

**FINANCIAL DISCLOSURE OF LISTED  
ROMANIAN COMPANIES AND ANALYSTS' FORECAST ACCURACY:  
AN EXPLORATORY RESEARCH**

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**Abstract:**

*The purpose of this paper is to investigate the relationship between financial disclosure of listed Romanian companies and analysts' forecast accuracy. The results confirmed the European and the international trends showing that increased disclosure leads to lower forecast errors. For the first time for the Romania capital market, the paper documented empirically that analysts' forecasts are more accurate for Romanian listed entities preparing financial statements conforming to IFRS.*

**Keywords:** financial reporting, analysts' forecast errors, IFRS adoption in Romanian

**JEL classification:** G32, M41

**Introduction**

Recent research has shown that financial reporting is an important source of information used by financial analysts for predictive purposes (Peek, 2005). Authors such as Vanstraelen, Zarzeski and Robb (2003) or Hope (2004) proved that increased disclosure leads to increased analysts' forecast accuracy. However, currently, there is not a consensus reached in the literature regarding the role plaid by the quantity of financial disclosure in enhancing analysts' forecast accuracy, authors such as Pope (2003) arguing that it is not clear whether financial disclosure is a fundamental determinant or just a complement of the recognition rules operating in different accounting regimes.

In this context, the purpose of this paper is to investigate the extent to which, on an emergent market, such as the Romanian one, a high volume of financial information made available to financial analysts materialises in improved forecasts.

**1. Literature review**

Several recent papers have showed that financial reporting is an important source of information used by financial analysts for predictive purposes (Peek,

2005). Consequently, there was an increase in the body of research investigating the relationship between financial disclosure and analysts' forecast accuracy. Authors such as Vanstraelen, Zarzeski and Robb (2003) or Hope (2004) proved that increased disclosure leads to increased analysts' forecast accuracy. Hope (2002), for instance, relates the CIFAR index of the level of annual report disclosure to forecast accuracy for a sample of 1,553 firm-years from 22 countries, showing that a high volume of financial information made available to financial analysts enhances their forecast accuracy.

IFRSs are allegedly high-quality financial reporting standards, with extensive disclosure requirements and evolved recognition and valuation procedures, expected to increase transparency, diminish information asymmetry, and, consequently, facilitate predictions in order to support investment decisions on capital markets. Starting with the adoption of IFRS in the EU, several papers tried to investigate the impact of IFRS adoption on the analysts' forecast accuracy. For instance, Brown, Preiato and Tarca (2009) showed on a sample of 40.123 monthly observations for companies operating in 13 European countries during 2002-2007 that forecast errors were significantly lower after the IFRS mandatory implementation. Ernstberger (2008) has also showed that on the German capital market analysts' forecast accuracy improved after the IFRS adoption. Tan, Wang and Welker (2009) obtained similar results on a sample of 38 countries, several European countries included. Furthermore, Tan, Wang and Welker (2009) documented empirically, that the IFRS adoption attracts foreign analysts, especially those with experience in IFRS, or whose countries make IFRS implementation compulsory at the same time.

However, the literature has not yet reached common grounds on the role plaid by the quantity of financial disclosure in enhancing analysts' forecast accuracy, authors such as Pope (2003) arguing that it is not clear whether financial disclosure is a fundamental determinant or just a complement of the recognition rules operating in different accounting regimes.

In this context, the purpose of this paper is to bring additional empirical evidence on an emerging market, as to our knowledge, the impact of financial disclosure of listed Romanian companies on analysts' forecast accuracy has not yet been investigated. At the same time, as, starting with 2005, listed Romanian companies prepare mandatorily financial statements in compliance with IFRS, while other apply IFRS for internal information needs, this paper also investigates the extent to which companies applying IFSR benefit from the most accurate forecast.

## 2. Research methodology

The sample was comprised of 19 companies listed on the Bucharest Stock Exchange followed by financial analysts according to Thompson Reuters' I/B/E/S data base. We used predictions made in 2008 for 2009 and 2010. After eliminating financial entities, the remaining sample was reduced to 24 firm-years observations, for which forecast errors were computed based on the following formula:

$$Error_{it} = \frac{|ActualEPS_{it} - ForecastedEPS_{it}|}{P_{it}}$$

Where:

$Error_{it}$  = analysts' forecast error for company  $i$  and year  $t$

$ActualEPS_{it}$  = actual earnings per share for company  $i$  and year  $t$

$ForecastedEPS_{it}$  = forecasted earnings per share for company  $i$  and year  $t$

$P_{it}$  = share price for company  $i$  and year  $t$

When data was analysed, the actual earnings per share was not available for one of the companies for the year 2010, and the sample was further reduced to 23 observations.

