Quality of the Explanatory Notes of Brazilian Federal Professional Councils

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Abstract

Objective: This study aimed to verify whether the audit and organizational factors of the Brazilian Federal Professional Supervisory Councils (CFFPs) influenced the quality of their notes to the financial statements for the year 2021. Method: A bibliographical and documentary study was carried out, with a quantitative, predominantly descriptive approach. Results: The results indicate that auditing, whether internal or external to the entity, improves the quality of the notes to the financial statements (NEs); size, whose proxy is the number of members, and time since incorporation, however, did not significantly affect it. Although this study did not focus on the organizational governance and asset size of CFFPs, the evidence shows that there is a positive and significant correlation between these factors and the quality of the NEs. Contributions: this research can contribute to a better understanding of the relationship between auditing and organizational factors in the quality of accounting information, providing inputs and empirical considerations for the development of more effective public policies aimed at improving the transparency and accountability of these entities.

Keywords: explanatory notes, auditing, organizational factors, professional councils

1. Introduction

The aim of this study is to verify whether the auditing and organizational factors of Brazil's Federal Professional Inspection Councils (CFFPs), such as the size and time of incorporation of the entity, influence the quality of their explanatory notes (NEs). These reports were evaluated under the aspects of regulatory compliance and the qualitative characteristics of accounting information.

The quality of accounting information has been widely debated in the accounting literature (Amiran et al., 2022). The worldwide increase in accounting scandals at the beginning of the 21st century points to deficiencies in the quality of financial reports (Herath, 2017). According to Jonas and Blanchet (2000), quality accounting information must be useful to its users. In addition, it must support the fulfillment of its objective, which is to provide information for the purposes of accountability and decision-making (Conselho Federal de Contabilidade [CFC], 2016b).

To understand the determinants of the quality and level of disclosure of accounting information, research points to evidence that auditing, and the arrangement of organizational characteristics interfere with this quality, such as the size and time of incorporation of the entities (Ahmed & Courtis, 1999; Agustiningsih et al., 2017; Ramos & Klann, 2019).

Auditors play an important role in the quality of financial statements (Gamayuni, 2018). By virtue of its role in ensuring that financial reports reliably report the reality of the entity, auditing increases users' confidence in the information disclosed (Jiang et al., 2020; Pforsich et al., 2006).

The size of the organization can also be considered a characteristic that affects the level of quality of the information disclosed. The larger the organization, the greater the pressure from the users of this information to improve it (Avelino et al., 2014).

In the case of the length of time the entity has been established, older companies are more experienced in the management and effectiveness of their internal controls and are therefore able to provide better quality reports (Doyle et al., 2007). In the same vein, according to Huang et al. (2012), the quality of an organization's financial reports is expected to improve over time as internal control becomes better structured.

Previous studies have observed information weaknesses in the first sector, marked by a lack of clarity, the use of jargon and an excess of information, which leads to a low level of understanding on the part of users in relation to the accounting information disclosed (Oliveira et al., 2018). Adequate use of NEs was one of the factors listed that could improve these reports (Oliveira et al., 2018; Abreu & Bezerra Filho, 2021).

This research is therefore justified by the need to improve the level of quality of the explanatory notes reported by the public sector and aims to meet the global demand, raised by Herath (2017), regarding the development of ideal methods for assessing the quality of financial reports.

While the few studies on NEs in the Brazilian public sector have focused on the direct administration (Federal Government, States, Federal District and Municipalities), the object of this research is Brazil's Federal Professional Supervisory Councils, whose accounting reports must be of a high quality, due to their constitutional duty to render accounts to society and promote adequate social control.

Evaluating the quality of CFFPs' NEs will make it possible to identify possible problems and opportunities for improvement related to the accountability mediated by these reports. In addition, this research can contribute to a better understanding of the relationship between auditing and organizational factors in the quality of accounting information, providing inputs and empirical considerations for the development of more effective public policies aimed at improving the transparency and accountability of these entities.

