

**The Association between Auditor Type and the Extent of
Forward-Looking Disclosures
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Abstract:

This study examines the association between auditor type and forward-looking information disclosure levels in integrated reports for a sample of 52 non-financial firms whose reports are available on the International Integrated Reporting Council (IIRC) official website for the year 2017.

The results indicate that audit firm size and audit committee size are positively associated with forward-looking information disclosure levels in integrated reports, while audit committee independence and audit committee financial expertise are not statistically associated with forward-looking disclosure in integrated reports.

This study contributes to the literature in determinants of forward-looking disclosures in integrated reports.

Keywords: forward-looking disclosures; auditor type; audit committee effectiveness; integrated reports.

Introduction:

In a world that had suffered from a global financial crisis and large corporation's bankruptcies and scandals, the need for additional disclosed information had increased to provide information users with reliable and relevant information that allows them to make better investment decisions. Additional information disclosed by the corporate management varies between historical and forward-looking financial and non-financial information which provide users with a full picture of firm performance and the ability to create value to assist them in the decision-making process.

Forward-looking disclosures (FLD) are highly valued by information users as they present firms projections related to their plans, operations, performance and ability to create value leading to a reduction in investors inaccurate beliefs about firm future, decrease information asymmetry problems (Bozanic et al., 2014), increase transparency, improve investors ability to anticipate firm future earning (Al-Najjar and Abed, 2014), leading to appropriate investment decisions. However, despite FLD importance, there is no conceptual framework for preparing and disclosing Forward-looking information (FLI) (Al-Najjar and Abed, 2014), which reduce firms incentives to disclose FLI to avoid possible litigations and reputation damages associated with false predictions (Hassanein and Hussainey, 2015), and due to

FLI future nature which has high levels of uncertainties making it unverifiable or auditable at time of disclosure causing additional pressure on external auditors (Zaky, 2015).

The external auditor who presents an external independent authority out of firm control responsible about tests and reports disclosed information fair presentation had suffered from additional pressure resulted from extra information disclosure especially future related information disclosed in annual IRs which is highly subjective, ambiguous and has high levels of uncertainty (Oprisor, 2015), and can be easily manipulated by management due to the absence of generally accepted standards related to FLI preparation and disclosure in annual IRs (Demartini and Trucco, 2017), which will subject the external auditors to possible litigation risk, disciplinary penalties and reputation damage, especially those related to Big4 audit firms (Zaky, 2015). So, the researcher will attempt to examine the relationship between auditor type (Big4/Non-Big4) and the extent of forward-looking disclosures.

The remainder of the study is divided as follows. Section two discusses forward-looking information disclosure in annual reports. Section three represents literature review and hypotheses development. Section Four describes research design and results discussion. Section five concludes the paper.

2. Forward-looking disclosures in integrated reports

Integrated reporting is a principles-based approach that applies integrated thinking to provide users of corporate reports with a comprehensive view about how a firm's operations, governance, and performance have led to value creation over short, medium and long term (Steyn, 2014; Camilleri, 2018; Dumay et al., 2018; Kılıç and Kuzey, 2018). Hence, integrated reporting helps to improve transparency, usefulness, and comparability of corporate disclosures and improve the firm's reputation and legitimacy (Ioana and Adriana, 2014; Steyn, 2014; Garanina and Dumay, 2017). This, in turn, enables users to make better investment decisions.

Forward-looking disclosures in integrated reports will assist investors in evaluating the firm's future performance, ability to create value (Menicucci, 2013, Bozanic, et al., 2014) and make better investment decisions (OSC, 2008; Leung, 2015; Kılıç and Kuzey, 2018; Abad and Bravo, 2018). However, forward-looking disclosures are highly uncertain and may differ significantly from actual results (Zaglol, 2004; Celik, et al., 2006), leading to potential litigation and reputation damage to the disclosing firms (Abdulrahman, 2010; PWC, 2013; Bozanic, et al., 2013; Kılıç and Kuzey, 2018). Therefore, the need for external auditors to reduce ambiguity associated with forward-looking information disclosure has increased.

