The Adequacy of Accounting Mandatory Disclosures: A Field Study in Cyprus

Andreas Andreou[1], Loukia Sergiou[2]

Abstract: Objectives: This research attempts to explore professional accountants and investors' perceptions on the adequacy of the quality and quantity of current accounting mandatory disclosure, within the Cyprus environment. Prior work: Listed companies from different countries have divergent disclosure policies and regulations which create challenges. On the one hand, professional accountants find difficulties in the auditing and reporting process, while on the other hand investors are struggling to comprehend and compare annual reports. Approach: This study is mainly based on a mixed method approach, and involves gathering data from a group of specialists in the accounting field and a group of investors in the Cypriot stock market. Results: Investors and professional accountants agree that the reporting framework can be considered as adequate both in terms of quality and quantity. Implications: Despite the fact that the current accounting principles are perceived to be adequate in the eyes of investors and professional accountants, there is still space for improvement and a requisite for disclosures of non-financial information. Value: The information provided by accountants and investors alike is helpful towards reforming and developing an enriched disclosure era in financial reports so as to meet decision maker needs under the current financial crisis.

Keywords: Accounting mandatory disclosure; quality; quantity; investors; professionals

JEL Classification: M41

1. Introduction

Business is the cornerstone of prosperity in society: companies create the resources that permit social development and welfare. The long-term survival of companies is partly dependent on maintaining relationships of trust. Deterioration of such relationships will jeopardise the ongoing development of the company.

As expected, companies listed in the Cyprus Stock Exchange (CSE) are influenced by minor investors and controlled by major ones. As a result, anextensive supervision by the appropriate parties on the way those investors and other interested parties are informed and protected is inevitable.

There is a compulsion of mandatory accounting standards and disclosures to ensure that listed companies operate and report for the best interest of all investors and the public in general. Currently, Cyprus resident companies are preparing the annual reports under the Companies Law Cap.113 and International Financial Reporting Standards (IFRS) as adopted by the European Union and thereafter by Cyprus, as a European Union member. Furthermore, the CSE and the Cyprus Securities and Exchange Commission (CSEC) impose their own regulations and standards in accordance with EU regulations.

This study is motivated by the absence of empirical evidence on the adequacy of quality and quantity of disclosed information in financial reports in Cyprus. It aims to identify the essentials for improving

[1] Assurance Associate, Grant Thornton Cyprus, Republic of Cyprus andreas.andreou@cy.gt.com.

[2] Associate Professor, PhD, Department of Business Administration, PA College, Executive Business School, Republic of Cyprus, Corresponding author: l.sergiou@faculty.pacollege.ac.cy.

the mandatory accounting disclosure, grounded on the International Accounting Standards (IAS)and IFRS.

2. Literature Review

While for investors an important concept is the “going concern”- which, confirms that a particular company is able to continue its operations for at least one year, - for some stock markets this is not the case. Joshi and Al-Mudhahki (2001) concluded that a high level of compliance was not in existence based on the requirements of IAS 1, by Stock Exchange listed companies in Bahrain. Listed companies should have stricter accounting requirements by the appropriate authorities andmanagement should clearly disclose in annual reports its intention and feasibility of the company to continue its operations.Furthermore, for auditors the ‘going concern’ assumption is important during and at the conclusion of an audit, so their report must be in accordance with EU- endorsed IAS/IFRS.

UK listed companies are aware of the catastrophic consequences of non-compliance with mandatory disclosure and the effect on the company’s value when complying with mandatory disclosure (Popova et al, 2013). This study has shown high compliance with mandatory requirements where UK listed companies give much emphasis on the IFRSs, as an acknowledgement that users and specifically investors will prefer to invest in such companies. Eventually, this had an effect on the companies’ earnings, since those companies who were highly complying with requirements expanded in their retributions.

Additionally, Galani et al (2011) in their study revealed that mandatory disclosure practices appear to be extensive. Most specifically, on average 86% of the Greek companies report mandatory information. Nevertheless, there is still room for improvements and these can be achieved by introducing educational policies to raise the awareness of companies for disclosure, as well as by ensuring that the Greek Commission of Stock Exchange improves its review of the disclosure content of annual reports.

An important study by Chang, et al. (2008) examined Australian listed companies by using an investor-relationship program and emphasising on the disclosure of quality information. The conclusion was that information asymmetry is affected as well as it guaranteesa higher proportion of institutional investors leading towards a higher trading volume. Similarly, Tsalavoutas & Dionysiou (2014) concluded that mandatory disclosure implies low information asymmetry and higher proportion of investors. Therefore, existing literature suggests that the adequacy of the quality of information disclosed is not only an obligation, but also a benefit for companies’ performance as well.

