

## The Importance of Standard Accounting Disclosure: An Assessment of External Auditor and Institutional Investor's Point of View

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### Abstract

This research is aimed to identify the importance of standard accounting disclosure for banking industry from point of view of external auditors and institutional investors. A survey-based questionnaire approach has adopted to record the responses. The research includes three main dimensions of accounting disclosures including income, expense and liabilities. The results of investigation revealed that external auditors are more concerned about loan facility management issued to customers while investors are more concerned about the income and expenses of banks. Further the responses of two groups are compared and found statistically equal. Therefore, a consensus in the perception about the importance of accounting disclosure of banks has identified.

**Keywords:** Accounting standards; Disclosure; External auditor; Institutional investor.



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### 1. Introduction

Banks and financial institutions is one of the most important pillars in economic development in any country through which all economic activities and events are connected. Large banks stocks are a homogeneous group of stocks that are traded in the stock market. The prominent banks in most of the countries are preferred by investors because of low risk as compare to others.

In recent years the subject of disclosure and transparency has increased interest in the presentation of financial statements. In fact, the interest in disclosure and transparency did not come out of thin air, as many outsiders and shareholders and investors rely on information published by the companies. Therefore, inadequate transparency in disclosure makes information contained in the financial statements misleading. Hence, this is reflected in the decision by the shareholder or investor interested in the information businesses (Faisal *et al.*, 2016; Hussain *et al.*, 2018; Salman and Shabbir, 2011; Shabbir, 2009; Shabbir *et al.*, 2016; Shabbir *et al.*, 2018). The accounting and auditing activities influence investment decisions through financial statements published by companies. Hence, companies should provide correct information for investors to take investment decisions (Anifowose, 2015; Hassan, 2013; Kuran, 2010; Mushtaq and Shazia, 2016; Okeke, 2012; Salehi *et al.*, 2011). Keeping in view the importance of transparency and accuracy of financial information the role of auditor is the most important to determine the financial health of business as reported in financial statement. The external auditor in turn is responsible to observe laws and regulations according to international auditing standards and strengthening the disclosure and transparency.

In this regard, the international accounting standards committee issued international accounting disclosure standard (30) on the financial disclosure of banks and financial institutions. The basic idea of this search based on analyzing the disclosure in bank statements upon which institutional investor are dependent while making decision about sale and purchase of shares of banks.

## 2. Foundation of Theoretical Literature

### 2.1. The Concept of Auditor

The auditor is called multiple labels as it is called Auditor in English law, auditor in Jordanian law, Commissioner in Lebanese law and Inspector in the Syrian law. In Iraqi-Egyptian company law it is labeled as Auditor. The auditor's role is not limited to auditing, but also includes monitoring the application of laws and regulations on the company's business. Under the recent amendment to article (117) of Iraqi companies Act No 21/1997 it an obligation for each company to prepare and present the report on final account of the previous year within first six months of each year (Behind, 2006).

As per Arab society of certified accountants auditors are known as "legal person whose is professional, independent, competent and eligible that brings measurable evidence for the purpose of preparing a report on the degree of congruence between quantifiable information and enacting standards and that does not go out of its frame" (Samurai, 2006). An external auditor reviews the financial statements of an organization as per explicit laws and is

autonomous of the element being audited. The person who audit and review multiple installations vary in nature and size, legal form, and may often commissioned by the company management and various research studies for some activities to assist management in making some decisions based on his recommendations (Al-Khatib *et al.*, 1998). The auditor is "scientifically and professionally qualified person, which is set by the owners to review their accounts" (Aloosi, 2003). Hence we can say that after reviewing these definitions it is pure lies in the content of one that an auditor is eligible, independent and autonomous scientific and practical identity assigned by the company's General Assembly to audit the financial statements of the company for the purpose of giving the opinion on financial statements and its clarity, sincerity and conformity to generally accepted accounting principles. This will ensure the relevance and adequacy of disclosure and transparency in financial reporting and be officially certified through auditing the financial reports.