3. Literature review and hypotheses development

The external auditors help in narrowing the information gap between firm management and shareholders through ensuring the fair presentation of firm disclosures which represent an incentive for firms to demand high-quality audits to reduce information asymmetry problems and gain shareholders' trust. So, the quality of audit work is important for shareholder to making appropriate investment decisions. Audit firm size represented in Big4 vs. Non-Big4 audit firms is considered the most commonly used indicator for audit quality (Al-Khaddash et al., 2013; Sulaiman et al., 2010), as Big4 audit firms have strong incentive to provide high-quality audit work due to reputation concerns associated with low audit quality (Lin and Hwang, 2010), and to avoid costly litigations (Khurana and Rama, 2004).

Besides, Big4 audit firms have greater financial resources and technology, and more experienced and skilled auditors who are cable of detecting material misstatement in client annual reports compared with Non-Big4 audit firms (Sakka and Jarboui, 2015; Smii, 2016; Akhalumeh et al., 2017), which will enhance corporation disclosure credibility and financial disclosure quality through encouraging clients to provide more comprehensive disclosure (Philip, 2008). Most of the prior studies that examined external audit process quality have focused on the associations between external audit quality and financial reporting quality.

Audit firms' size: External auditor plays an important role in reducing information asymmetries through an external independent verification for the fair presentation of corporate disclosures (Philip, 2008; Kaklar et al., 2012). Such independent verification helps improve reporting quality (DeFon and Zhang, 2014). So, the quality of external audit work is essential for users to rely on corporate disclosures (Orens and Lybaert, 2013). High-quality auditors are more capable of detecting material misstatements in the client's financial statements (Kaklar et al., 2012; Al-Khaddash et al., 2013; Nwanyanwa, 2017) and more likely to help improve client's disclosure transparency and credibility (Demartini and Trucco, 2017).

Wang et al. (2008) indicated that Big-4 firms tend to impose more extensive disclosure requirements on the client to protect their reputation and avoid possible litigations. Al-Ajmi (2009) found that the audit firm size affects the credibility of financial reporting by providing better audit quality. And Francis and Yu (2009) found that Big-4 audit firms tend to have high audit quality compared with Non-Big-4 audit firms due to their extended expertise in detecting material problems in client financial statements compared with Non-Big-4 audit firms.

Al-Khaddash et al. (2013) stated that audit quality and audit firm size are positively associated. Achyarsyah and Molina (2014) examined the effect of audit firm size on audit quality for

public accounting firms registered in the Indonesian capital market. Results indicated that audit firm size significantly influences audit quality. However, Yuniarti (2011) indicated that the audit firm size does not affect audit quality. Kaklar et al. (2012) found a negative association exists between audit firm size and financial reporting quality. Kamolsakulchai (2015) found no correlation between audit firm size and financial reporting quality.

Based on the overall findings in prior studies discussed above, we formulate the following hypothesis (stated in the alternative form):

H1. There is a significantly positive association between audit firm size and the extent of forward-looking information disclosure in integrated reports.

Audit Committee Size: Represents the number of members composing the audit committee team. According to the Resources Dependency Theory; larger audit committees have more authority and resources (Allegrini and Greco, 2011; Madi et al., 2014), more diversity in expertise, and are more able to conduct better monitoring (Bédard and Gendron, 2010). Studies conducted by Bédard et al. (2004), Li et al. (2012), Haji (2015), and Talpur et al. (2018) found that large audit committees positively enhance the levels of disclosure and reduce information asymmetry problems. And Velte (2018) found a

positive association between audit committee size and IRs. While both Karamanou and Vafeas (2005) and Wang and Hussain's (2015) studies indicated the existence of a negative association between audit committee size and FLD.

And Haji and Anifowose (2016) empirical results failed to find any association between audit committee size and levels of disclosure in IRs. The researcher believes that audit committee size positively enhanced FLD levels in IRs through performing better monitoring over the disclosure process and reducing information asymmetry problem, and suggest the following hypothesis:

H2: There is a positive statistically significant association between audit committee size and the level of forward-looking information disclosure in integrated reports.