On the other hand, mandatory risk disclosure is a tactic for bankruptcy and is not compulsory to be mandated, as stated by Cordella & Eduardo (1998). The authors concluded that when banks have complete control over the volatility of their loan portfolio, public disclosure reduces the probability of banking crises. However, when banks do not control their risk exposure, the presence of informed depositors may increase the probability of bank failures. Likewise, from another study’s findings it has been supported that the International Monetary Fund, the World Bank and others, should increase disclosure and improve transparency in the banking sector (Hossain, 2008).

Further evidence to this dispute was given by Epstein & Pava (1994) where investors responded negatively on a questionnaire given to them, where they expressed their dissatisfaction towards the information disclosed on annual reports. The majority of them replied that clarifications of accounting disclosure information as well asthe application of technical terms are essential. Moreover, Egyptian companies are selective in their choice of the accounting standards' compliance, as concluded by Dahawy and Conover (2007). The results of this study showed that, overall disclosure practices of actively traded Egyptian companies are low, with an average of 61% of the required law mandated by the Egyptian capital market.

Moreover, Zoubi and Zoubi (2012) concluded that investors disagreed with accounting academics on the adequacy of the quantity of accounting disclosure, because investors need more disclosed information to reduce risks and uncertainty of investments. On the one hand, academics in the field of accounting might be able to express an opinion for the issue but, on the other hand professional accountants have more precise knowledge based on the daily experience they gain through the exercise of their profession. In this sense, the absence of appropriate competence of one type of participants on that study is a limitation. This presents the genuine need for that topic to be further studied.

In summary, there needs to be more examination of the IAS and the way they are implemented in each country, with special emphasis on the local culture and environment. It is true that the International Accounting Standards Board (IASB) should find a one-size-fits-all set of standards that would satisfy the culture and environment of every country and at the same time fulfil the goals of the IASB to develop and harmonise accounting practices all over the world.

3. Research Methodology

A mixed method approach is used in the present study through a combination of quantitative and qualitative methods. The aim is to achieve a descriptive and comparative analysis from a group of investors in the Cypriot stock market as well from a group of specialists in the accounting/auditing sector.

Investors participated in the study via *questionnaires*comprising of closed ended questions/statementsrelating to the adequacy of the quantity and quality of accounting mandatory disclosure, with 5point Likert scale answers. Percentage frequencies were calculated for each variable in each section to give the percentage and average level of satisfaction for both variables, as well as for all sections together by combining all statements, for an overall conclusion.

To gather insights from professional accountants, *interviews*were used with a demonstrative sample representing the population.The semi-structured interviews were prepared not only with the aim to answer the research questions but also to elaborate in more depth the adequacy of accounting mandatory disclosures and the challenges professional accountants face at a compliance level. Including labelling and descriptions used for the interviews, using the general analytical procedure the researchers then classified and matched the responses of each question/topic. Finally, frequency percentages for each statement and as a total, were calculated which gave the level of satisfaction of professional accountants in the form of agreement or disagreement.

4. Data Analysis

4.1. Questionnaires

Tables1 and 2 below exhibitthe percentages of investors' responses for each statement set in the questionnaires, and the total proportions for each level of satisfaction. Investors' level of satisfaction is coded with 1 up to 5:"completely unsatisfied", "somewhat unsatisfied", "neither unsatisfied nor satisfied", "fairly satisfied", and "strongly satisfied" respectively.

Table 1 reveals that investors are unsatisfied as a total (41%) in relation to the adequacy of the *quality* of accounting mandatory disclosures. More specifically, non-satisfaction of investors relates to areas of presentation of accounting information, disclosure of accounting information presenting the company's opportunities and threats as well as disclosure of sensitive and risky information.It is worth noting that 37% of the respondents answered that they are neither unsatisfied nor satisfied.

Additionally, Table 2 below indicates the level of satisfaction from investors' perceptions towards the adequacy of the *quantity* of accounting mandatory disclosures, represented in annual reports of the Cypriotlisted companies.Investors tend to be unsatisfied (42%) in a number of areas of disclosure relevant to intellectual property information, fines for non-compliance, presentation of sensitive information in other reports as well as corporate governance facts and figures. On the contrary, investors are slightly satisfied (22%) for the disclosure of notes in the financial statements as well as prior years' performance information.

