

**THE RELATIONSHIP BETWEEN QUALITY OF
DISCLOSURE IN CORPORATE ANNUAL
REPORTS AND FIRM-SPECIFIC
CHARACTERISTICS: THE CASE OF NACRA**

BY

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ABSTRACT

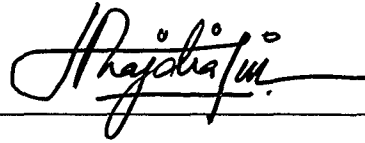
This study empirically examined the relationship between firm-specific characteristics and the quality of disclosure of company annual reports in Malaysia. Due to the increasing need of users towards accounting information, a full, quality and transparent disclosure must to be provided by companies. As a measurement of quality, the present study used the NACRA as a benchmark of sound quality of reporting. Firms that won NACRA were considered as firms that provided quality of disclosure in their annual reports. The independent variables tested in this study were firm size, ownership structure, leverage and profitability. The match-paired sample comprises 52, 56 and 66 firms that won and lost NACRA during the years 1999, 2000 and 2001. This study used descriptive statistics, Mann-Whitney U test, Logistic regression and Linear regression (as the test of robustness) to test the hypotheses. Results show that ownership structure is the only variable found to be significant in influencing the level of disclosure by firms in Malaysia. Nevertheless, this study also realizes some limitations like the small number of independent variables tested and the small size of sample.

ملخص البحث

يقوم هذا البحث تجريبيا بدراسة العلاقة بين مميزات الشركة الذاتية وبين درجة جودة نشر المعلومات في تقريرها لسنوي في ماليزيا. ونظرا لإزدياد حاجة المستخدمين نحو معلومات المحاسبة، فإن النشر الكامل والجلي عن المعلومات وعلى درجة عالية من الجودة من جانب الشركات أصبح أمرا لازما. في هذا البحث استخدمنا شركة ناكرا كمقيا س مثالي للجودة في إعطاء تقارير سليمة و موثوقة. وبناء على ذلك تم مقارنة الشركات الأخرى بشركة ناكرا، وعليه فإن الشركات المتفوقة على شركة ناكرا تعتبر من ضمن الشركات التي زودت تقارير سنوية ذات جودة في النشر. ومن بين العوامل المتغيرة المستقلة التي تم اختبارها في هذه الدراسة عامل حجم الشركة، وهيكل الملكية للشركة، وعامل التأثير (نسبة الدين)، وعامل الربحية. وشملت العينة التي أجريت لها المقارنته ثنائيا/ زوجيا 56,52 و 66 شركة التي فازت أو خسرت أمام شركة ناكرا في خلال السنوات 1999, 2000, 2001. واستخدمت هذه الدراسة إختبارات مان-وايتني يو، وتحليل الإنحدار الولوجستيكي والإنحدار الخطي (كأداة إختبار ذات فاعلية قوية) لإختبار الفرضيات المطروحة. وحسب النتائج التي توصلنا إليها فقد ظهر لنا أن معامل هيكل الملكية للشركة هو العامل المتغير الوحيد الذي له أهمية كمؤثر على مستوى نشر المعلومات في التقارير السنوية لدى الشركات في ماليزيا. ومع ذلك فإن هذا البحث يعترف بأن له محدودية نظرا لقلة عدد المتغيرات المستقلة التي تم إختبارها وأيضا لصغر حجم العينة المستخدمة في هذا البحث

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a thesis for the degree of Master of Science in Accounting.



Hafiz Majdi Abdul Rashid
Supervisor

I certify that I have read this study and in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a thesis for the degree of Master of Science in Accounting.



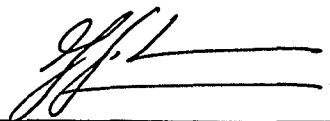
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DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

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THE RELATIONSHIP BETWEEN QUALITY OF DISCLOSURE IN CORPORATE ANNUAL REPORTS AND FIRM SPECIFIC CHARACTERISTICS: THE CASE OF NACRA

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I dedicate this dissertation to:

My beloved husband, Halil.

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In the name of Allah the Most Gracious the Most Merciful

Praise be only to ALLAH Al Mighty for his bounty and blessing showers upon us, and peace be upon prophet Muhammad, his family, his companions, and his followers until the end of the day.