In view of the above, the main theoretical contributions of this research are: (1) to understand the level of quality of the NEs of the CFFPs; (2) to understand the influence of the audit of financial statements, the size and time of incorporation of the entity on this result; and (3) to provide relevant information to regulatory and supervisory bodies in order to encourage a reassessment of enforcement and incentive measures with the aim of improving the quality of accounting reports.

As far as practical contributions are concerned, the following stand out: (1) promoting benchmarking, through the results of the ranking of the Quality Index of Explanatory Notes (IQNE), so that knowledge can be shared among the preparers of NEs; (2) raising awareness among the managers of professional councils about the importance of accounting audits; and (3) increasing the perception of the relevance of NEs to the decision-making and accountability process. The results of this research, therefore, may be useful to the professional councils themselves and to other users of the accounting information of these entities, such as regulated professionals, public and private organizations, among other interested parties.

2. Method

For the purposes of this study, the scope of NEs included financial and non-financial information related to the performance and economic-financial reality of the entity, such as equity, financial, budgetary and/or cost aspects.

The choice of analysis base considered the deadline laid down in Normative Instruction 84 of the Federal Court of Auditors (TCU) for the disclosure of accountability by these municipalities. The 2021 financial year was chosen because it was the most recent year for which disclosure had already become mandatory at the time of data collection.

The data was organized as a cross-section panel and imported from MS Excel® into Stata® software. The boxplot showed the presence of outliers in the variables and the winsorization technique was used to treat them at the 1% level.

2.1 Sample

The universe of this research includes the 32 Federal Professional Inspection Councils in Brazil that have published explanatory notes, as well as those whose data was obtained from transparency portals or through the information request list.

2.2 Data Collection

About data collection, the NEs were obtained from the CFFPs' transparency portals on their websites. After this stage, a list of information requests was sent through the electronic communication channels (Ombudsman's Office and e-SIC) containing crucial questions to answer the central question of this research.

Checklists I and II were then applied. While Checklist I was developed to assess the quality of NEs from the perspective of regulatory compliance, Checklist II aimed to analyze them from the perspective of the qualitative characteristics of accounting information.

Checklist I was adapted from the model developed by Abreu and Bezerra Filho (2021), to bring it closer to the

specificities of the CFFPs and update it about the accounting standards applicable to the public sector in force in 2021.

In a complementary way, Checklist II derives from the models built by Abreu and Bezerra Filho (2021), Beest et al. (2009), Gabriel (2011) and Lourenço and Francisco (2016), which makes them more adherent to the reality of these municipalities, considering that most of these authors did not use them in public entities, but in private sector companies.

Checklist I contain 15 questions, taken from MCASP 8th edition or NBC TSPs, which were broken down into a total of 62 items. Checklist II, on the other hand, covers 17 items, 4 of which deal with the characteristic of relevance; 4, reliable representation; 4, comprehensibility; 3, comparability; 1, verifiability and 1 on timeliness.

In terms of scoring, unlike Checklist II, where each item has a specific criterion, Checklist I will use a structured scale with a three-point rating for each item evaluated: (1) 0 for not meeting the item; (2) 1 for partially meeting the item; and (3) 2 for fully meeting the item.

When analyzing the responses to the request for information on question 1, some CFFPs consider that the Audit Committee (CTC) and the Fiscal Management Council (CGF), or similar bodies, carry out internal audits. However, for the purposes of this research, these committees were not considered, as they are not made up of technical positions specializing in accounting auditing.

The evaluation of the content of the NEs resulted in the Quality Index of Explanatory Notes (IQNE), a proxy that represents the level of quality of the NE of the CFFP. We chose to construct the IQNE because measuring quality using an index is one of the most common methods, according to research by Gabriel (2011), Yurisandi and Puspitasari (2015) and Ramos and Klann (2019).

To calculate the IQNE for each CFFP, we first applied the following equation 1 was applied, the result of which is the score for each item assessed.

$$S = \sum_{i=1}^{n} qx = \frac{-b \pm \sqrt{b^2 - 4ac}}{2a} \tag{1}$$

Where:

S: score obtained by each Federal Council in each question.

i: number of items in the item to be checked.

n: maximum number of points to be obtained in the item.

q: sum of the score obtained for each item.