Table 1. Frequency percentagesof the adequacy of the quality of accounting mandatory disclosures

No	Statement	Investor's level of satisfaction				
		1	2	3	4	5
a)	Listed companies present accounting information in a clear way for investors	6%	53%	7%	30%	4%
b)	The accounting information disclosed by listed companies presents the company's opportunities and threats	31%	21%	41%	7%	0%
c)	Listed companies disclose information in relation to fair value gains or losses in an explanatory way	5%	39%	26%	23%	7%
d)	Listed companies avoid the use of technical jargon when information is disclosed in the form of text and seekunderstandability	9%	34%	56%	1%	0%
e)	Listed companies disclose sensitive information in a striking way for new investors	4%	54%	37%	5%	0%
g)	Listed companies transparently disclose related parties transactions and clearly explain their nature and purpose	7%	36%	41%	16%	0%
h)	Listed companies clearly disclose potential exposures in relation to pledges of assets used in business, enhancing decision making	7%	21%	36%	33%	3%
i)	Listed companies disclose valuable information for investment undertakings	0%	10%	53%	30%	7%
j)	Listed companies clearly disclose and explain the effect of profit or loss for the year on earnings per share (EPS)	0%	27%	41%	24%	8%
All statements:		***8%***	***33%***	***37%***	***19%***	***3%***

Source: Authors' processing

Table 2. Frequency percentages of the adequacy of the quantity of accounting mandatory disclosures

No	Statement	Investor's level of satisfaction				
		1	2	3	4	5
a)	Listed companies extensively disclose information in the notes of financial statements	0%	7%	56%	37%	0%
b)	The quantity of accounting information disclosed by listed companies is relevant and is not misleading investors	3%	23%	50%	24%	0%
c)	The figures in the face of financial statements are disclosed in the notes of financial statements	0%	6%	34%	39%	21%
d)	Listed companies disclose adequate information in the notes in relation to the company's plans for the foreseeable future	20%	33%	31%	10%	6%
e)	Listed companies publish sufficient amount of periodic financial information	7%	47%	36%	10%	0%
f)	Listed companies disclose adequate information for prior year performance	0%	0%	47%	46%	7%
g)	Listed companies disclose appropriate information in relation to intellectual property such as, the people responsible for its daily running	34%	26%	33%	7%	0%
h)	Listed companies disclose information regarding fines for non-compliance in an explanatory way enabling effective decisions	17%	47%	27%	9%	0%
i)	Listed companies disclose sensitive and important information beyond mandated one	33%	29%	31%	0%	7%
j)	Listed companies disclose sufficient information in other reports other than the annual report during the financial year	3%	59%	31%	7%	0%
k)	Listed companies disclose adequate information regarding corporate governance enhancing decision making by investors	24%	43%	24%	9%	0%
l)	Listed companies disclose additional and appropriate information during financial crisis situations	0%	46%	33%	14%	7%
All statements:		***12%***	***30%***	***36%***	***18%***	***4%***

Source: Authors' processing

4.2. Interviews

The second method of data collection used for this study is interviews. Specifically, semi-structured interviews have beenapplied with the aim to generate the level of agreement or disagreement of the professional accountants towards the adequacy of both the quality and quantity of accounting mandatory disclosures.

Theresearch findings indicate thata hundred per cent of the professional accountants agree that the current accounting mandatory disclosures areadequate both in terms of quality and quantity. It is also revealed from the analysis of the interview schedules that the standards setters, the Cyprus Securities and Exchange Commission (CSEC), and the CSE exercise adequate supervision on listed Cypriotcompanies and this is publicised by new standards and requirements in relation to investors' needs. Besides, Cyprus is a member of the European Union and all the IFRS that are issued or revised are adopted by the European Union, andas a consequence by Cyprus. This is definitely encouraging for investors since there are strict requirements for listed companies.

In addition, despite the fact that the majority (80%) of the professional accountants agree that the annual reports are understandable by non-professional people, the insights indicate that non-professional people can acquire only a basic understanding of the annual reports of listed companies. Investors who have no extensive knowledge of annual reports are advised by the professional accountants to read the annual reports diligently and to seek professional advice.

Furthermore, on the question “Do listed companies disclose sensitive and important information beyond mandated one?” all of the professional accountants come to an agreement that they do not and that they disclose such information up to the minimum required. This is not detrimental for investors, as agreed by the professional accountants, since such information will be also available to competitors.