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LIST OF ABBREVIATIONS

AFM	Amman Financial Market
ANOVA	Analysis of Variance
DTA	Debt to Assets Ratio
DTE	Debt to Equity Ratio
IAS	International Accounting Standards
IASC	International Accounting Standards Committee
KLSE	Kuala Lumpur Stock Exchange
MACPA	Malaysian Association of Certified Public Accountants
MIA	Malaysian Institute of Accountants
MICPA	Malaysian Institute of Certified Public Accountants
MIM	Malaysian Institute of Management
MNC	Multinational Corporation
NACRA	National Annual Corporate Report Awards
NZSE	New Zealand Stock Exchange
OLS	Ordinary Least Square
ROA	Returns on Assets
ROS	Returns on Sales
SSE	Swedish Stock Exchange
VIF	Variance Inflation Factors
VSE	Valencia Stock Exchange
ZSE	Zimbabwe Stock Exchange

CHAPTER ONE

INTRODUCTION

1.1 Background

The stable performance of Malaysian stock market has attracted local and overseas investors. One possible reason contributing to this stability is the continuous efforts by the government to increase transparency and corporate governance among public-listed companies. Since corporations' stakeholders depend on the annual reports as a main source of information, the sound and quality disclosure of annual reports is vital as communication tools between the company and them. The annual report not only reflects the performance and financial health of the company, it also contains information about the company's vision, its governance structure, the various initiatives it has undertaken to promote the interest of its stakeholders and to conserve the environment, and its plans for the future.

Consistent to the vision of building a significant economic growth in Malaysia, the quality of disclosure in annual reports is an important element to build the confidence of the stakeholders which indirectly contribute towards nation building. Quite an extent of literature has been done in the area of quality of disclosure in annual reports. However, evidence to the Malaysian environment is limited. Due to the lack of information and research in this field, this paper, therefore hopes to contribute to the extent of knowledge and understanding of the academics and practitioners on the issue of disclosure quality.

In brief, this study empirically examined the relationship between the quality of disclosure in the annual reports by firms listed in Kuala Lumpur Stock Exchange (KLSE) and four firm specific characteristics namely: firm size, ownership structure, leverage, and profitability. Previous research normally developed a disclosure index as a dependent variable of their research. This disclosure index contains a list of mandatory and/or voluntary items that should be disclosed by a company. The drawback of disclosure index is the subjectivity involved in its development and measuring disclosure quality. However, this study used the National Annual Corporate Report Awards (NACRA) as an alternative of the disclosure index in assessing disclosure quality. In Malaysia, the existence of NACRA is designed to promote excellence in the presentation and reporting of information by organisations to their stakeholders. The awards are given to the company that provide the best, full and quality disclosure in their corporate reports. The sample in this research comprised 26, 28 and 33 matched pair firms that were considered as winners and losers in term of NACRA for the years 1999, 2000 and 2001.

Kohler (1957) refers the concept of disclosure as a clear showing of a fact or condition on a balance sheet or other financial statements, in footnotes thereto, or in the audit report while Owusu-Ansah (1998) defines disclosure as the communication of economic information, whether financial or non-financial, quantitative or otherwise concerning a company's financial position and performance. It seems that both scholars agree that disclosure should show the true colours of firm's performance, and it is not only restricted to the financial information *per se*. In defining disclosure, Parker (1992) extends the opinion by highlighting the function of the users. He posits

that disclosure is the reporting of information to users of accounting reports, especially to investors. He also argues that disclosure can be both mandatory as well as voluntary.

Gibbins, Richardson and Waterhouse (1990) argue that companies develop disclosure strategies in response to both internal and external condition. Therefore, it seems that the firm's disclosure decisions are primarily to satisfy the need of their users as well as the requirement by the regulators. Thus, to attain this aim, firms need to provide quality disclosure in their corporate annual report to fulfil the needs of both internal and external parties. Conceptually, disclosure of information in corporate financial reports is considered "adequate" if it is relevant to the needs of users, capable of fulfilling those needs, and timely released (Buzby, 1974; Wallace, 1987). In other words, adequate disclosure in a corporate financial report is a function of the quantity and quality of information disclosed therein, the form in which they are presented and how frequent and timely they are publicly reported (Owusu-Ansah, 1998).

