



THE RELATIONSHIP BETWEEN COMPANY CHARACTERISTICS AND DISCLOSURE LEVEL - CASE OF ALBANIA

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Abstract

This paper aims determining the impact of different characteristics of companies on the disclosure index. The instrument used to measure the level of the compliance with mandatory disclosures is the unweight disclosure index. For this purpose, financial statements notes of 120 Albanian companies for the reporting period ending December 31, 2018 are examined. The relationship between the disclosure index and the characteristics of companies is examined through the analysis of multiple linear regression. The independent variables are: size of the company, type of auditor, age of company, leverage, profitability and the sector of economy. The dependent variable is the disclosure index. The results of the econometric model reveals that the size of the company, sector, profitability and the type of auditor are positively related to the disclosure index while other variables such as: age of the company, leverage reveals that do not have statistically significant relationship with the respective index.

Keywords: disclosure index, company characteristics, relationship, Albania

INTRODUCTION

Notes to the financial statements are an important factor in process of raising the credibility related to corporate financial reporting. The beginning of the 21st century brought the confrontation with some negative phenomena in the field of accounting, which made members of the business community, politicians and the general public aware of the importance of increasing transparency even through the notes to the financial statements. For this purpose, the inclusion of legal and regulatory changes in financial reporting, related to the requirements for quality financial reporting, and the improvement of communication of financial information through notes to the financial statements took place.

Evidence shows that the implementation of the Sarbanes-Oxley Act of 2002 in the United States significantly contributed to raising awareness of the need for accounting regulation worldwide. This law was intended to protect investors from false financial reporting by companies. Also in the same year, the European Parliament, through Regulation 1606/2002 of 19 July 2002, on the application of International Accounting Standards, decided that, from 2005 onwards, all listed European companies are required to apply a single set of accounting standards, namely International Financial Reporting Standards (IFRS). Using IFRSs would increase the usefulness and reliability of financial reporting (Conceptual Framework, 2010). In addition, in 2003 the European Commission actively discussed corporate governance issues, making a considerable number of recommendations, which were taken into account during the revision of national codes, implemented in all member countries.

Despite all the interventions carried out, still examples of intentional incorrect presentation of accounting figures in financial statements appeared. A series of corporate scandals in the early 2000s, like Enron and WorldCom in the US and Parmalat and Royal Ahold in Europe illustrate how employees within corporations used the information to manipulate the accounting system by avoiding reporting significant liabilities and presenting a fictitiously positive, unrealistic, financial position of companies. In this way, not only the management level fail to act on behalf of its shareholders, but also the current monitoring mechanisms, such as monitoring by the board and the independence of the auditors, proved to be inadequate.

Currently, almost two decades after the implementation of the aforementioned regulatory reforms, both setters of accounting standards and various researchers have questioned whether the regulations gave the intended effects. Indeed, research in empirical accounting has shown intended and unintended effects of disclosure rules (Landsman and Lang, 2008; Lee and Walker, 2015). However, the results are ambiguous. Hence, more evidence is needed, especially for market effects and externalities from regulation (Leuz and Wysocki, 2016). The purpose of all disclosure requirements is for investors to obtain all the information on which they

can rely to make effective decisions. This would enable the avoidance of uncertainties and fully understanding of the company's values through the reading of its reports (Glassman, 2003).

Moreover, the current situation shows that business and capital markets have become more challenging and complex in business models, sources of risk and uncertainty, as well as more sophisticated in how they manage risk. This progress reflects users' desire for information, even if it may be more subjective and less credible.

The changes mentioned above had also to respond to the requirements and practices of financial disclosures by moving from simply breaking down the main items of the financial statements to providing more detailed disclosures, including assumptions, models, possible valuation methods and sources of uncertainty valuation. Notes to the financial statements became the means by which companies find ways to provide reliable and useful information in decision making.

As it is known, investors or stakeholders can get information from multiple sources during the decision-making process. However, the main source of the information are the financial statements with the relevant notes. The Accounting Law sets out the accounting rules that are conform to EU directives. These rules, make stakeholders to believe that the company's financial position is presented in a true and a fair manner. Using disclosures that do not provide accurate information can lead to wrong decision making.

The purpose of this study is to investigate through multiple linear regression model the relationship between some company characteristics and the disclosure level for the Albanian companies.