In order to determine the level of financial disclosure of listed Romanian companies, we investigated their websites, computing a score function based on the following items available to financial analysts in the year 2008.

**Table 1: List of disclosure variables**

	<b>Variables:</b>
1	Financial statements in compliance with RAS (Romanian Accounting Standards);
2	Financial statements in compliance with IFRS;
3	Interim financial statements (quarterly and half-year) in compliance with RAS;
4	Interim financial statements (quarterly and half-year) in compliance with IFRS;
5	Auditor's report;
6	Manager's report;
7	Revenue and expense budget;
8	Income statement with expenses classified by function.

Items 1, 2, 5-8 were granted scores from 0 (not on the website) to 1 (on the website), except for one company disclosing excerpts from financial statements, which received a quarter of the maximum value. Items 3 and 4 received scores from 0 to 2: both quarterly and half-year interim financial statements available (2 points), one interim set of financial statements (1 point), and no interim financial

statements available (0 points). All variables contributed equally to the final score, its maximum value being 10. The revenue and expense budget and the income statement with expenses classified by function were given equal importance in computing the final score, taking into account their potential in supporting predictions of earnings per share.

Considering the empirical evidence existing so far for other markets, we posit that:

**H:** Analysts' forecasts are more accurate for listed Romanian companies disclosing more financial information.

### 3. Research results

The values obtained after the operationalization of the variables are presented in the table below:

**Table 2: Descriptive statistics**

Variables	Disclosure	Forecast Error	Double Reporting (RAS/IFRS)
Mean	5,750	0,234	3,417
Standard deviation	1,738	0,245	1,213
Minimum	2,5	0,081	1
Maximum	8	1,007	5
Observations	24	23	24

The majority of listed Romanian companies followed by financial analysts incurred good scores for disclosure, their websites featuring annual and interim financial statements as well as other financial information.

The relationship between financial disclosure and analysts' forecast errors was tested using the following regression model:

$$Error_{it} = \alpha_0 + \alpha_1 FD_{it} + \varepsilon_i$$

Where:

$Error_{it}$  = analysts' forecast error for company  $i$  and year  $t$

$FD_{it}$  = the level of financial disclosure for company  $i$  and year  $t$

**Table 3. Regression results**

Statistics	Values
R	0,473
R <sup>2</sup>	0,224
$\alpha_0$	0,617
(t)	(3,797, sig. 0,001)
$\alpha_1$	-0,068
(t)	(-2,459, sig. 0,023)
F	6,046 (sig. 0,023)
Durbin-Watson	2,308
Observations	23

The results showed a negative correlation between forecast errors and the level of financial disclosure, confirming our hypothesis. In other words, listed Romanian companies disclosing more financial information through their websites had the most accurate forecasts.

Analysing the relationship more carefully, it was discovered that the negative association is determined especially by the kind of financial reporting of listed Romanian companies. More exactly, companies publishing financial statements according to IFSR incurred lower forecast errors. The relationship between the type of reporting (double reporting: both IFSR and RAS) and analysts' forecast errors has been analysed by means of the following regression model:

$$Error_{it} = \alpha_0 + \alpha_1 DR_{it} + \varepsilon_i$$

Where:

$Error_{it}$  = analysts' forecast error for company  $i$  and year  $t$

$DR_{it}$  = (double reporting) an aggregate score for the type of financial reporting (RAS and IFRS) published by company  $i$  for the year  $t$

**Table 4. Regression results**

Statistics	Values
R	0,543
R <sup>2</sup>	0,295
$\alpha_0$	0,608
(t)	(4,457, sig. 0,000)
$\alpha_1$	-0,112
(t)	(-2,961, sig. 0,007)
F	8,770 (sig. 0,007)
Durbin-Watson	2,255
Observations	23

As the results show, there is a negative relationship between the type of financial disclosure and forecast errors, the type of reporting explaining approximately 30% of the forecast errors variation.

### **Conclusions, limits and further research**

The purpose of this paper was to investigate the extent to which high level of disclosure of listed Romanian companies led to more accurate analysts' forecasts. The results confirmed the European and the international trends showing that increased disclosure leads to lower forecast errors. For the first time for the Romania capital market, the paper documented empirically that analysts' forecasts are more accurate for Romanian listed entities preparing financial statements conforming to IFRS.

In contrast to similar research performed in other countries, the sample used in this paper is much more reduced due to the small number of listed Romanian companies followed by financial analysts.

We believe that further research is needed to identify the types of financial information (predictive information, certain valuation and recognition policies etc.) associated with analysts' forecast errors, allowing for a more efficient functioning of the capital market.

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