Challenges of Corporate Voluntary Disclosures Through the Annual Reports: Evidence from Iraq

Akeel Almagtome, Inaam Almusawi and Karrar Aureaar

Faculty of Administration and Economics, University of Kufa, Iraq

Abstract: This study aims to explore the challenges of corporate voluntary disclosure practices in the annual reports of listed companies in Iraq Stock Exchange ISX by analyzing the relationships between the voluntary disclosure and some firm-specific characteristics. A disclosure checklist comprising of 50 items is used to identify the level of voluntary disclosure in the 2016’s annual reports of the sample companies. The sample consists of 58 companies listed in systematic market, which represents 82% of the total population was randomly selected. The findings indicate that the firm size, Industry, profitability, ownership type and audit type are closely related to the extent of voluntary disclosure, while the correlation between voluntary disclosure and leverage was not significant. This study provides an empirical evidence for the stakeholders of Iraqi companies and regulators to find out the reasons and reliability of voluntary disclosures in the annual reports and to improve the transparency of Iraqi listed companies. The overall results contribute to understanding the disclosure trends of management in big and small companies, sensitive and non-sensitive industries, state owned and private owned companies and those audited by small or big audit firms.

Key words: Voluntary Reporting • Annual Reports • Audit Type • Disclosure Index • Firm-Specific Characteristics

INTRODUCTION

Information disclosure imply a series of practical regulations and activity standards for some particular parties in the capital market who report the information of the entity by certain way [1, 2]. Generally, financial information disclosed by the annual reports whether mandatory or voluntary disclosures have a crucial importance in decision making. Corporate Voluntary Disclosure (CVD) refers to the providing a certain information beyond the mandatory items in the financial reports, which in turn may lead to minimize information asymmetry problems by dissemination of private information to the public. Recently, in both developed and developing economies a considerable research studies have been conducted on CVD, by these studies, the low levels of information disclosures have been noted in most developing countries. For instance, the Iraqi companies tend to disclosure the mandatory requirements of information by their annual report, whereas the voluntary disclosures still at minimum level in most cases. In the last few years there has been a growing interest in the motivations of voluntary disclosure in the annual reports [3-9].

Even though it is acceptable to say that management will tend to report enhanced voluntary information in order to maximize disclosure and reporting benefits, the questions remain of whether there are serious challenges and determinants for corporate voluntary disclosure levels. This paper is one of the first studies that examine the challenges of corporate voluntary disclosure information in the annual reports of Iraqi listed companies. The paper reports the extent of voluntary disclosures by a set of companies listed in Iraqi Stock Exchange ISX and examines the association between voluntary disclosure level and six specific characteristics of the companies.

Literature Review: The financial reports of firms play an important role in providing the information needs of investors, financial analysts and other interested parties. It is plausible to think that accounting standards and rules by which these reports prepared are likely to affect their...
assessments [10]. Although, the accounting standards and rules impose a considerable amount of mandatory disclosure through the firm’s periodic financial reports, the managers tend to voluntarily release additional relevant information using a variety of indirect disclosure tools, such as press conferences, meetings and Internet sites and other communication channels [11, 12]. In this context, voluntary disclosure represents an additional information provided besides the mandatory information, such disclosures are provided for different reasons, including improving the image of the firm, decreasing the political costs, gaining a social support and supporting their social legitimacy. Generally, the financial disclosure provides the stakeholders with the financial information that influence their decision making via the annual reports. The previous researches reveal two types of information disclosure, the first deal the information mandatory prepared in accordance with the generally accepted accounting principles and regulation of local authorities, While the second type represents the voluntary disclosure.

The focus of recent accounting literature has been on the motivation of voluntary disclosure in the annual reports. The question was concentrated on the desire of management to provide additional information rather that those required by ‘FASB’ or other regulators [13 -19]. Most of previous studies have categorized the reasons of voluntary disclosure into two motivations and constraints, the voluntary disclosure motivations may include capital markets information asymmetry, corporate control strengthens, stock compensation, enhanced analyst forecasts, management proficiency signaling and investors’ confidence [20 - 22]. The accounting literature on voluntary disclosure have been taken a substantial domain in the field of academic research since 1970s. Accordingly, a great effort has been devoted to investigate the characteristics of corporate voluntary disclosure in both developed and emerging countries [23 - 25]. Ordinarily, these efforts were focused on the factors affecting the level of CVD. For instance, Francis et al. (2008) found a negative correlation between corporate voluntary disclosure and cost of capital and earning quality [26]. In Iraq, the mandatory disclosure constitutes the main part of financial reporting via the annual report due to the strict compliance with the accounting principles and the local regulators and authorities. However, some Iraqi companies tend to disclose additional information voluntarily in order to improve the firm’s image. This type of disclosure faces a unique situation related to the political conflicts and terrorism that influence the economic activities as whole in this country. Then, this study, unlike most previous studies, focuses on the practical challenges of corporate voluntary disclosure that restrict the firm’s ability to enlarge the level of information disclosed by its annual reports.