THEORETICAL BACKGROUND

The degree to which a researcher can be involved in constructing a disclosure index varies from full inclusion, to the total exclusion. Full inclusion means that the researcher controls the entire process of constructing an index, from the selection of information items to be included in the index till to their codification.

According to Marston and Shrives (1991) "the use of the disclosure index as a measure of disclosure depends very much on the selection of the items to be included in the index". So, there is no pre-defined list of items, which can be used to measure the level of disclosures.

Cooke (1992), followed by various authors (for example: Ahmed, 1996; Wallace et al., 1994; Hossain et al., 1995), suggest the construction of the unweighted disclosure index, since it gives to each item included in the index the same importance.

Hassan and Marston (2010), suggest the creation of an index by the researcher himself, where previous researchers or professional bodies did not established a tool to measure the

notes to the financial statements. This index is constructed taking into account the objective (s) that the same researcher (s) want (s) to achieve.

According to the literature many characteristics of companies influence the level of disclosure.

1. Leverage

Companies that have more debt in their financing structure tend to have higher agency costs (Alsaeed, 2006). The purpose of providing more notes to the financial statements is to avoid agency costs and reduce information asymmetry (Inchausti, 1997). More debt companies have, the more disclosures they will provide to meet the information needs of their creditors (Uyar and Kılıç, 2012). Numerous empirical studies used financial leverage as a factor influencing the level of disclosure. Managers in a corporation with capital structure distribution are motivated to provide more information because it increases transparency giving to the shareholders a sense of control over board decisions (Huang et al., 2011).

2. Size of the company

The size of the company is another important determinant of the level of disclosures. This is justified by the fact that the publication of information is less costly for large companies. Firth (1979) argued that large companies tend to be in the center of public attention and attract more attention from government bodies. As a result, large companies tend to provide more disclosures than smaller ones because of their competitive cost advantage (Lang and Lundholm, 1993). Researchers such as: (Cerf, 1961; Singhvi, 1968; Lang and Lundholm, 1993; Wallace et al. 1994; Inchausti 1997; Huang et al., 2011) find a positive relationship between the size of an company and the amount of disclosures. Jaworska, 2015, confirms that larger companies provide more disclosures in their financial statements and on their website.

3. Age of the company

Roberts, 1992 identified that the age of the company influences the level of disclosures. Companies operating for a long time, have improved their financial reporting practices. The same companies tend to provide more disclosures. .

4. Type of auditor

In most cases, audit companies prepare disclosure checklists. Many preparers of notes to the financial statements, welcome such practical assistance because it helps them to meet the disclosure requirements. In previous studies hypotheses relates to the are positive relationship between the type of the auditing company and the level of disclosures provided. The audit plays a key role in controlling the management of companies. An external auditor can significantly affect the amount of disclosure provided. Large audit companies invest more to maintain their reputation as providers of effective control compared to smaller ones (DeAngelo,

1981). Auditors also play an important role in developing corporate disclosure policy. Large and well-known audit companies are able to convince auditees of the importance of disclosures on the decision-making process. According to Jaworska and Matusiewicz, 2015, companies audited by Big Four audit companies (Ernst and Young, KPMG, PriceWaterhouseCoopers and Deloitte), which are considered the most experienced, knowledgeable and often the most respected, increase investor confidence guaranteeing the quality of information.

5. The sector of economy

Different studies reveal that the sector of economy where a company operates influences the disclosure level (Leventis and Weetman, 2004). Fathi (2013) has categorized the companies under consideration according to the sector in which they operate, namely production, service and telecommunications. The results of his analysis showed that companies operating in the manufacturing sector provide more information in the notes than those operating in the others.

6. Profitability

Profitability is another factor that affects the level of disclosures. Often high-profit companies, in order to inform potential investors about their potential profits, tend to provide more disclosures than lower-profit companies. Agency theory suggests that the heads of for-profit companies provide more disclosures to support their sustainability and payment arrangements (Inchausti, 1997).

