

## Disclosure of related party transactions and information regarding transfer pricing by the companies listed on Bucharest Stock Exchange

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**Abstract:** Related party transactions and transfer prices have begun to be considered a powerful instrument of financial frauds as a result of the recent financial scandals. Transactions with related parties situated in tax havens are one of the principal elements which contribute to the faltering confidence of the investors. We focused on the related party transactions and transfer prices in the context of Romanian listed companies given the features of the local institutional context. For example, 36% of the companies listed on Bucharest Stock Exchange have affiliates in tax havens. The objective of this study is to analyse how the Romanian companies listed on Bucharest Stock Exchange disclosed during 2012-2014 the related party transactions and information regarding transfer pricing and what institutional factors are associated with disclosure. We found that companies audited by a Big Four, large companies and companies which perform transactions with non-resident related parties disclose more information compared with companies audited by a non-Big Four entity, small or medium companies and companies which perform transactions with resident related parties. We also found that factors like sector of activity and nature of capital (foreign or local) do not significantly influence the disclosure of related party transactions and transfer pricing aspects. Results might be of interest for other emerging economies, offering insights with regards to the importance of such disclosures for investors. On the other hand, the results might be useful for developed countries (e.g. western investors) which find Romania an attractive country in terms of investments.

**Keywords:** related party transactions, transfer pricing, financial reporting, investors, performance

**JEL codes:** M41

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## 1. Introduction

Once with the financial scandals of some big corporations of the world (e.g. Enron, Arthur Andersen, Adelphia, WorldCom, Tyco, etc.) the investors have begun to consider the related party transactions as an instrument used by companies for opportunistic purposes (Wong & Jian, 2003). Moreover, in the context of internationalization and globalization of business, in which most of the world trade takes place between companies of the same group, transfer pricing implications have begun to be considered one of the most important issue generated by the related party transactions. In this respect, Tong *et al.* (2014) noted that “by manipulating transfer prices, economic resources can be transferred between different stakeholders, resulting in gains to some and losses to others, and therefore the related party transaction may distort financial statements leading to higher information asymmetry and a general erosion of investors' confidence in the firm”.

Taking into account these aspects, we considered that a disclosure of the related party transactions and also the disclosure of information regarding transfer pricing could enhance the investors' confidence and could contribute to a proper understanding of the financial performance and position of a company. Moreover, given the fact that 36% of the companies listed on Bucharest Stock Exchange have affiliates in tax havens (Afrăsinei *et al.*, 2016) and due to this, in lack of sufficient information, the investors' confidence could be faltered, we found interesting to investigate the way in which the Romanian companies listed on Bucharest Stock Exchange disclose their related parties transactions and information regarding transfer pricing. Therefore, our research questions were the following: How do the Romanian companies listed on Bucharest Stock Exchange disclose the related party transactions and information regarding transfer pricing? And what factors influence these kind of disclosures?

In order to find an answer to the first question, our research approach was represented by the computation of a disclosure index. We used the disclosure index built by Buzby (1974) and further developed by Cooke (1989). The disclosure index comprised the following 6 items: the presentation of the related parties with which the companies analysed performed transactions, the presentation of the type of the related party transactions performed (e.g. the sales/acquisition of goods, provision of services, contracting of loans), their nature (e.g. provision of marketing services, sales of building materials), their value, the presentation of the terms and conditions in which the related party transactions were performed and in the end the presentation of information about transfer pricing. Regarding the data sources, these are represented by: the companies' annual reports, annual financial statements and reports of administrators (which were consulted by accessing the website of each company). In order to observe the evolution in time of the disclosure of related party transactions and transfer pricing aspects, our analysis

took into account the last three years for which the companies would be required to publish their financial reports (i.e. 2012-2014).

With regards to the second question, based on the literature reviewed we expected to find that factors like the type of the auditor (Big Four or non-Big Four) and the size of the company analysed influence the disclosure of the related party transactions and transfer pricing aspects performed by the companies, while factors like the sector of the activity and the nature of the capital (local or foreign) do not influence such disclosures. In addition, we expected to find an influence of the type of the related parties involved in transactions (whether they are resident of Romania or not) on the disclosure performed by the companies analysed. In this respect we considered that companies which carry out transactions with foreign related parties are more suspicious to manipulate their transfer pricing than other category of companies, and as a consequence these companies should disclose more information about the related party transactions and transfer pricing aspects. In order to confirm or not the research expectations we used a linear regression model, where the dependent variable was represented by the disclosure index used in order to find an answer to the first research question and the independent variables were represented by the type of auditor, nature of capital, type of related party, size of the company and sector of activity.