## 2.2. The Concept of Disclosure

They diversified and varied opinions and views regarding the concept of standardized disclosure ensure that all financial statements achieve their desires disclosure level. Though researchers have developed several definitions of disclosure, argued that disclosure is intended to display important information to Investors, shareholders and creditors and others stakeholders in a way that allows to predict the ability of the company to achieve profits in the future and ability to repay its obligations. While some researchers asserted that financial disclosure is a procedure through which the company builds its connection to the outside world by providing all the financial information (Saadani, 2007). Thus, it is difficult to provide a broad concept of disclosure because of the different interests of the users of financial statements.

The disclosure is about all the basic financial information of interest to stakeholders to analyze the financial position of company and decisions (AbdulAllah, 1995). Therefore, company should disclose all information whether it is appropriate or not appropriate for organization or management through which investors, stakeholders and creditors take the right decisions. The publicity about all information convenience of interest to readers should not be biased and understandable and timely.

The company should disclose the accounting policies and methods used in the preparation of financial statements, and that this information can be in the same financial statements between the braces, or margins (Iraqi accounting rule (6), 1995). Also, the disclosure is to make the financial accounting report disclose all the necessary information to avoid misleading.

Further, the disclosure meant to be comprehensive financial statements on all necessary information that helps to give a clear picture of the company's business.

## 3. Methodology

This study is aimed to record and analyze the responses of auditors and investors on the level of importance of financial disclosures in financial reports with accounting standards followed by Iraqi banks. The certified auditors and institutional investors have been interviewed to record their responses on main items of financial statement for banks. In total 140 questionnaires containing the list of major items of financial statements from three subsections Income, Expenses and Liabilities has been distributed among External auditors and Institutional investors. Where 70 questionnaires were distributed among institutional investors and 70 were distributed among external auditors. Convenience bases sampling technique is adopted to collect data from respondents. Descriptive data analysis technique has adopted to analyze responses and the mean response score of external auditors has been reported. The responses were collected on a likert scale based on five anchors. (1= highly not important, 2 = not important, 3= important, 4=moderately important, 5=highly important). Data analysis for the responses of the external auditor on accounting disclosure standard requirements for income statement items is presented in table 1-3.

Table-1. Responses of Auditors on Income Items

Standard Provisions	Mean
Interest income and other income	4.72
Interest expense and other burdens	4.65
Income from dividends	4.22
Income from fees and commissions received	4.51
Fees expenses and commissions paid	4.42
Dealing in foreign currencies gains less losses other items operating income	4.28
Loan losses and banking facilities	3.73
General administration expenses	4.70
Other operating expenses	4.03
Income and expenses items are classified according to the nature and types of income and expense	3.68
Disclosed President endorsement data that does not include clearing between expense items except for deals coverage and assets and liabilities in the event of a legal right of set-off	4.54
<b>The arithmetic mean of all items of the income</b>	<b>4.39</b>

The results shown in table 1 illustrate the mean responses of the external auditor on the accounting disclosure standard requirements for income. It is found that loan losses and classification of income and expenses according to nature are scored 3.73 and 3.68 respectively which is the lowest score among all items. The reason for this is due to the relatively less importance of these items in the income statement. The auditor's main interest is on the main sources of income for the Bank not the secondary sources. Further, results showed that the top two scored items are interest income and interest expenses which lies among 4.72 and 4.65 respectively. Note that due to the auditor's attention focusing on ultimate goals of granting credit facilities not relying on secondary sources of income. The total mean score for all the income related items is 4.32 which demonstrates the importance of these requirements from the perspective of the external auditor.

In the line of this means responses of external auditor on accounting disclosure standard requirements for general budget items has been classified in table 2.