![Fig. 1: Challenges of Corporate Voluntary Disclosure](image)

The empirical and theoretical literature of accounting disclosure suggests a number of variables that may represent some challenges of corporate voluntary disclosure (as indicated in Figure 1), in this study we consider six interpreting variables that include the following:

**Firm Size:** The firm size measured by the total assets represents an important factor to motivate the firm’s manager to disclose enhanced information in the annual reports. According to agency theory the managers in larger companies would have incentives to provide more information about the environmental, social and economic activities voluntarily. There are a number of theoretical explanations for expecting a positive relationship between company size and level of voluntary disclosure. Typically, most of these studies focus on determinants of CVD. For instance, Arcay and Vazquez [10] found a positive correlation between firm size and extent of voluntary disclosure in the Spanish companies where investor protection policies are very weak. Then, it is can be assumed that large firms disclose more information than the small ones.
Industry: Due to the nature of product and research activities the companies working in the chemical industry are likely to be more sensitive about the disclosures to society and competitors than companies working in other industries. The competitive damages and political costs will rise in certain industries and decrease in others [27]. In addition, the nature of disclosing items can also be varied across industries. For example, in highly technical industries the research and development disclosures are more relevant to be voluntarily disclosed in the annual reports. Therefore, the industry membership is assumed to have an influence on the voluntary disclosure.

Financial Leverage: The leverage measured by long-term debt/equity stands for the contribution of the foreign funds to the total funds available in the company. The companies with high leverage percentage in their capital structures will face a higher political cost, stemming from the stakeholder pressures, because the high leverage increases the possible wealth transfer from debtholders to shareholders. Therefore, it is potential that the interest conflict between shareholders and debtholders lead managers to disclose voluntary information to decrease the information asymmetry between these conflict parties.

Profitability: Before making investment decisions the investors and creditors review the profitability level, financial position, other information related to the firm’s operations. A good firm profitability measured as return on asset (ROA) is considered as preferable information to be conveyed to stakeholders, which is useful in decision making. Therefore, it is assumed that good profitability will influence voluntary disclosure to avoid information asymmetry [7]. The companies with high level of profitability might have incentives to provide more voluntary disclosures in order to convey their good performance investors.

Ownership Type: Ownership type is considered a determinant of voluntary disclosures in terms of private or public ownership can be stated that state-owned companies may not disclose extensively due to the governmental funding, which lead to reduce the need to attract the external funds and the fact that these companies are supported by the governmental agencies. In addition, in most developing countries the state-owned companies are strongly politically associated, thus, such companies tend to provide less information to protect their political, social and business linkages in comparison with publicly-owned companies. Therefore, it is likely to expect that there a high level of voluntary disclosures in the annual reports of privately held companies. This study distinguishes two types of ownership, are privately held companies and mixed held companies.

Auditor Type: The external auditors are expected to provide an effective assurance that the companies comply with the requirements of mandatory disclosures. The membership of the big audit firm may create a pressure on the audit client to disclose non-mandatory information explaining the corporate governance mechanisms, sustainability strategies, social activities and internal control structure. In Iraq, the responsibility of external auditors is dedicated only to ensure that the company’s compliance with the mandatory disclosure requirements. Thus, the audit type may affect transparency of the company or the providing of non-mandatory information to the public by voluntary disclosures in the annual reports. This study distinguishes between two auditor types, are big-5 auditors and non-big-5 auditors. Big-5 auditors refer to companies audited by the one of the big 5 auditing firms, while the non-big-5 companies stands for the companies that audited by auditors other than the big-5 firms. Thus, this study assumes that the companies with big-5 will disclose more voluntary information in comparison with other companies.