METHODOLOGY

In order to measure the disclosure level the notes to the financial statements are examined. The analysis includes 120 companies operating in Albania in different sectors of the economy (hydrocarbon and mining industry, construction, trading, production, service, transport and telecommunication). The data belong to the reporting period ending on December 31, 2018. The annual reports, part of which are the notes to the financial statements are manually downloaded from the official website of the National Business Center in PDF format. The financial statements of the selected companies are prepared in accordance with National Accounting Standards or International Financial Reporting Standards and are audited. The selection of companies that have as a legal obligation the audit of financial statements is done intentionally since their Financial Statements are certified. In order to analyze the relationship between different characteristics of the companies and the disclosure index (DI) the multiple linear regression model is applied.

$$DI = \sum_{i=1}^m di/n$$

Where: DI – Disclosure index

The disclosure index includes 7 items. For each item, score “0” refers to the missing information about the respective item and score “1” otherwise.

The regression model is:

$$DI = b_0 + b_1 * TR + b_2 * AGE + b_3 * ROE + b_4 * DE + b_5 * AUD + b_6 * SE + \epsilon_i$$

Where:

TR = Total revenues, as a measure of the size of the company.

MO = Age of company

ROE = Return on Equity, as a measure of profitability

DE = Debt/Total Assets, as a measure of leverage.

AUD = type of auditor

SE = sector of economy

ϵ = error term

and $b_0, b_1, b_2, \dots, b_6$ are unknown constants

To investigate the relationships that exist between the level of mandatory disclosures and the characteristics of the company, the following hypotheses are raised:

H₁: There is a positive relationship between the size of the company and the disclosure index

H₂: There is a positive relationship between the type of and the disclosure index

H₃: There is a positive relationship between the company's profitability and the disclosure index

H₄: There is a positive relationship between the leverage and the disclosure index

H₅: There is a positive relationship between the economy sector and the disclosure index

H₆: There is a positive relationship between the age of the company and the disclosure index

The data was subjected to Multiple linear regression analysis to test the hypotheses.

ANALYSIS AND RESULTS

Linear regression results

According to the linear regression, the dependent variable, the disclosure index (DI) is measured in percentage. The results of linear regression are presented in Table 1.

Table 1: Multiple linear regression results

Dependent Variable: DI				
Method: Least Squares				
Sample: 1 120				
Included observations: 120				
White heteroscedasticity - consistent standard errors & covariance				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.351268	0.151469	2.319082	0.0222
TR	0.059752	0.025875	2.309229	0.0227
AGE	0.021521	0.029432	0.731202	0.4662
ROE	0.017073	0.004200	4.064683	0.0001
de	-0.029871	0.079350	-0.376453	0.7073
AUD	0.245953	0.048427	5.078848	0.0000
SE	0.032465	0.014300	2.270312	0.0251
R-squared	0.280344	Mean dependent var	0.725000	
Adjusted R-squared	0.242132	S.D. dependent var	0.301009	
S.E. of regression	0.262045	Akaike info criterion	0.215962	
Sum squared resid	7.759436	Schwarz criterion	0.378565	
Log likelihood	-5.957698	Hannan-Quinn criter.	0.281996	
F-statistic	7.336570	Durbin-Watson stat	2.104358	
Prob(F-statistic)	0.000001	Wald F-statistic	15.04525	
Prob(Wald F-statistic)	0.000000			

$$DI = 0.351268 + 0.059752*TR + 0.021521*AGE + 0.017073*ROE - 0.029871*DE + 0.245953*AUD + 0.032465*SE + \varepsilon_i$$

Validity tests (Fisher statistics) reveals that the model is statistically significant with significance level $p < 1\%$ (i.e. with 99% reliability). This means that such a model lies in its general form of correlated variables. But if we analyze the statistical significance of each variable in the model, the student statistic (t-test, which should be greater than 2 or less than -2) shows that with significance level $p < 5\%$ (i.e. with reliability 95%), the variables "AGE" and "DE" are statistically insignificant, while all other variables explain the variation of the disclosure index (DI). According to the multiple regression linear model, we find the following relationships:

- Hypothesis "H₁", predicted a positive relationship between the size of the company and the disclosure index. This hypothesis is accepted. Companies that have high levels of revenues also have a higher level of disclosures. There exists a positive relationship,

statistically significant ($t = 2.309229$) between DI (dependent variable) and TR (independent variable). An increase of one shift of the variable "TR" causes an increase of about 6% of the index "DI" (all other variables are held constant). Such a positive relationship is explained, firstly by the fact that large companies are targeted by more investors and secondly, they have the opportunity to afford extra costs for providing detailed disclosures. Being under the attention of more investors makes large company more willing to disclose. Large companies tend to increase their level of disclosure to maintain the reputation in the market. The positive relationship that exists between the DI and the size of the company is consistent with the results evidenced by various researchers such as Cerf, 1961; Singhvi, 1968; Francis et al., 1994; Hossain, et al., 1995; Huang et al., 2011, Bialek Jaworska, 2015.

