Voluntary versus Mandatory Corporate Disclosures on Management Responsibilities for Financial Reporting: An Empirical Investigation

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This paper examines whether voluntary disclosure of management responsibilities for financial statements promotes transparency in corporate financial reporting as much as that promoted under the mandatory reporting. Examining this issue is of special interest because of the discontent, surrounded the enactment of the SOX in 2002, for the departure from the voluntary cost-benefit disclosures. It also finds support through the request of the Committee on Capital Markets Regulation (2006) to reconsider the effects of SOX on US global business competitiveness. In addition, the recent failure of the financial industry raises doubt on the effectiveness of SOX in deterring management from making risky operating decisions that were not fully disclosed, though management certified the financial statements. We hypothesize that voluntary disclosure provides richer information that differentiates good reporting firms from bad ones. This differentiation is lost under the pooled-equilibrium mandatory and uniform disclosure. We use a sample of firms that voluntarily reported management responsibilities for financial statements prior to 2002, and compare their results to the SEC’s one time mandatory certification sample in 2002. The results show that voluntary reporting has higher positive association with security returns and lower bid-ask spread than those associated with mandatory reporting after controlling for other accounting metrics such as earnings, book value and size. These findings suggest that voluntary reporting is more effective in promoting transparency and helps reduce investors’ risk resulting from information asymmetry. From the financial reporting policy making, we conclude that forthcoming voluntary disclosure, on management responsibilities for financial statements, is as effective as mandatory reporting. Furthermore, voluntary reporting helps investors differentiate firms with transparent reporting from others which becomes a hard task to determine under disclosure provided within the uniform pooled-equilibrium mandatory certification.

Keywords: voluntary disclosure; value relevance; certification of financial statements.

Data Availability: Data used in this study are from public sources as explained in the body of the paper.

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