MATERIALS AND METHODS

As a result of the above discussion, this paper aims to identify the level and the extent of corporate voluntary disclosure in the annual reports of Iraqi companies. Moreover, the paper examines the effect of several firm specific characteristics (firm size, industry, financial leverage, profitability, ownership type and type of auditing) on the level of corporate voluntary disclosure measured using a voluntary disclosure index based on the content analysis methodology.

Sample and Data: This study seeks to examine the extent of voluntary disclosure in Iraqi listed companies, in addition to identify some firm specific characteristics of corporate voluntary disclosure in Iraqi companies. To achieve these objectives the content analysis has been used to measure the extent of voluntary disclosures in a sample including 58 companies. The study focused on several components of corporate voluntary disclosures, that is: general information, historical information, performance ratios, future forecasts and other narrative information.
The population of this paper is the Iraqi companies listed in the Iraq Sock Exchange ISX, for this study a sample of 58 companies were selected from the 8 different sectors as indicated in Table 1, their annual financial reports for the year ended on December 2015 were collected and analyzed. The data set necessary for the research has been extracted from the annual reports database of in Iraq Sock Exchange ISX. Table 1 provides a breakdown of sample companies showing the industry distribution of sample companies.

Table 1: Industry Breakdown of Sample companies

<table>
<thead>
<tr>
<th>Industry Type</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>19</td>
<td>33%</td>
</tr>
<tr>
<td>Tourism</td>
<td>7</td>
<td>12%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>12</td>
<td>21%</td>
</tr>
<tr>
<td>Agricultural</td>
<td>6</td>
<td>11%</td>
</tr>
<tr>
<td>Services</td>
<td>6</td>
<td>11%</td>
</tr>
<tr>
<td>Communication</td>
<td>2</td>
<td>3%</td>
</tr>
<tr>
<td>Insurance</td>
<td>4</td>
<td>6%</td>
</tr>
<tr>
<td>Financial Investment</td>
<td>2</td>
<td>3%</td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
<td></td>
</tr>
</tbody>
</table>

Measurement of Voluntary Disclosure: The first step to measure the level of corporate voluntary disclosure for the sample companies is creating a suitable disclosure checklist. The checklist is established based on some related accounting literatures and the local laws and regulations. The disclosure index consists of six disclosure groups: (1) general information, (2) historical information, (3) performance information, (4) future information and (5) other information. It contains 50 disclosure items distributed into these five groups. To measure the extent of corporate voluntary disclosure a coding scheme is used in which the presence and absence of disclosure items are considered. In this context, the scheme gives one (1) point for the presence of each disclosure item and conversely gives zero (0) point for the absence of each disclosure item. Consequently, each disclosure item of 50 disclosure items within disclosure checklist that provided by the sample companies through their annual reports will receive one point and then the maximum score of each company could reach to 50 points. The checklist of voluntary disclosure items is indicated in Table 2.

Table 2: Checklist of Voluntary Disclosure Items

1. General information
   1. Brief History
   2. Vision and Mission
   3. Strategies and objectives
   4. Number of Board of directors
   5. Information on the Audit Committee

2. Historical information
   11. Change in creditors
   12. Change in debtors
   13. Change in assets
   14. Change in liabilities
   15. Change in equity

3. Performance information
   21. Return on Assets
   22. Return per share
   23. Return on equity
   24. Asset turnover rate
   25. Deviation of main activity revenues

4. Future information
   31. Expected market share
   32. Cash Flow Forecast
   33. Capital expenditures
   34. Earnings Forecast
   35. Sales volume forecasts

5. Other information
   41. Contribution of the Unit to support the national economy
   42. Contribution of the unit to society
   43. Contribution to environmental protection
   44. Description of the local and foreign shopping network
   45. Classification of shareholders by sector

   6. Information on staff training courses
   7. Employment Policy
   8. Description of the company's main products
   9. Information on quality control methods
   10. Organizational Chart
   16. Change in capital
   17. Change in the output of the main activity
   18. Change in revenues of the main activity
   19. Change in key operating expenses
   20. Change in salaries and wages
   26. Deviation of main activity expenses
   27. Ratio of current assets, liquid / total deposits
   28. Profitability Ratios
   29. Operating ratios
   30. Ratio of debt to equity
   36. New Products / Services
   37. Sales / Services Expansion Plan
   38. Expected R & D expenditures
   39. Revenue Forecast
   40. Expected earnings per share
   46. Classification of shareholders by number of shares
   47. Donations to charities
   48. Support government-sponsored campaigns
   49. Constraints encountered by the unit
   50. Ways to resolve obstacles
RESULTS AND DISCUSSIONS