It should be noted that the IQNE can vary from 0.00 to 1.00: the closer it is to 1.00, the higher the quality of the NE. In percentage terms, the closer to 100%, the better the quality. The IQNE corresponds to the proportion between the sum of the scores for the items on Checklists I and II and the sum of the maximum scores for the items assessed.

Equation 2 was then applied to calculate the IQNE for each CFFP, as shown below:

$$IQNE = \frac{\sum S}{\sum T} x = \frac{-b \pm \sqrt{b^2 - 4ac}}{2a} \tag{2}$$

Where:

IQNE: Quality Index of the Explanatory Note.

S: score obtained by each CFFP in each question.

$\sum S$: Sum of the score obtained by each CFFP in each question.

T: maximum score for each item analyzed.

$\sum T$: Sum of the maximum score for each item analyzed.

To provide the various users with a more transparent perspective, stimulate the improvement of the NEs to the DCASPs and promote benchmarking, a ranking of the CFFPs was drawn up, to be presented in later topics, seeking to highlight those with the best levels of informational quality about the NEs.

In cases of a tie, alphabetical order was adopted as the ranking criterion, considering the profession that the CFFP oversees. This is because there is no hierarchy between the qualitative characteristics, since, according to the Federal Accounting Council (2016b), the relative importance of these characteristics in each situation is a matter of professional judgment.

The IQNE, as a proxy for the quality of the explanatory notes, is the dependent variable in this study. The independent variables, which aim to explain the behavior of the IQNE variable, are Audit of financial statements (d_externalorinternal1), Size of the entity (registered) and Time of incorporation of the entity (Id).

The variable Audit of financial statements (d_externalorinternal1) seeks to identify those CFFPs whose financial statements are assessed by an audit, whether internal or external. The proxy for the size of the entity is the number of active registrations in that profession's council system, covering both individuals (PF) and legal entities (PJ). The entity's time of incorporation, in turn, comprises the time elapsed between the date of the law creating the council and the date of this research.

3. Results

Table 1 shows the descriptive statistics for the variables that make up the IQNE of the CFFPs, with criteria that measure the degree of compliance with the applicable accounting standards and compliance with the qualitative characteristics of accounting information: relevance, reliable representation, comprehensibility, verifiability, timeliness, and comparability.

Table 1. Descriptive Statistics of the Quality Index of Explanatory Notes

Variable	No. of observations	Average	Standard Deviation	Quartiles				
				Minimum	.25	.50	.75	Maximum
IQNE	25	0.3558	0.1366	0.1127	0.2692	0.3418	0.4426	0.6342
ICONF	25	0.3045	0.1453	0.0726	0.2339	0.2661	0.3710	0.6371
IRELEV	25	0.7000	0.2500	0.2500	0.6250	0.7500	0.8750	1.0000
IREF	25	0.6066	0.2723	0.0000	0.5000	0.5000	0.8750	1.0000
ICP	25	0.6310	0.1704	0.2250	0.4913	0.6500	0.7500	0.9500
ICOMP	25	0.3400	0.1766	0.1667	0.1667	0.3333	0.3333	0.6667
IVER	25	0.4200	0.4000	0.0000	0.0000	0.5000	0.5000	1.0000
ITEMP	25	0.0400	0.1384	0.0000	0.0000	0.0000	0.0000	0.5000

Note: each item on the checklist can vary from 0 to 2. IQNE = Quality of Explanatory Notes Index; ICONF = Compliance Index; IRELEV = Relevance Index; IREF = Reliable Representation Index; ICP = Comprehensibility Index; ICOMP = Comparability Index; IVER = Verifiability Index; ITEMP = Timeliness Index.

Of the 32 CFFPs established in Brazil, 25 reported NE. The average NEQI of these 25 CFFPs was 0.3558, showing that 35.58% of the maximum score was met, which was close to the population's central score of 34.18%. The maximum IQNE obtained was 63.42%, while the minimum was 11.27%. When analyzing the quartiles, only 25% of the councils have this index above 44.26% and that 50% have a score below 34.18%, generally indicating low quality explanatory notes.