Audit Committee Independence: Based on the Agency Theory; independent directors help in monitoring management's behavior more effectively due to the absence of any personal or economic interests with management. So the independence of the audit committee helps in ensuring the quality of committee performance (Bédard and Gendron, 2010), reduce agency costs and information asymmetry problems (Allegrini and Greco, 2011; Al-Najjar and Abed, 2014; Haji, 2015). Studies conducted by Bédard et al. (2004), Akhtaruddin and Haron (2010), Madi et al. (2014), and Talpur et al. (2018) found a positive significant

relationship between audit committee independence and levels of disclosure. And O’Sullivan et al. (2008), Al-Najjar, and Abed (2014) and Joseph (2017) studies empirical results stated that FLD and audit committee independence is positively associated as independent audit committee members help to reduce information asymmetry and increase the levels of FLD in annual reports.

However, Li et al. (2012), Othman et al. (2014), and Wang and Hussainey (2013) find no association between FLD and audit committee independence. And Chariri and Januarti (2017) and Haji and Anifowose (2016) studies stated that audit committee independence does not affect information disclosure in IR. Considering the agency theory perspective and the above discussions, the researcher expects to find a positive association between audit committee independence and FLD levels in annual IRs, and suggests the following hypothesis:

H3: There is a positive statistically significant association between audit committee independence and the size of forward-looking information disclosure in integrated reports.

4. Research Design

4.1 Sample and data

The initial sample includes the 90 non-financial firms with integrated reports available on the Integrated Reporting Examples Database accessible on the IIRC website for the year 2017. We did not include firms operating in financial services

and utilities due to significant differences in their financial reporting practices. Then, 38 firms had been dropped as they did not disclose information about auditor fees, which is used in this study as a proxy for auditor independence. The final sample consists of hand-collected data for 52 non-financial firms from Europe (46 percent), South Africa (33 percent), Asia (9 percent), Australasia (6 percent), North America (4 percent), and South America (2 percent) region. These firms operate in different industries such as basic materials (46 percent), consumer goods (19 percent), consumer services (13 percent), health care (12 percent), and technology (10 percent).

4.2 Dependent variable

In investigating the association between auditor type an indicator for audit quality and the extent of forward-looking disclosures in annual integrated reports, we used a forward-looking information disclosure index constructed by manual content analysis of forward-looking information disclosed by non-financial firms in their integrated reports. The manual content analysis used in the study is similar to the method employed by Kent and Ung (2003), Uyar and Kilic (2012), Bravo (2016), Menicucci and Paolucci (2017), and Kılıç and Kuzey (2018) in their studies on various issues related to forward-looking information disclosed in integrated reports.

The forward-looking disclosure index divided total forward-looking information disclosures into 15 items related to advertising and publicity plans, capital expenditure plans, expected cash flows, earning targets, financial risks, growth opportunities, industry or market risks, investment projects, expected market share, political risks, planned product research, and development, expected profitability, sales target, share price, and environmental risks

4.3 Test variables

The quality of external audit has been evaluated through using auditor fees and effectiveness of the internal control system. Auditor fees (AF) was measured as the natural log of total fees paid to the audit firm scaled by the nature log of firm size. Audit committee size (ACS) was given a scale of 1 if the audit committee includes 4 members or more and 0 otherwise. Audit committee independence (ACIND) was given a scale of 1 if all audit committee members are independent and 0 otherwise.

4.4 Control variables

In the empirical model specified below, we controlled for the effects of corporate governance mechanisms and firm characteristics. Regarding corporate governance mechanisms, we control for the effects of the board of directors (size, financial expertise, and independence) on the extent of forward-looking

information disclosure in integrated reports. Furthermore, we control for the effect of firm characteristics including firm size and profitability.

The board of directors' size (BODSIZE) is measured by the total number of executive and non-executive directors on the board at the end of the fiscal year. Both Agyei-Mensah (2016) and Mustafa et al. (2018) found a positive association between board size and audit quality, and between board size and disclosure quality. They argue that more directors on the board provide more resources and experience, which will enhance board monitoring ability, enhance information transparency and increase the amount of information disclosed in annual reports.