Actually, the quality of disclosure is not measured by the long beautiful words or the colourful image in the annual report. Singhvi and Desai (1971) stressed that the quality of disclosure lies in the completeness, accuracy and reliability of information itself. Thus, regardless of whether that information is mandatory or voluntary, it is not useful to the users unless the information provided is true and fair.

Thus, the extent of disclosure *per se* (e.g., thickness of annual reports) does not necessarily ensure quality financial reporting. Therefore, in order to solve such a

problem, the selection of information that is deemed relevant to stakeholders is beneficial. This could be performed by individual researchers or professional authorities.

The only main criticism of the individually developed disclosure index is its subjectivity. Therefore, the study utilised a professionally developed measure, i.e., NACRA, as the measure of quality financial reporting.

1.2 Objectives And Contributions Of The Study

This research has two main aims. The first is to identify the firm-specific characteristics that influence the award of NACRA (i.e., quality reporting) in Malaysia for the years 1999, 2000 and 2001. A comparison between the two groups of sample (i.e., winners and losers) will be done. It is important to investigate the features of the firms that won NACRA and vice versa because it will provide evidence whether the winners and losers are those firms that have similar or different types of characteristics by comparing means between two groups.

The second objective is to assess whether a number of independent variables (viz. firm size, ownership structures, leverage and profitability) affect the level of quality of the disclosure in the corporate reports. This study tries to determine the relationship and the importance of these firm-specific characteristics towards the quality of disclosure by regressing firm-specific characteristics on quality financial reporting.

This research extends our understanding about the characteristics of the firms that won the NACRA. This information may be useful as a guideline for companies or preparers of accounting information, which intend to improve the quality of disclosure in their annual reports. In addition, the users of annual reports will also have some information about the disclosure level of companies in Malaysia. Since this type of research, which analysed comprehensive disclosure level is quite limited in Malaysia, this paper hopes to contribute some knowledge and understanding about the quality of disclosure of annual reports in Malaysia. Furthermore, the empirical findings from this study can also be used as a reference for future research.

1.3 Organization Of The Study

This research comprises of six chapters and they are organised as follows:

CHAPTER ONE: INTRODUCTION

Chapter one consists of the background of the study, objectives and the contributions of the study.

CHAPTER TWO: INSTITUTIONAL BACKGROUND

This chapter will discuss the objectives of NACRA in Malaysia, the organisers, the participants in NACRA competitions, the meaning of quality disclosure in annual report as well as the process of winners' selection.

CHAPTER THREE: LITERATRE REVIEW

This chapter will review some previous research on the disclosure of annual reports and firm-specific characteristics. This type of study is done in various countries including United Kingdom, Japan, Zimbabwe, Malaysia and others.

CHAPTER FOUR: METHODOLOGY OF RESEARCH

Chapter four comprises the hypothesis development, nature of study, sampling procedures, data collection, selection of periods of study, statistical analyses that have been used in this study: descriptive statistics, Mann-Whitney test, Spearman correlation and Logistic regressions. The theoretical assumption and empirical findings from previous research will be used to develop the hypotheses. This part will also discuss in detail each independent and dependent variable tested in this study.

CHAPTER FIVE: EMPIRICAL RESULTS AND DISCUSSION

Chapter five will discuss the results and findings of the statistical analyses on the relationship between quality financial reporting and firm-specific characteristics.

CHAPTER SIX: CONCLUDING REMARKS AND LIMITATIONS

The last chapter concludes the study and discusses its limitations. Some recommendations on further enhancement of this research in the future will be outlined in this chapter.

CHAPTER TWO

INSTITUTIONAL BACKGROUND

2.1 NACRA in Malaysia

In Malaysia, NACRA is an annual event, to encourage companies to be competitive in presenting their corporate reports and improve the level of disclosure among the Malaysian listed companies¹. Kuala Lumpur Stock Exchange (KLSE), the Malaysian Institute of Management (MIM), the Malaysian Institute of Accountants (MIA) and the Malaysian Institute of Certified Public Accountants (MICPA) jointly sponsor this event (www.klse.com.my/website/news/pr). This event was started in July 1990.