To explore the level of voluntary disclosure in the annual reports of the sample companies, the checklist of voluntary disclosure was applied. The results in figure 2 show the CVD of the five components of the voluntary disclosure index. The CVD scores in 2015 indicate that the Iraqi companies on average disclose 35% of 50 voluntary disclosure items. The mean scores of CVD for the index categories suggest that the sample companies disclosing 45% historical corporate information items in their annual reports in 2015, whereas they are disclosing 1.8% of future corporate information, which is the least voluntary disclosure score among the index categories. The results also indicate that the voluntary disclosure score in other disclosure categories that include general, other and performance information were 34.4%, 26.3% and 17.6% respectively. These finding imply that the sample companies tend to disclose a more clarifications and explanation of mandatory financial disclosures in the financial reports of these companies since this type of information is needed by the investor to decrease the information asymmetry between management and other groups of stakeholders. Conversely, the future corporate voluntary disclosure was the least among the disclosure index categories, which reveals that there is a lack of interest in the information that reflect the company’s plans, objectives and management forecasts.

Fig. 2: CVD scores of Disclosure items

Table 3 shows the descriptive statistics of dependent and independent variables that include minimum, maximum, mean and standard deviation. The results indicate that the average value of the voluntary disclosure in the annual reports of Iraqi companies listed in Iraq stock exchange ISX in 2015 is 17.64 points of 50 points possible. The maximum level of voluntary disclosure is 35 points and the minimum is 6 points. The standard deviation of the sample companies is 7.79. The results also show the average levels of dependent variables which include firm size, industry, financial leverage, profitability, ownership type and audit type were 348.822 million, 5.67, 0.336, 0.009, 1.327 and 1.672.

Table 3: Descriptive Statistics of the study variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>CVD</td>
<td>58</td>
<td>6.00</td>
<td>35.00</td>
<td>17.644</td>
<td>7.78820</td>
</tr>
<tr>
<td>FMS</td>
<td>58</td>
<td>.31</td>
<td>4073.80</td>
<td>348.822</td>
<td>738.01125</td>
</tr>
<tr>
<td>IND</td>
<td>58</td>
<td>1.00</td>
<td>8.00</td>
<td>5.67</td>
<td>1.85801</td>
</tr>
<tr>
<td>LEV</td>
<td>58</td>
<td>-3.23</td>
<td>6.02</td>
<td>.34</td>
<td>1.00159</td>
</tr>
<tr>
<td>PRO</td>
<td>58</td>
<td>-1.10</td>
<td>.42</td>
<td>.007</td>
<td>.17827</td>
</tr>
<tr>
<td>OWT</td>
<td>58</td>
<td>1.00</td>
<td>2.00</td>
<td>1.327</td>
<td>.47343</td>
</tr>
<tr>
<td>AUT</td>
<td>58</td>
<td>1.00</td>
<td>2.00</td>
<td>1.672</td>
<td>.47343</td>
</tr>
</tbody>
</table>

Valid N (listwise) 58

CVD = Corporate Voluntary Disclosure (measured by checklist of 50 points).
FMS = Firm size (measured by total assets).
IND = Industry type 1, 2, 3, 4, 5, 6, 7 and 8.
LEV = Leverage (measured by the ratio of debts to owner equity).
PRO= Profitability (measured by ROE).
OWT= Ownership type, state owned 1 and private owned 2.
AUT= Audit type (Big 5 firms 1, non-big 5 firms 2).

In order to identify the most important challenges of corporate voluntary disclosure in Iraqi companies listed in the Iraq stock exchange ISX, the Spearman correlation test was used. The Spearman rank correlation Matrix for Variables in table4 shows that there is a significant correlation between corporate voluntary disclosure CVD and firm size, industry, profitability, ownership type and audit type. In contrast, the results indicate that there is an insignificant relationship between CVD and Financial leverage. In addition, the Spearman rank correlation coefficients of disclosure index items in the annual reports of the sample companies reveal that there is a strong correlation between CVD and firm size (0.639), whereas there is a medium correlation between CVD and Industry (0.493), Audit type (0.482), ownership type (0.435) and the least correlation was between CVD and profitability (0.427).