**Table-2.** Responses of Auditors on Items of General Expenses

<b>Standard Provisions</b>	<b>Mean</b>
Cash and balances with Central Bank	4.74
Treasury bills and other permissions for the Central Bank discount	4.51
Cash and deposits in other banks, loans and advances	4.58
Granted to those banks	4.35
Other deposits money in money markets	4.76
Loans and advances to customers	4.32
Deposits in other banks	4.28
Other deposits of money markets	4.26
The required amounts to other applicants	4.14
Certificates of deposit	4.16
Notes payable and other liabilities that are documented	4.10
Other borrowed funds	4.58
Items classified according to the nature of the assets and liabilities	4.69
Assets and liabilities are classified according to the relative liquidity	4.63
<b>The arithmetic mean of all the items of the general budget</b>	<b>4.44</b>

The results in table (2) illustrate the responses of external auditors on the importance of accounting disclosure standard requirements on the general budget items. The lowest average across all responses ranging (4.10-4.32) and higher arithmetic mean is ranging from 4.58-4.74. Here note that the auditors believe that it is necessary to disclose these items show for denominational data users and particular uses of funds being contains shows the risk level. It is noted that the overall average score by external auditors is 4.4 which is higher than the income category.

Further, the financial disclosure regarding liability section of financial statement is analyzed in the light on responses of external auditors. The results are placed in table (3).

**Table-3.** Responses of Auditors on Liability Items

<b>Standard Provisions</b>	<b>Mean</b>
The nature and quantity of the link providing the credit is irrevocable, as it selects the bank without the risk of a fine or expense	4.31
Nature and value of contingencies related to direct credit alternatives and linkages, including general debt guarantees, guarantees and documentary credit withdrawals, used as financial guarantees for loans	4.11
Nature and values of contingencies involving transactions of implementation and guarantees to participate in tender and warranty guarantees and documentary credits for use	4.18
Nature and values of short-term contingencies related to trade, such as documentary credits where the shipping documents used as collateral.	4.13
Nature and values of contingencies related to rates and exchange rates including swaps, options and futures contracts	4.03
Nature and values related to banking facilities available and renewable facilities	4.01
Disclosure of Bank analysis of assets and liabilities in accordance with appropriate classification for their collections, indicating maturities	4.20
The Bank disclose any significant concentration of assets and liabilities and off-balance sheet items	4.09
The Bank disclosing payments risks related to important foreign currency accounts	4.10
The disclosure of accounting policies followed in defining the bases of bad debts as an expense and then removed	4.33
The Bank to disclose details of a custom transaction losses loans during the period	4.47

The Bank to disclose the total value of net loans and advances	4.53
The Bank disclosed the amount write-off loans and advances and the amount recovered during this period of loans and advances that were removed earlier.	4.35
The Bank to disclose any amounts are set aside to offset loan losses and banking facilities	4.11
The Bank to disclose any amount set aside to meet the general banking risks, including future losses	4.06
The disclosure of the aggregate value of secured liabilities and the nature of the encumbered assets as collateral.	4.09
<b>The arithmetic mean of all items of contingent liabilities and subsequent events</b>	<b>4.19</b>

Table (3) presents the responses on contingent liabilities and subsequent events. The lowest average responses account for banking facilities provided and renewable security facilities provided by the bank as 4.01. It is noticed that the reason that the auditors believe that the effect of this item on the financial status of the bank is indirect and can face disadvantages of decreases interest of investors. As far as the highest means score for is concerned, total value for loan losses and advances scored 4.53. This drives the external auditor to believe that this item directly determines the quality of the risks assessment before granting loans to customers. It is noted that the overall mean score for contingent liabilities and subsequent events reached 4.19. This demonstrates the importance of these requirements from the perspective of external auditor.

Table 3-6 illustrates the mean responses of investor perception regarding importance of main items of financial statements of banks according to accounting standards. Table (4) presents the mean responses on income related items of financial statement.

**Table-4.** Responses of Institutional Investors on Income Items

<b>Standard Provisions</b>	<b>Mean</b>
Interest income and other income	4.54
Interest expense and other burdens	4.44
Income from dividends	4.02
Income from fees and commissions received	4.31
Fees expenses and commissions paid	4.25
Dealing in foreign currencies gains less losses other items operating income	4.25
Loan losses and banking facilities	3.83
General administration expenses	4.61
Other operating expenses	3.86
Income and expenses items are classified according to the nature and types of income and expense	3.70
Disclosed President endorsement data that does not include clearing between expense items except for deals coverage and assets and liabilities in the event of a legal right of set-off	4.48
<b>The arithmetic mean of all items of the income statement.</b>	<b>4.20</b>

The results shown in the table (4) on the mean responses of institutional investor on accounting disclosure standard requirements for income. The below average responses of institutional investors is on income and expenses was between 3.70 – 3.86 whereas, the above mans values ranged between 4.02-4.61. The institutional investor's legitimate rights to know items of the income and expenses of the company. Further it is noted that the average institutional investor responses to all requirements of the standard accounting for total income is 4.20. The rising value shows the importance of these requirements according to institutional investor.