- Hypothesis "H₂", predicted a positive relationship between the type of auditor and the disclosure index. This hypothesis is accepted. There exists a positive relationship, statistically significant ($t = 5.078848$) between DI (dependent variable) and AUD (independent variable). Thus, the level of disclosures is higher for those companies whose Financial Statements (FSs) are audited by international audit companies. When the audit is conducted by international audit companies an increase of about 25% in the index "DI" is measured (all other variables are held constant). This is because international audit companies, which are considered to be the most experienced as well as often the most sought-after, are more reliable to investors, guaranteeing the quality of the accounting information provided in the FSs. It is also worth noting that the positive relationship that exists between the disclosure index and the type of auditor is consistent with the results evidenced by various researchers such as: Singhvi and Desai, 1971; Inchausti, 1997; Jaworska, 2005; Uyar, 2011; Fathi, 2013; Jaworska and Matusiewicz 2015.
- Hypothesis "H₃", predicted a positive relationship between profitability and the disclosure index. This hypothesis is accepted. There exists a positive relationship, statistically significant ($t = 4.064683$) between DI (dependent variable) and ROE (independent variable). Companies that have a higher ROE have a higher value of the disclosure index. An increase of 1% of the variable "ROE" causes an increase of about 2% in the DI (all other variables are held constant). This result suggests that companies that are profitable tend to provide more notes to the financial statements. Also, as the company's profits increase, executives aim to provide more information to the market in order to

signal quality. According to signal theory, executives of well-performing companies are expected to provide more information about their current situation. The positive and statistically significant relationship between profitability and the disclosure index is consistent with the results of studies conducted by: Singhvi and Desai, 1971; Haniffa and Cooke, 2002.

- Hypothesis “H₄”, predicted a positive relationship between leverage and the disclosure index. The results reveals that there is no statistically significant relationship ($t = -0.376453$) between leverage and the disclosure level. This hypothesis is rejected. The results for this hypothesis are consistent with those obtained by McKinnon and Dalimunthe, 1993; Hossain et al, 1995; Aitken et al, 1997.
- Hypothesis “H₅” predicted a positive relationship between the sector of the economy and the disclosure index. This hypothesis is accepted. There exists a positive relationship, statistically significant ($t = 2.270312$) between DI (dependent variable) and SE (independent variable). A change of one shift of the “SE” variable will result in a change of about 3% of the DI (all other variables are held constant). So, the disclosure index is higher for the sectors of: construction, trade and service, which are sectors with a significant weight in the country's economy. The results of this hypothesis are the same as those reached by Stanga, 1976; Camfferman and Cooke, 2002; Haniffa and Cooke, 2002.
- Hypothesis “H₆”, predicted a positive relationship between the age of the company and the disclosure index. The results of this model show that there is no statistically significant relationship ($t = 0.731202$) between the age of the company and the disclosure index. This hypothesis is rejected. Also Alsaeed, 2006, has reached the same conclusion.

CONCLUSIONS

The main objective of this paper was to verify the relationship between characteristics of companies and the mandatory disclosure index. The linear regression results showed that the disclosure index is positively correlated to the size of the company. Larger companies provide more disclosures than the smaller ones. These companies can afford extra costs to provide more detailed information. The disclosure index is positively correlated to the type of auditor. Albanian companies audited by international audit companies have a higher level of disclosure.

These audit companies have more experience and often are considered the best. The disclosure index is positively correlated to the company's profitability, which means that albanian companies with higher ROEs provide more disclosures. This to convince existing and potential investors of their profits. The disclosure index is positively correlated to the sector of economy. Construction, trade and service sectors have the highest levels of the disclosure index. These sectors are the most important sectors in Albania. The disclosure index does not have a statistically significant relationship with either age or leverage of the company.

RECCOMANDATIONS

Based on the findings of the study, the following reccomandations are made:

- Albanian companies should pay more attention to the fulfillment of the mandatory disclosures requirements.
- Companies that are audited by non-Big 4 auditors need to improve their disclosures.
- Sectors of the economy such as: hydrocarbon and mining industry, transport and telecommunication should provide more notes to the financial statements.

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