According to the results indicated in the table 4 above, there is a significant positive correlation between CVD and firm size (scaled by total assets) which imply that the big Iraqi firms disclose more information than the smaller firms. This result is consistent with most prior studies that found a positive relationship between firm size and voluntary disclosure (e.g. [17, 19, 28 - 31]). The industry type also exhibits a significant positive
correlation with corporate voluntary disclosure. This reveals some differences in the mean corporate voluntary disclosure level of firms between the industries. This outcome reveals the effect of industry on the level of CVD in Iraqi listed companies, which indicate that the firms working in environmentally sensitive industries will disclose more information than other firms. However, the findings indicate that the level of CVD in banking, tourism and manufacturing industries took the first three ranks (45%, 28%, 28%, respectively), while the last rank was taken by the financial investment industry (12%) as shown in table 5.

Table 5: The Averages of CVD by Industry

<table>
<thead>
<tr>
<th>#</th>
<th>Industry</th>
<th>CVD %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Banking</td>
<td>45.0%</td>
</tr>
<tr>
<td>2</td>
<td>Tourism</td>
<td>28.4%</td>
</tr>
<tr>
<td>3</td>
<td>Manufacturing</td>
<td>28.1%</td>
</tr>
<tr>
<td>4</td>
<td>Agricultural</td>
<td>24.5%</td>
</tr>
<tr>
<td>5</td>
<td>Services</td>
<td>24.2%</td>
</tr>
<tr>
<td>6</td>
<td>Communication</td>
<td>21.4%</td>
</tr>
<tr>
<td>7</td>
<td>Insurance</td>
<td>21.1%</td>
</tr>
<tr>
<td>8</td>
<td>Financial Investment</td>
<td>12.3%</td>
</tr>
</tbody>
</table>

The results in table 4 show that there is a positive correlation between CVD and profitability, the correlation coefficient was 0.427, which means that CVD increases in the firms that have a good financial performance. Thus, a larger profitability percentage may encourage the manager to voluntarily disclose additional information. Accordingly, the financial performance measured by ROA is considered a constrain for the corporate voluntary disclosure in Iraq. The ownership type also has a correlation with CVD, the CVD increases in privately owned firms in comparison with publicly owned firm. This result refers to that privately-owned firms face more social pressure and tend to avoid these pressures and related political costs using voluntary disclosures. In addition, the Iraqi government has not had enough regulations as to the increase the transparency of the financial activities in order to increase the stakeholders’ confidence. Thus, the ownership type is considered as another constraint on the level of CVD in Iraqi Companies. Finally, a correlation matrix in table 4 shows that management’s decision to disclose voluntary information significantly correlates with audit type. The findings state that the companies audited by big 5 auditing firms disclose more voluntary information than those with non-big 5 firms. This imply
that the companies under scrutiny of big auditing firm tend to disclose additional voluntary information so as to satisfy the strict requirements of auditor and to convey a positive image of the firm to the external parties through simulating the disclosures strategies of leading firms.

CONCLUSION

This study seeks to identify the level of corporate voluntary disclosure in the annual reports of a sample of Iraqi companies listed in the Iraq Stock Exchange ISX, as well as exploring the most important challenges of voluntary disclosure in Iraqi Companies. The study provides evidence that the level of corporate voluntary disclosure in the annual reports of Iraqi companies still relatively low in comparison with other developing countries such as Iran, Egypt, Jordan, Bangladesh and Malaysia [32 - 37]. The possible reason of this result is the exceptional situations of Iraq in last decade, including political conflicts and fighting with terrorism and led to the deterioration of the economic activities, consequently, the transparency got a little attention by pressure groups in the society and governmental authorities. The results also reveal that firm size, industry, profitability, ownership type and audit type are the most important challenge of corporate voluntary disclosure in Iraq. This study indicates that the level of corporate voluntary disclosure increases in companies with high firm size, sensitive industry, high performance, private ownership and with the big audit firm. The evidence in this study supports the idea that the companies utilize corporate voluntary disclosures to manage the perceptions of the stakeholders about the economic outcomes of these companies. In addition, unlike the companies working in normal situations the Iraqi companies face less social pressures and interrelated political costs and accordingly lead to less corporate voluntary disclosures. These findings help Iraqi managers, policy makers and regulators understand the challenges of corporate voluntary disclosure practices and possible procedures to increase the effectiveness and reliability of such disclosures in the annual reports.

REFERENCES