Our results show that companies disclose related party transactions and transfer pricing aspects in a medium to large measure, such disclosures being influenced by the type of the auditor and the size of the company analysed. Factors like sector of activity and nature of capital do not significantly influence the disclosure of related party transactions and transfer pricing aspects. These results comply with the results obtained by other researchers, presented within the literature reviewed.

In addition, our study shows that disclosures made by companies in relation with transfer pricing aspects and related party transactions are influenced by the type of related party involved in transactions, companies which perform transactions with non-resident related parties disclosing more information compared with companies which perform transactions with resident related parties. We did not find within the literature reviewed by us a research regarding the influence of the type of the related parties involved in transactions on the disclosure performed by companies in relation to the related party transactions and transfer pricing aspects. Given this, we consider that this results contributes and rich the literature, filling the gap in this domain.

In another train of thoughts, we were motivated to find answers to the research questions mentioned above for two main reasons. The first reason was represented by the fact that the Romanian tax authorities have begun to pay more attention to the related party transactions, more exactly to the transfer pricing used by related

companies. In this respect, we noted that the Romanian tax authorities have begun to perform more tax audits in the field of transfer pricing, imposing additional taxes, interests and late payment penalties. Second, the activity of a company which is facing with the situation of paying additional taxes as a consequence of the transfer pricing adjustments could be considerably affected. Moreover, an adjustment of the transfer pricing means that the financial statements did not present a fair view and the users were not properly informed about the performance of the respective company.

In this context, we consider that a disclosure of information about the related party transactions and transfer pricing aspects could assist investors in analysing whether there is a risk with regards to the related party transactions. Of course, that a more deeply analysis could be performed based on other disclosures, like the transfer pricing file, but a properly disclosure of the related party transactions and transfer pricing aspects, within the financial reports, could be a starting point for the increasing of the investor confidence.

Therefore, taking into account the fact that the disclosure of related party transactions is very important for investors because these transactions have the potential for distorting the financial information, as well as the fact that Romania is considered an attractive country for foreign investors, we consider that our study could be useful for both, local or international investors.

The originality of our study is due to the fact that we have considered that a company performed a properly disclosure of the related party transactions if this company presented the main information which are requested by both, the accounting and tax legislation. Moreover, in order to perform our research we have considered as related parties two or more companies which are part of the same group of entities. We also considered that a legal person is affiliated with another legal person if it owns that legal person, directly or indirectly, in a proportion of minimum 25% or if it effectively controls that legal person. In addition, we considered that two legal persons are related parties if there is a third person (i.e. an individual or other legal person) who owns the both legal persons, directly or indirectly, in a proportion of minimum 25% or if it effectively controls those legal persons.

As within the literature review are fewer studies performed in relation with the disclosure of related party transactions and transfer pricing aspects by Romanian companies, we believe that our research contributes to filling the gap in this domain.

The paper is organized as follows. Section 2 discusses the background literature on disclosure of related party transactions and information regarding transfer pricing.

Section 3 describes the research methodology. Section 4 presents the results of our research, more exactly the way in which the Romanian companies listed on Bucharest Stock Exchange disclose the related party transactions and information regarding transfer pricing and the influence of some factors on the disclosures made by companies from the sample. In the final section, the conclusions are accompanied by a description of tentative avenues of research and by limits of the research.

## **2. Literature review**

Pizzo (2013) defines the related party transactions as a transfer of goods or services between a reporting company and its related parties and considers that these transactions depend on „the ability to influence contractual terms and conditions”. The author notes that before 2002-2003 the subject regarding the related party transactions was not deeply analysed, the most studies performed until this period being focused on the arm`s length principle. After this period, due to the financial scandals occurred (e.g. Enron, Arthur Andersen, Adelphia, WorldCom, Tyco, etc.) the related party transactions have begun to be considered by the researchers „a powerful instrument of financial frauds”.