The arithmetic mean sample responses for institutional investor on accounting disclosure standard requirements for general expense items are presented in table 5.

**Table-5.** Responses of Institutional Investors on General Expense Items

<b>Standard Provisions</b>	<b>Mean</b>
Cash and balances with Central Bank	4.80
Treasury bills and other permissions for the Central Bank discount	4.67
Cash and deposits in other banks, loans and advances	4.64
Granted to those banks	4.60
Other deposits money in money markets	4.54
Loans and advances to customers	4.31
Deposits in other banks	4.22
Other deposits of money markets	4.25
The required amounts to other applicants	4.08
Certificates of deposit	4.08

Notes payable and other liabilities that are documented	4.28
Other borrowed funds	4.57
Items classified according to the nature of the assets and liabilities	4.44
Assets and liabilities are classified according to the relative liquidity	4.15
<b>The arithmetic mean of all the items of the general budget</b>	<b>4.40</b>

Test results showed in the table (5) illustrates the sample responses of external auditor about the requirements for standard accounting disclosure on expenses. The lowest mean score has reported on certificate of deposits and its also lower as compare to external auditor's responses on the same item. And achieve the score of 4.08. It is worth mentioning that the reason of lower scores for certificate of deposit that these are guaranteed and does not bear any risks. It is also noted that the average institutional investor sample responses to all items of expenses is 4.40. This shows the the importance of these requirements from the perspective of institutional investor.

The means responses of institutional investor on requirements of standard accounting disclosure for contingent liabilities and subsequent sections have reported in table 6.

**Table-6.** Responses of Institutional Investors on Liability Items

<b>Standard Provisions</b>	<b>Mean</b>
The nature and quantity of the link providing the credit is irrevocable, as it selects the bank without the risk of a fine or expense	4.19
Nature and value of contingencies related to direct credit alternatives and linkages, including general debt guarantees, guarantees and documentary credit withdrawals, used as financial guarantees for loans	4.02
Nature and values of contingencies involving transactions of implementation and guarantees to participate in tender and warranty guarantees and documentary credits for use	3.67
Nature and values of short-term contingencies related to trade, such as documentary credits where the shipping documents used as collateral.	3.73
Nature and values of contingencies related to rates and exchange rates including swaps, options and futures contracts	3.44
Nature and values related to banking facilities available and renewable facilities	3.41
Disclosure of Bank analysis of assets and liabilities in accordance with appropriate classification for their collections, indicating maturities	3.86
The Bank disclose any significant concentration of assets and liabilities and off-balance sheet items	3.73
The Bank disclosing payments risks related to important foreign currency accounts	4.48
The disclosure of accounting policies followed in defining the bases of bad debts as an expense and then removed	4.28
The Bank to disclose details of a custom transaction losses loans during the period	4.41
The Bank to disclose the total value of net loans and advances	4.02
The Bank disclosed the amount write-off loans and advances and the amount recovered during this period of loans and advances that were removed earlier.	4.35
The Bank to disclose any amounts are set aside to offset loan losses and banking facilities	4.08
The Bank to disclose any amount set aside to meet the general banking risks, including future losses	4.00
The disclosure of the aggregate value of secured liabilities and the nature of the encumbered assets as collateral.	4.19
<b>The arithmetic mean of all items of contingent liabilities and subsequent events</b>	<b>4.02</b>

The results shown in the table (6) presents the mean responses of institutional investor on accounting disclosure standard requirements for contingent liabilities and subsequent events. The below average scores for liability items ranged between 3.41-3.86. While the above average items are related to high risk ratios and ranging between 4.00-4.41. It is also noted that the average institutional investor sample responses to all of the requirements for contingent liabilities and subsequent events reached 4.00.