Also, non-financial information in general can be helpful for investors but should not be included in annual reports, instead should be disclosed in other reports or publications. In other words, professional accountants explain that such information will capture a long time to be audited,and if included in the annual reports will resultto increasedaudit fees, leading to lower returns for investors.

Another important finding of this research is revealed from the question in relation to whether auditors are auditing the corporate governance statement within the director’s report.From 2016 onwards, professional accountants clarify that auditors are obliged to audit the corporate governance statement and provide an opinion in the new auditor’s report. This finding reemphasises the fact that a deficiencyexistsin this area, and providentiallythe standard setters and authorities latelyimposed a new standard for enhancing the quality and quantity of accounting information.

From this research, it seems clear that there is no disclosure of intellectual property in the annual reports; the majority of the interviewees stated that listed companies neither publish proper periodic financial information nor they disclose adequate information in the notes of financial statements in relation to company’s plans.

Finally, there is an agreement by the interviewees that high fines for not publishing the annual reports on timeeventually affect the investors. Unfortunately, investors are not protected when the companies are imposed with high fines for delays. It is true that a fine is added in the operating expenses of a company and consequently decreases the returns proposedfor investors.

5. Discussion of the Findings

It is revealedthat the quality of an accounting mandatory disclosure is interrelated with the knowledge and professional use of an annual report. Thus, an important lesson is that the annual reports may be understandable by non-professional people, and that the requirements are not perfect but they are adequate in both the nature and extensiveness however, any users of the reports should use it diligently and responsibly. As Linsley and Shrives (2005) concluded, there are no mandatory requirements to disclose information regarding the risk that a company faces.

That is why the users of annual reports should not over rely on them during the decision making process. There are a lot of other determinants to consider before making any decision in relation to a company. Definitely, audited annual reports can provide a true and fair view of the financial performance and position of a company however; further analysis and research may be needed in order to achieve an integrated picture.

Moreover, investors have not hidden their dissatisfaction in relation to the disclosure of adequate information regarding corporate governance enhancing decision making by investors. However, for annual reports with year ended 31 December 2016 and with the deadline to be published no later by the end of April 2017 there are new standards, laws, and requirements for auditors. These include among others, that auditors have to check the information provided by the directors in the corporate governance statement as well as to provide an opinion in the auditor’s report on this information based on the tests and evidence performed and obtained. Similarly, Hernández et al. (2012) concluded that

Spanish listed companies tend to disclose the minimum required in relation to corporate governance and that they do not consider the needs and requirements of the shareholders and other users.

Nevertheless, it is important to mention that there is a change in the requirements of the auditor's report. This is in line with the dissatisfaction of investors in relation to non-financial information disclosures in the annual report. The new requirements, oblige auditors of listed companies to disclose the key audit matters, the procedures performed, the materiality used, risky areas of the company's accounting records, and eventually the level of satisfaction towards the company. It is important to say that such information had never come up in the past. It will add value, by providing transparency, as well as assisting investors in the decision making process. Further evidence to this concern was given by Epstein and Pava (1994) with investors expressing their dissatisfaction towards the information disclosed on annual reports. Particularly, the explanation requested by investors is obviously referring to the quantity and technical terms to the quality of information disclosed.

In addition, investors showed their dissatisfaction towards the following statement: "The Cyprus Securities and Exchange Commission exercise adequate supervision on listed companies and timely informs investors for non-compliance offences". As discussed by the researchers, the CSEC publishes on its website appropriate information in relation to affairs and offences of the listed and other regulated companies. The fact that investors showed their dissatisfaction is that they are unaware of the information provided by the Cypriot authorities.

6. Conclusions and Recommendations

Based on the results of the analysis, it is obvious that both investors and professional accountants come to an agreement that the reporting framework can be assessed as adequate both in terms of quality and quantity. Accountants conclude that the amount of accounting information disclosed in mandatory financial reports is sufficient to meet the needs of financial reporting users. On the other hand, investors considerably need more disclosed information to reduce the uncertainty and serve their intended purposes effectively towards various investment decisions.

It is crucial for users of financial information to know that in the case of misinformation there are laws and regulations. Researchers recommend that there is a need for re-consideration of disclosure requirements by accounting bodies regarding accounting information disclosed, to meet the needs of investors and other financial reporting users. This gives rise to harmonisation of the accounting and financial reporting standards.

This study provides information which can be utilised by various Cypriot decision makers in order to rationalise their decisions and maximise benefits, as well as enabling investors and other users to understand the effects of the global financial crisis.Furthermore, researchers could make use of this current study and rely on it to accomplish further related studies in the future.

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