Bava & Gromis di Trana (2015) point out that in the literature review, the related party transactions have been studied from two different perspectives: *conflict of interests and the efficient transaction hypothesis*. Regarding the first perspective, the authors note that between the insiders of a company (e.g. executive directors and management) and outsiders (i.e. the users of the financial statements) could be a conflict of interests. In this regard, through the related party transactions, the insiders, which are remunerated based on the results of the corporation, could manipulate the transfer prices in order to obtain a private gain and as a consequence they present financial statements which do not reflect a true and fair view. Poorzamani & Arabloo (2015) observed that companies which have a high reputation auditor have lower related party transactions which could be subject to a conflict of interests, than companies which do not have a high reputation auditor. According to the second perspective, the related party transactions could facilitate the transfer of technology and other resources within a group of companies, being in this respect an efficient measure for the allocation of internal resources. Also, the related party transactions could contribute to the reduction of the time needed, as well as to the reduction of the risk associated with the foreign markets (Corlaciuc & Tiron, 2013a).

Huang & Liu (2010) studied the relationship between the related party transactions and the performance of the high-technology companies and concluded that this kind of relationship depends on the cultural and political environment of the

country from which are the companies analysed. In this respect, the two authors pointed out a positive relationship between the performance and related party transactions of high-technology firms from Taiwan and a negative relationship between the performance and related party transactions of high-technology firms from China. Moreover, Huang and Liu considered that in order to protect the interests of investors, countries should adopt stricter regulations in relation with the related party transactions. In this respect, the attention should be focus on the disclosure of these transactions in the financial reports.

### **2.1 Disclosure of related party transactions**

Chaghadari and Shukor (2011) consider that the disclosure of related party transaction could “provide stakeholders with necessary information to either discipline firms that engage in related party transactions or take precautions against them”. In addition, according to Bautch & Sammon (2004) if a company does not disclose, in the financial statements, sufficient information with regards to the business purposes of the related party transactions, the stakeholders will not be able to determine the true financial condition of that company. Pucek & Richards (2013) point out that a clear and adequate disclosure (in the notes to the financial statements) of related party transactions represents a critical step for many companies. The opinion of the two authors is that a clear and adequate disclosure should include a presentation of the related parties, a description of the transaction and the line items from the financial statements which are affected by the respective transaction.

Regarding the information which should be disclosed in relation with the related party transactions, many jurisdictions use “the concept of material information”. For example, Austria and Switzerland have strict regulations only for the disclosure of material related party transactions. Jurisdictions which pay attention to the protection of the investors are characterized by a clear definition of the related party transactions and by comprehensive disclosure requirements (Trivun *et al.*, 2012).

Ariff and Hashim (2013) consider that the disclosure of the related party transactions should play an important role in the analysis and decisions of the investors. During their research, the authors observed that many companies disclose the related party transactions in the annual reports, rather than in the financial statements. In this respect, studies show that 66% of companies disclose related party transactions only in the annual reports, 20% of companies disclose information about these transactions only in the notes to the financial statements, and 12% of companies disclose this kind of information, in both the annual reports and the notes to the financial statements.

In another train of thoughts, according to Ariff and Hashim the non-monetary information about related party transactions provides more details compared with the monetary information. This is due to the fact that the non-monetary information “may be required to distinguish whether related party transactions are value-enhancing or value-destroying activities”. On the other hand, Tiron (2006) outlines the idea that the disclosure of the related party transactions should be performed separately for each related party and should include at least the nature and the amount of the respective transaction.

In order to analyse the way in which the related party transactions are disclosed, there can be used factors such as CEO duality, ownership structure, proportion of outside director, size or industry (Zhang & Zhou, 2011). Utama (2014) analysed whether the disclosure of related party transactions is influenced by factors such as the size of the company, the auditor quality, the sector of activity, corporate governance practice, ownership structure and financial leverage. The results showed that there is a positive correlation between the disclosure of related party transactions and the corporate governance practice. Also, a positive correlation was found between the disclosure of related party transactions and the size of the company.

#### *2.1.1 Romanian accounting requirements regarding the disclosure of related party transactions*

According to the provisions of the Romanian accounting legislation (i.e. OMFP 1802/2014), the disclosure of related party transactions should include, at least, the following information:

- the amount of the transaction;
- the amount of the outstanding balances;
- the nature of the transaction;
- details of any guarantees given or received in relation with the transaction;
- details of the terms and conditions.

Moreover, starting with 2012, companies whose securities are admitted to trading on a regulated market are required to apply the International Financial Reporting Standards (IFRS) in order to prepare the financial statements. In this respect, in order to disclose the related party transactions, the Romanian companies listed on Bucharest Stock Exchange should respect the provisions of International Accounting Standard 24 “Related Party Disclosures”.

