS 1.
- Only one entity does not present the comparative information related to the previous year figures.

- 35% of the entities present non-financial disclosure, such as business risk management.

Figure 1: Percentage of companies that disclose the items of DI



The study reveals that companies, on average, report 92% of the mandatory information.

Other items verified

- Number of disclosure pages varies between 8 and 40, with an average of 22 pages. The number of disclosure pages is too low compared to that of developed countries. According to the study by Beattie, Dhanani & Jones (2008) this figure in England in 1965 was approximately 26.
- 71% of the companies use the new terminology introduced by the IASB. 29% of them do not use the updated terminology.
- 24 out of 41 companies describe provisions in the summary of significant accounting policies applied, 15 out of 24 recognize a provision and 2 out of 41 companies do not mention provisions.
- 25 out of 41 companies describe impairment of receivables in the summary of accounting policies applies. 13 out of 25 companies test receivables for impairment, i.e. create an allowance for doubtful accounts, or make an explicit statement that their receivables are not impaired at the end of the reporting period. 3 companies do not mention impairment of receivables.
- Only 2 out of 41 entities do not present notes in the same order as prescribed inIAS 1:114, the updated version of IAS 1, in context of Disclosure Initiative.

CONCLUSIONS

The main objective of this paper was to verify the compliance with the mandatory disclosure requirements as per IAS 1, by large companies using IFRS in Albania. Moreover, the authors aimed to contribute with an up to date knowledge regarding the Disclosures and Disclosure Initiative. In order to meet the main objective, a data set for year 2016 was analyzed with 41 large companies. The empirical results indicate that the average disclosure level among Albanian companies investigated was 92%, while the minimum and maximum level were 50% and 100% respectively. This indicates the need for regulatory bodies to start enforcing laws that assure the compliance with mandatory requirements. However, a DIof 92% is considered to be a satisfactory level for our country.

Only one of the entities taken into consideration does not present the basis of preparation and does not make a summary of significant accounting policies applied. All the entities give supporting information for the items presented in their FS. 26% do not present information related to commitments and contingent liabilities. 6 entities out 41 do not present information about risk management. 5 entities out of 41 do not cross-reference the notes with the respective items presented in FS. The terminology used in the preparation of the notes is updated for more than 70% of the entities studied.

The major part of the companies describe the impairment of accounts receivable and provision in the summary of significant accounting policies applied session, but only half of them test the receivables for impairment and recognize an allowance for doubtful accounts. This means that, actually they do not use those accounting policies.

In conclusion, it would be necessary to conduct further research on the application of IAS 1 notes requirements in the context of the latest developments according to disclosure effectiveness. It would be interesting to study how the concept of materiality is applied to make it possible to provide more detailed information on figures, more explicit information on related party relationships and further details on exposure to risks in aim to improve the quality of financial reporting.

It would also be very interesting to conduct further study within the same area of research, with the incorporation of more items in the self-constructed disclosure index. Another area of study could be comparing the same disclosure index for different years, in order to see how the compliance with IAS 1 disclosure requirements has evolved over the years.

RECOMMENDATIONS

Based on the findings of the study, some following recommendations are:

- For a sustainable disclosure environment in the developing countries like Albania, more attention should be given on organizational culture, monitoring and enforcement by the regulatory body.
- Regulators body and government should enforce laws and regulations that guarantee full compliance with the mandatory requirements, reflecting in time the related amendments made in standards during the improvement process.
- Continuous training to the preparers of the notes, about the procedure of the compiling notes of the FSs.

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