A significant proportion of the population obtained a minimum score of zero in the verifiability (IVER) and

timeliness (ITEMP) characteristics. Around 40% of the boards that disclosed NE did not meet the verifiability requirement, which assesses the disclosure of assumptions and estimates used in the preparation of financial statements. Failure to disclose this information affects the user's assessment of expectations of future events and confidence that the financial statements do in fact reflect the council's economic and financial reality.

About timeliness, the aim of the question being to assess whether the financial report was published within the legal deadline, none achieved the maximum score. Approximately 92% of these councils scored zero for not mentioning this date. The presence of this information is necessary to make society aware of the fulfillment of the duty to render accounts, under penalty of holding the omitted manager responsible for this obligation. It is also understood that the untimely disclosure of these reports can cause users to make decisions due to the lack of timely information.

On the other hand, comprehensibility (ICP) stood out positively because, compared to compliance and the other qualitative characteristics, it had the highest average score, which was 63.10%. It should be noted, however, that no CFFP achieved the maximum score. One possible reason for this is that few used cross-references to improve informational understanding.

The lack of standardization of the CFFFPs' NEs meant that none of them achieved the maximum score on the comparability index (ICOMP). This characteristic is relevant in several respects, such as: making benchmarking possible, especially between councils due to their similarities, making it possible to compare their performance with other entities and subsidizing self-evaluation in relation to previous years.

As a result of applying the methodological procedures of this study, Table 2 shows a ranking, ordered in descending order by the IQNE of each CFFP:

Table 2. Explanatory Notes Quality Index Ranking

	Federal Councils	Acronym	IQNE
1°	Federal Council of Physical Education	CONFEF	63.42%
2°	Federal Accounting Council	CFC	58.18%
3°	Federal Council of Architecture and Urbanism of Brazil	CAU/BR	53.92%
4°	Federal Nursing Council	COFEN	53.92%
5°	Federal Council of Psychology of Brazil	CFP	46.96%
6°	Federal Council of Chemistry	CFQ	46.96%
7°	Federal Council of Medicine	CFM	44.26%
8°	Federal Council of Dentistry	CFO	41.77%
9°	Federal Administration Council	CFA	40.63%
10°	Federal Council of Industrial Technicians	CFT	40.25%
11°	Federal Council of Social Service	CFESS	38.73%
12°	Federal Council of Speech and Hearing Therapy	CFFa	35.35%
13°	Federal Council of Biology	CFBio	34.18%
14°	Federal Council of Librarianship	CFB	32.78%
15°	Federal Council of Commercial Representatives	CONFERE	32.49%
16°	Federal Council of Nutrition	CFN	30.76%
17°	National Council of Radiology Technicians	CONTAIN	29.49%

	Federal Councils	Acronym	IQNE
18 °	Federal Council of Museology	COFEM	27.56%
19 °	Federal Pharmacy Council	CFF	26.92%
20 °	Federal Council of Engineering and Agronomy	CONFEA	24.01%
21 °	Federal Council of Economics	COFECON	22.11%
22 °	Federal Council of Realtors	COFECI	20.00%
23 °	Federal Council of Veterinary Medicine	CFMV	19.83%
24 °	Federal Council of Public Relations Professionals	CONFERP	13.80%
25 °	Federal Council of Physiotherapy and Occupational Therapy	COFFITO	11.27%
-	Federal Council of Home Economists	CFED	Did not disclose NE
-	Federal Council of Biomedicine	CFBM	Did not disclose NE
-	Federal Council of Educators and Pedagogues	CFEP	Did not disclose NE
-	Federal Council of Statistics	CONFE	Did not disclose NE
-	Order of Musicians of Brazil	OMBCF	Did not disclose NE
-	Federal Council of Agricultural Technicians	CFTA	Did not disclose NE
-	Federal Council of Document Brokers of Brazil	CFDD	Did not disclose NE

Note: this table shows the IQNE *ranking* achieved by the CFFPs for the 2021 financial year.