Compared with the provision of the national legislation (i.e. OMFP 1802/2014) which does not require the disclosure of information about transfer pricing, according to the provisions of IAS 24, the financial statements should contain “a statement that related party transactions were made on terms equivalent to those

that prevail in arm's length transactions". This statement should be made only if it can be substantiated.

### *2.1.2 Previous studies performed in Romania in relation to the disclosure of related party transactions*

Corlaciuc and Tiron (2013b) conducted a research in order to test the compliance of the disclosures regarding the related parties, performed by the companies listed on Bucharest Stock Exchange with the requirements of IAS 24. The research took into consideration the period between 2008 and 2012. The two authors concluded that globally, the requirements provided by IAS 24 in relation to the disclosure of information about the related parties are fulfilled by the companies analysed in a medium measure.

Furthermore, Corlaciuc and Tiron (2013c) analysed the correlation between the disclosures performed by the companies listed on Bucharest Stock Exchange, during 2008-2012, in relation to the related parties and nine factors of influence (i.e. turnover, total assets, profit/loss, net asset value, the origin of the capital – foreign or Romanian, the nature of the capital – private or public, the ownership structure - concentrate/dispersed, listing category in BSE – I, II or III, the conceptual framework applied – IFRS or OMFP and the type of the financial auditor – Big Four, other auditor). The results of the research showed that there is a medium to small correlation between the disclosures performed by the companies analysed and the ownership structure and the type of the financial auditor. The other factors included in the research do not influence the disclosures performed by the companies with regards to the related parties.

## **2.2 Transfer pricing disclosure**

The importance of related party transactions is due to the transfer pricing implications (Corlaciuc & Tiron, 2011). In this regard, Pozzoli and Venuti (2014) point out the fact that the transactions between a parent company and its subsidiaries or transactions between the subsidiaries of the same group could not be performed on the same conditions and terms as the transactions carried out between independent companies. Taking into account these aspects, the related party transactions could distort the true and fair view of the financial statements (Gordon *et al.*, 2012).

Moreover, Cottingham and Hussey (1995) consider that the disclosure, within the financial reports, of the related party transaction is not useful for sophisticated decision making. In this context, a transfer pricing disclosure could be more useful.



Regarding the information disclosed by companies in relation to transfer pricing, Borkowski and Gaffney (2012) noted that U.S. corporations disclose “more information relating to the tax authorities currently disputing transfer-pricing positions and years under audit, enabling financial statement users to better ascertain the degree and nature of audit risk faced by a multinational”. Also, the two authors observed a positive correlation between the quantity and quality of transfer pricing disclosures. In this regard, they noted that U.S. corporations have registered an increase of the average size of a transfer pricing note from 108.8 words in 2006 to 140.5 and 163.8 words in 2007, respectively 2008.

### **3. Research methodology**

In the current context, in which more than 80% of the world trade takes place between companies of the same group, the disclosure of related party transactions could represent a key element for the users of financial statements. Moreover, taking into account that the multinational companies could try to manipulate their transfer pricing in order to reduce their global corporate income tax, we consider that the users of financial statements, especially the investors, should pay more attention to the disclosure of the related party transactions and transfer pricing aspects. Another reason for which the related party transactions and transfer pricing subject should be in the sight of the investors is represented by the fact that, in order to obtain a private gain, the management staff remunerated based on the performance of the multinational company could try to manipulate transfer pricing involved within the transactions performed with related parties.

Our empirical research aims to analyse how the Romanian companies listed on Bucharest Stock Exchange have disclosed during 2012-2014 the related party transactions and information regarding transfer pricing. Through this analysis we tried to identify whether these companies disclose sufficient information about the related party transactions and transfer pricing involved in order to assist the investors in their decisions. Furthermore, we have tried to identify the impact of some factors on the disclosure of the related party transactions and transfer pricing aspects.

In order to perform the analysis we have considered related parties two or more companies which are part of the same group of entities. We also considered that a legal person is affiliated with another legal person if it owns that legal person, directly or indirectly, in a proportion of minimum 25% or if it effectively controls that legal person. In addition, we considered that two legal persons are related parties if there is a third person (i.e. an individual or other legal person) who owns the both legal persons, directly or indirectly, in a proportion of minimum 25% or if it effectively controls those legal persons.

### 3.1 Sample description and data sources

Our sample is represented by 82 listed companies on Bucharest Stock Exchange belonging to the premium and standard categories. We excluded from our sample 11 companies from the financial sector due to the different reporting rules applied.