Furthermore, the responses of both samples external auditors and institutional investors have tested statistically to verify the significance of responses. For the purpose, t- test has been adopted to compare mean values whether these mean score are not equal to zero or not. Table 7 reports the results of t-test for auditor's responses.

**Table-7.** T-Test Results for External Auditor Responses

Financial Statement Items	T-value	Table T-value	Sig.
Income	2.009	1.96	0.00
Expenses	11.955	1.96	0.04
Liabilities	8.186	1.96	0.00

The null hypothesis for t-test for the equality of mean is that the sample means value represents the true mean ( $\mu$ ) while alternative hypothesis stated that sample mean values has some differences from true mean value. The value for each dimension of financial statement (income, expense, liability) has got greater T-values then the table t-value and all the values are significant at 0.05 level. This shows that all the computed mean scores for external auditors on the each dimension of financial statement is truly represent the population and statistically significant. Hence, these values are not by chance.

In second step the same procedure is applied to estimate the statistical significance of institutional investor's responses on each dimension of financial statement. Table 8 explains the t-test results for institutional investor responses.

**Table-8.** T-Test Results for External Auditor Responses

Financial Statement Items	T-value	Table T-value	Sig.
Income	2.592	1.96	0.01
Expenses	3.055	1.96	0.02
Liabilities	2.459	1.96	0.014

It is explained in the table 8 that mean value of responses on all the dimensions of financial statement from investor's point of view is statistically significant. All three dimensions of financial statement have achieved greater t-value as compare to table t-value. Furthermore, all the values are significant at 0.05 level of significance.

Further in last step the responses of both groups have compared to identify the statistical difference among the mean responses of external auditors and institutional investors. Table 9 presents the t-test values for comparison of two samples means scores.

**Table-9.** Comparison of Mean Responses of Auditors and Investors

Comparison of Auditors and Investors	T-value	Table T-value	Sig.
Income	3.292	1.96	0.00
Expenses	5.723	1.96	0.001
Liabilities	3.124	1.96	0.013

The null hypothesis for two sample t-test is that the mean value for both groups is equal while alternative hypothesis states that mean value for both groups is statistically not equal. It is found that all the mean values for each category of financial statement for both groups is statistically equal. Hence we can say that we fail to reject null hypothesis that both groups perception about the importance of accounting standard is different. The Auditors and investors are on the same page when talking about the importance of standard accounting procedures while making financial statements. However, the mean score are apparently different for each group but statistically these mean values are equal.

#### 4. Conclusion and Recommendations

The study has reached at the conclusion that the requirements of accounting disclosure standards are important from the perspective of both the auditor and the institutional investor. There is a relatively large consensus between the standpoints of the external auditor and the institutional investor in assessing accounting disclosure standard requirements for income related disclosures. The auditor's attention riveted on overdraft related items and not focusing on income from secondary sources. While the Institutional investors focus on income and expenses related to the basic operations of the income. There is a strong consensus between the two points of view both of the external auditor and the institutional investor in assessing accounting disclosure requirements for balance sheet. Auditor's attention to the items focused on the uses of money and need to be disclosed to users of financial statements. The institutional investor also focused on these items being carries with great risk. There is a relatively large consensus between the standpoints of both the auditor and the institutional investor in assessing the accounting disclosure requirements for contingent liabilities. That major focus is on the total value of dedicated loan losses and advances by the auditors. Whereas, institutional investor interested in accounting disclosure requirements that focus on very high-risk ratios.

Based on the above findings, this study recommends the accounting disclosure standards issued by the authorities should incorporate the concerns of interested parties of financial statements. The regulators of the external auditor need to set a standard disclosure policy to appropriate and objective presentation of financial situation of banks. The auditor should be informed and familiar with the institutional investor perspectives in terms of the information disclosed in the audited financial reports. Therefore, the purpose of making the right investment

decision using financial statement data should be accomplished. The institutional investor needs to be up to date with the latest standards and procedures. Financial disclosure standard should be updated from time to time due to changing investor behavior as social, political and economic conditions

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