Board of directors' financial expertise (BODFX) was coded 1 if more than half of the board members had finance or accounting experience and 0 otherwise. Mustafa et al. (2018) found that board members with financial background and experience tend to demand better audit services to enhance their monitoring capabilities over management. Besides, the board of director's independence (BODIND) measured by the number of non-executive directors on the board. Agyei-Mensah (2016) and Mustafa et al. (2018) studies reported that independent board members tend to provide external pressure to enhance firm performance, lower the occurrence of financial reporting problems or fraud, and increase the level of disclosure.

Firm size (FSIZE) is measured by the book value of total assets. Agyei-Mensah (2016) stated that larger firms tend to have higher reporting quality as they have more resources, are exposed to more public scrutiny and can afford the costs associated with additional disclosures compared with smaller firms. Firm profitability is measured by return on assets (ROA) ratio. Both Philip (2008) and Agyei-Mensah (2016) found a positive association between firm profitability and the level of disclosure as firms with good performance tend to disclose more information to publicize their performance compared to firms with poor performance.

The above variables are included in the empirical model, as specified below, to test the three hypotheses presented earlier:

$$FLI = \beta_0 + \beta_1AS + \beta_2ACSIZE + \beta_3ACIND + \beta_4BODSIZE + \beta_5BODFX + \beta_6BODIND + \beta_7FSIZE + \beta_8ROA + \varepsilon.$$

5. Results and discussions

5.1 Descriptive statistics

Table 1 presents the descriptive statistics for the dependent, test and control variables. The extent of FLI disclosed in the IRs ranges from 8 items to 29 items with an average of about 17 items. The average of audit firm size is 0.98, meaning

most of the sample firms were audited by the Big-4 audit firms. The average of the board of directors' size was 10.96, meaning that the board on average has about 11 members. The board of directors' independence means is 5.71, which indicates that about 6 of the board members are independent. The mean of the board of directors' financial expertise is 0.15, meaning that 15 percent of the sample firms' board had more than half of board members with financial expertise. The average of audit committee independence is 85.54 percent, meaning that 85.54 percent of audit committee members are independent. Furthermore, the average firm size nature log is 3.6369. Finally, the ROA ranges between 16.4% and 26.70% with an average of 5.697%.

Table 1**Descriptive statistics results**

Key variables	Mean	Median	Sd. Deviation	Minimum	Maximum
FLI	17.04	17.5	5.099	8	29
AS	0.98	1	0.139	0	1
ACSIZE	0.73	1.00	0.448	0	1
ACIND	0.65	1.00	0.480	0	1
BODSIZE	10.96	11	2.574	6	18
BODIND	5.71	4.5	2.656	3	13
BODFX	0.15	.00	0.364	0	1
FSIZE	3.8369	3.8845	0.9424	1.81	6.03
ROA	5.697%	4.980%	7.123%	-16.4%	26.7%

Table 2 shows the Spearman and Pearson Correlation matrices between the dependent and the independent (i.e., test and control) variables. The results of the correlation analysis indicate that the board of directors' independence has a significantly positive relationship with the extent of forward-looking information disclosures in integrated reports ($r=0.322$, $P<0.05$). However, none of the remaining testing variables has a significant relationship with the dependent variable.

Table 2**Spearman and Pearson correlation coefficient**

No.	variable	1	2	3	4	5	6	7	8
1	FLI	1	.057	.045	.322*	-.089	-.106	.236	-.184
2	AS	.065	1	-.057	-.281*	-.328*	-.101	-.243	.158
3	BODSIZE	.014	-.089	1	.425**	.090	.014	.050	-.239
4	BODIND	.325*	-.216	.394**	1	.229	-.081	.234	-.311*
5	BODFX	-.098	-.328*	.106	.241	1	-.186	.112	.164
7	FSIZE	.256	-.229	.057	.182	.149	.268	1	.101
8	ROA	-.155	.201	-.251	-.248	.107	-.156	.046	1

5.2 Multivariate regression analysis

The results of OLS regression analysis are provided in Table 5. First, the results indicate the existence of a significant positive association between audit firm size (AS) and the extent of forward-looking information disclosure in integrated reports (coefficient = 7.135, p -value < 0.1). Therefore, the results support H1, suggesting that firms audited by the Big-4 auditors provided more forward-looking information disclosure in the

integrated reports. The results are consistent with the findings in Wang et al. (2008), Philip (2008), Al-Ajmi (2009), Francis and Yu (2009), Al-Khaddash et al. (2013), and Achyarsyah and Molina (2014) that audit quality is positively associated with higher-level or better-quality disclosures.