Regarding the data sources, these are represented by: the companies' annual reports, annual financial statements and reports of administrators (which were consulted by accessing the website of each company).

In order to observe the evolution in time of the disclosure of related party transactions and transfer pricing aspects, our analysis took into account the last three years for which the companies would be required to publish their financial reports (i.e. 2012-2014). For each year analysed and for each company, we have checked the availability of the financial reports and whether the company has carried out transactions with its related parties.

The table 1 from below presents, for each year of the three analysed, the number of companies included in our sample, as well as the number of companies excluded due to the non-availability of financial reports or due to the fact that no related party transaction was performed.

**Table 1. Number of companies included/excluded from our sample**

<i>Number of companies</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
○ <b>included in our sample</b>	<b>50</b>	<b>53</b>	<b>55</b>
○ <b>excluded from our sample:</b>	<b>21</b>	<b>18</b>	<b>16</b>
▪ due to non-availability of financial reports	2	1	0
▪ due to the fact that no related party transaction was performed	19	17	16

In the next step, in order to analyse how the companies included in the sample have disclosed the related party transactions and information regarding transfer pricing, we have used the disclosure index built by Buzby (1974) and further developed by Cooke (1989). Therefore, the disclosure index has been computed as follows:

$$D_I = \frac{\sum_{i=1}^m d_i}{\sum_{i=1}^n d_i},$$

where

$$D_I \in [0,1]$$

$D_I$  = disclosure index;

$d_i = 1$  if the information (item) is disclosed and 0 otherwise;

$m$  = number of items actually presented;

$n$  = number of total possible items that could be presented.

In order to design the disclosure index, we have selected as items the main information which is requested for the disclosure of related party transactions by both, the Romanian accounting legislation (i.e. OMFP 1802/2014) within the financial statements, and the Romanian tax legislation (i.e. Order 442/2016 regarding the content of the transfer pricing file) within the transfer pricing file. More exactly, we chose as items that information from the Order 442/2016 which is requested by OMFP 1802/2014 to be presented within the financial statements.

Therefore, the disclosure index comprises the following items:

- the presentation of the related parties (e.g. the name of them, their activity, the percentage of ownership). If there was disclosed any element with regards to the presentation of the related parties we have attributed to this item the value 1. If there was not disclosed any information in this respect, the value of the item was 0;
- the type of the transactions performed (e.g. the sales/acquisition of goods, provision of services, contracting of loans). If there was disclosed the type of the transaction, the value of the item was 1, otherwise 0;
- the nature of the transactions performed (e.g. provision of marketing services, sales of building materials), If there was disclosed the nature of the transaction, the value of the item was 1, otherwise 0;
- the value of the transactions. If there was disclosed the value of the transaction, the value of the item was 1, otherwise 0;
- the terms and conditions in which the transactions were performed (e.g. payment terms, warranties granted, the interest charged in case of delayed payment, terms regarding the grant/repayment of loan). If there was disclosed any element about the terms and conditions in which the transactions were performed, the value of the item was 1, otherwise 0;
- information about transfer pricing. Despite the fact that the accounting legislation does not require the presentation of information related to transfer pricing subject, we have included an item regarding the disclosure of transfer pricing aspects. By including this item, our objective was to analyse whether companies make remarks on this topic and to note the type of information related to this subject included by the companies from our sample in their financial reports. If there was disclosed any information about the transfer pricing subject, the value of the item was 1, otherwise 0.

Practically, the items presented above comprise the number of total possible items that could be presented by a company and the disclosure index shows how many items presents a company reported to the total number of items. As a result of the determination of the exact items which comprise the disclosure index, the calculation formula may be presented as follows:

$$D_1 = (e_1 + e_2 + e_3 + e_4 + e_5 + e_6) / 6,$$

where

$e_1 \dots e_6$  = items which are comprising the disclosure index, as they are presented in the table 2 from below.

**Table 2. Items of the disclosure index**

<b>e<sub>1</sub></b>	presentation of the related parties
<b>e<sub>2</sub></b>	type of the related party transactions performed
<b>e<sub>3</sub></b>	nature of the related party transactions performed
<b>e<sub>4</sub></b>	value of the related party transactions
<b>e<sub>5</sub></b>	terms and conditions in which the related party transactions were performed
<b>e<sub>6</sub></b>	information about transfer pricing

### 3.2 Research expectations

In this step of the research we tried to identify the measure in which some factors influence the level of the disclosure index. In this regard, based on the literature reviewed, we expected to obtain the results below. As our study is performed on the level of Romania, while big part of the studies performed in relation with related party transactions are performed on the level of Western countries, where the economic environment is different, we chose to conduct our survey based on expectations, instead on hypotheses. Moreover, we considered that a hypothesis should be apply when there is a tentative answer to a research problem that is advanced so that it can be tested, this not being the case of Romania.