It is worth noting that the auditing of financial statements by an accounting professional is a common factor among the 3 CFFPs with the best IQNEs. Both CAU/BR and CONFEF have their financial statements audited by a private sector company, while the CFC has its financial reports assessed by employees from the internal control sector.

This suggests that audits carried out by accounting professionals improve the quality of NEs, to the detriment of those carried out by agents who do not belong to this profession, as is the case of councils whose DCs are audited solely by the CTC, the Fiscal Management Council (CGF) or similar, which in most cases are made up of "non-accounting professionals".

The findings of this study confirm H1, given that the result of the mean test reached 99% significance, i.e. CFFPs whose financial statements are evaluated by an audit, whether internal or external to the entity, have better quality NEs.

These results, which confirm H1, are in line with the research by Jiang et al. (2020), as their reports state that auditing helps to ensure the reliability of the accounting information disclosed by entities, improving the quality of accounting information.

In the same vein, it is possible to see the importance of the role of auditors in the process of improving the quality of financial statements, since the evaluation by these professionals contributes to the reliable representation of the financial reports disclosed by the entities, raising the level of confidence of the interested parties in relation to the accounting information (Pforsich et al., 2006; Gamayuni, 2018).

4. Discussion

In view of the need to improve public accountability, the instrumentalization of social control and the provision of financial and non-financial information to support decision-making by users of public sector financial statements, there is a need to improve the quality of the CFFPs' NEs. This study analyzed the level of quality of the explanatory notes of the CFFPs, in the 2021 financial year, using checklists adapted from Abreu and Bezerra Filho (2021), Beest et al. (2009), Gabriel (2011) and Lourenço and Francisco (2016). To answer the research question, we used data

collected from the CFFPs' websites, as well as requests for information through institutional channels for access to information.

The findings of this study indicate that, on average and with 99% confidence, auditing, whether internal or external to the entity, raises the quality of the NEs of the CFFPs. It should be noted that auditing plays an important role for society by ensuring greater reliability of financial statements, which increases the usefulness of the accounting information disclosed.

Contrary to expectations, the results show that the length of time the CFFP has existed correlates negatively with the IQNE. One of the possible reasons for this finding is that some CFFPs that have been in existence for less time hire external auditors because they don't have internal auditors on their staff, which increases the quality of their reports.

In line with expectations, the size of the CFFP correlates positively with the quality of the NEs. The failure to reach significance at a minimum level of 90% can be explained by the lack of more robust data, given that some CFFPs do not report or do not keep track of the number of registrants, individuals, and companies, which hampers the analysis of this variable.

Despite this, the evidence shows that there is a statistically significant correlation, at a level of 90%, between asset size and IQNE, indicating that CFFPs with more assets can invest more in the quality of their accounting reports.

The results also point to a low level of investment in employee training, since of the CFFPs that responded that they have accounting professionals or auditors on staff, around 15% invest in training programs. It is hoped that the results found can stimulate improvements in the quality of the CFFPs' NEs, as well as stimulate debates on the subject, such as a re-evaluation of enforcement measures and incentives, with a view to improving the levels of accountability of these federal authorities.

In general terms, the research has limitations because not all CFFPs have disclosed NEs, affecting the active transparency of these entities, and because they have a low level of passive transparency, given the difficulty in obtaining information based on the Access to Information Law. These limitations therefore compromised the database as it had a low number of valid observations (18) in relation to the number of CFFPs (32), making it impossible to apply an econometric model to estimate the IQNE.

Finally, it is worth emphasizing that there are opportunities for further studies, for example, examining the relationship between the quality of the explanatory notes and corporate governance, which, although it was used in this study as a control variable, showed a statistically significant correlation of 99% with the level of quality of the CFFPs' NEs.

Provenance and peer review

Not commissioned; externally double-blind peer reviewed.

Data availability statement

The data that support the findings of this study are available on request from the corresponding author. The data are not publicly available due to privacy or ethical restrictions.

Data sharing statement

No additional data are available.

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