Table 3**Regression analysis results for the study model**

Test and controlling variables		Dependent variable
β		t
AS	7.135	1.358*
BODSIZE	-0.431	-1.440
BODIND	0.843	2.396**
BODFX	-2.853	-1.396
ACSIZE	2.512	1.458*
ACIND	-3.457	-0.949
FSIZE	3.477	3.018**
ROA	-11.806	-1.114
Constant	2.955	0.346
Sample size	52	

Study empirical results indicated the existence of a statistically significant positive association between audit committee size (ACSIZE) and Total FLD in annual IRs. Thus H2 was accepted. These results were consistent with Bédard et al. (2004), Li et al. (2012), Haji (2015), Velte (2018) and Talpur et

al. (2018) studies empirical results as large size audit committees have more resources (Madi, et al., 2014) and greater diversity in expertise which result in better monitoring over the reporting process and more disclosure (Bedard and Gendron, 2010). Therefore, firms with large audit committees tend to have members with different expertise and knowledge to do better-monitoring activities over management actions leading to low information asymmetry, better reporting, and high levels of FLD in annual IRs.

Meanwhile, the study empirical results failed to find any statistically significant association between audit committee independence (ACIND) and Total FLD. So, H3 had been rejected. These results are consistent with Li et al. (2012), Othman et al. (2014), Wang and Hussainey (2013), Chariri and Januarti (2017) and Haji and Anifowose (2016) which failed to found an association between audit committee independence and FLI voluntary disclosure. Justification for such results is that although audit committee independence is important to ensure the absence of any pressure imposed by management on audit committee members during the monitoring process, it cannot be used as a pressure method to force management to increase the size of information disclosed in annual reports (Li et al., 2012). So, that could be the reason why the levels of FLD in annual IRs had not been affected by audit committee independence

6. Conclusion

In response to users' need for information, corporations have increased the amount of information, especially forward-looking information, disclosed in different reports to assist users in evaluating firm performance and ability to create value to make better investment decisions (Leung, 2015). However, forward-looking information disclosures have been criticized due to their future nature. Therefore, there exists the need for external authority independent of management to assess forward-looking information disclosure (DeFond and Zhang, 2014).

Accordingly, the study examined the association between auditor type (Big4 vs. Non-Big4) and the extent of forward-looking information disclosure in integrated reports. Results found a significantly positive association between audit firm size and the extent of forward-looking information disclosure in integrated reports. This finding is consistent with prior research results that larger audit firms tend to impose more extensive disclosure requirements on the client to protect their reputational capital and avoid potential litigation, leading to an increase in the extent of forward-looking information disclosure in integrated reports. The study also found positive associations between audit firm size and FLD as large size audit committees have more resources and greater diversity in expertise which results in better monitoring over the reporting process and more disclosure of

future information. While study failed to find any association between audit committee independence.

The study makes several made contributions to accounting disclosure literature by providing empirical evidence on the determinants of forward-looking information disclosure in integrated reports. Prior studies on forward-looking information focused on examining forward-looking information disclosure in traditional annual reports, and there is paucity in studies that examined the extent of forward-looking information disclosure in integrated reports despite its importance in assisting investors in evaluating firm future performance and ability to create value over the short, medium and long term.

The study has some limitations. First, the study sample is relatively small because of relatively few companies, as available on the IIRC website, have adopted the integrated reporting concept. Also, many firms adopting integrated reporting are dropped because other requisite data are not available and/or the need to be hand-collected. Second, the study examines the extent of forward-looking information disclosure in non-financial firms integrated reports for only the year 2017 as data on forward-looking disclosures need to be hand-collected. Third, the study examines the determinants related to audit quality of forward-looking disclosure in integrated reports. Future research may examine the consequences of such forward-looking disclosures.

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