NACRA have four main objectives. The first objective of NACRA is to promote a better and effective communication between organisations and stakeholders through the publication of quality annual reports. The second objective is to recognise and encourage excellence in the presentation of financial and business information. The third objective is to create public awareness of the objectives of enterprises, their operations and their financial performance and the last objective is to promote the compliance of higher standards of corporate governance among the Malaysian companies (www.mia.org.my/class/nacra/criteria.htm).

However, certain non-public listed companies will also be considered if those companies apply for consideration.

¹ However, certain non-public listed companies will also be considered if those companies apply for consideration.

NACRA has a different theme for every year and the theme is normally related to current issues in business and corporate world as well as the necessity of the users. In 1999, a new award namely Environmental Reporting Award was introduced by NACRA to encourage companies to implement environmental preservation and to provide environmental disclosure information in their annual reports. NACRA has set a different theme for every year, and it has started since the year 2000. The theme for the year 2000 was "Towards Better Governance", and the theme for the year 2001 was "NACRA-The Way to Stockholders' Confidence". Although the theme is different every year, NACRA's main criteria still remain the same.

2.1.1 The Awards

NACRA comprises five categories of awards, namely the Overall Excellence Award, Industry Excellence Awards for Listed Companies, Presentation Awards, Environmental Reporting Award and the Special Award for Non-Listed Organisations.

Overall Excellence Award is the award for the most outstanding Annual report of the year. This Award will be awarded to the company which provides the highest standard of quality of reporting in its annual report. Industry Excellence Awards are awards that will be presented to companies which have shown the highest quality in annual reporting in their respective industrial sectors (*www.klse-ris.com.my*). There will be a total of eleven Industry Excellence Awards presented in accordance with the following categorisations:

Table 2.1: KLSE Industrial Sectors

Main Board	Second Board
Consumer Product	Consumer Products
Industrial Products & Technologies	Industrial Products
Trading & Services	Trading & Services
Finance	Construction
Construction & Infrastructure Project Companies	
Properties & Hotels	
Plantations & Mining	

The presentation awards can be divided into two categories, namely: Best Annual Report in Bahasa Malaysia and Best Designed Annual Report. The Environmental Reporting Award will be awarded to a company which implements good practice and puts serious efforts towards environmental preservation. This award stressed on the need for environmental reporting which is important to the stakeholders and public. The Special Award for Non-Listed Organisation is designed to encourage the improvement of quality of annual reports by non-listed companies, the public sector and other Malaysian organisations (*www.klse-ris.com.my*).

2.1.2 The Certificate Of Merit

The certificate of merit is given to firms that provide sound and quality disclosure in their annual report. The award of this certificate is not restricted to a certain number of firms, but depends on adjudicators' discretion. Those firms that were awarded the certificate of merit are firms that are eligible to be selected as a winner. However, only the best annual report will be selected as the winner for a respective category. Thus, those firms that did not win the awards would receive a certificate of merit as a

consolation for having quite a good quality of reporting and those firms who won the awards will be awarded a certificate of merit together with their awards.

In this study, the sample companies comprised all firms that won the certificate of merit for the years 1999, 2000 and 2001. Thus, these firms that have been awarded the certificate of merit constitute the benchmark companies from which awards winners will be selected. They all possess good quality reporting, nevertheless, only the best will be selected for the award. In this study, firms that have received certificate of merit were classified as Winners. A matched-pair sample consisted of firms that did not receive any awards or certificates of merit and classified as Losers. This issue will be discussed in detail in the research methodology chapter.

2.2 NACRA Criteria

The NACRA criteria consist of two main parts; they are specific criteria and general criteria.

2.2.1 Specific Criteria

Specific criteria are used as a benchmark and evaluation for several awards namely: The Most Outstanding Annual Report of the Year, The Best Annual Report in Bahasa Malaysia, The Best Designed Annual Report and Environmental Reporting Award. In this research I will give two examples of specific criteria, which are the specific criteria for Best Annual report in Bahasa Malaysia and Environmental Reporting Award.