- According with one of the research expectations, *the type of company (Big Four or non-Big Four) which has performed the financial audit influences the information disclosed in relation to the related party transactions and transfer pricing aspects*. We considered that companies audited by a Big Four disclose more information about the related party transactions and transfer pricing aspects than companies audited by a non-Big Four. This assumption is based on the professionalism proved until now by the Big Four companies and on the research performed by Corlaciuc and Tiron (2013c) according with the disclosure of related party transactions performed by the companies is influenced by the financial auditor.
- We also expected that *companies which have performed transactions with related parties which are not residents of Romania to register a value of the disclosure index higher than that obtained by companies which have performed transactions with related parties which are residents of Romania*. This expectation was based on the fact that we considered that companies which carry out transactions with foreign related parties are more suspicious to manipulate their transfer pricing than other category of companies, and as a consequence these companies should disclose more

information about the related party transactions and transfer pricing aspects.

- Taking into consideration the results obtained by Corlaciuc and Tiron (2013c) *we expected to find that the nature of the capital (foreign or local) does not influence the disclosure of the related party transactions.* More exactly, we did not expect the value of the disclosure index to be influenced by the nature of the capital.
- Based on the results obtained by Utama (2014), we expected to find *a positive correlation between the disclosure of related party transactions and the size of the company.* In this respect, we expected to find a value of the disclosure index higher for the large companies than for the other ones (i.e. small or medium).

We considered a company to be large if it exceeds, at least two of the following three thresholds:

- total assets = EUR 43,000,000;
- net turnover = EUR 50,000,000;
- average number of employees = 250.
- Another research expectation was represented by the fact that *the company's sector of activity should not influence the level of the disclosure index.* This research expectation somehow is based on the results obtained by Utama (2014).

In order to confirm or not the research expectations and check the correlation between the disclosure index and the factors presented above we have used the following linear regression model:

$$D_i = \beta_1 \times \text{Type of Auditor} + \beta_2 \times \text{Nature of Capital} + \beta_3 \times \text{Type of Related Party} + \beta_4 \times \text{Size} + \beta_5 \times \text{Sector of Activity} + \varepsilon$$

<i>Type of Auditor</i>	=	<b>1</b> if the financial audit is performed by a Big Four company and <b>0</b> if the financial audit is performed by a non-Big Four company;
<i>Nature of Capital</i>	=	<b>1</b> if companies have a foreign capital and <b>0</b> if companies have a local capital;
<i>Type of Related Party</i>	=	<b>1</b> if related parties are not residents of Romania and <b>0</b> if related parties are residents of Romania;
<i>Size</i>	=	<b>1</b> if the company is large <b>0</b> if the company is small;
<i>Sector of Activity</i>	=	<b>1</b> if companies manufacture/sell goods and <b>0</b> if companies provide services;
$\beta$	=	the coefficients of regression;
$\varepsilon$	=	error.

Therefore, in our analysis the disclosure index is the dependent variable, while the others variables (i.e. type of auditor, nature of capital, type of related party, size, sector of activity) are the independent ones.

The computer software used for the organization of the sample data as well as for the implementation of the regression model consists of both Microsoft Excel and SPSS (Statistical Package for the Social Sciences).

Table 3 from below presents the variables which were entered in the regression model.

**Table 3. Variables entered in the regression model**

Model	Variables Entered	Method
1	Size, Type of Related Party, Sector of Activity, Type of Auditor, Nature of Capital <sup>b</sup>	Enter

a. Dependent Variable: D<sub>i</sub>; b. All requested variables entered

#### **4. Results and interpretations**

Table 4 presents for each year analysed the number of companies which have obtained a disclosure index higher than 0.5 points, equal to 0.5 points and less than 0.5 points. To not distort the results and obtain an accurate evolution of the disclosure index during 2012-2014, we have included in the table only companies which published their financial reports and performed transactions with related parties in each of the three years.

**Table 4. Evolution of the disclosure index**

<i>DI</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
<b>&gt; = 0.5</b>	<b>41</b>	<b>41</b>	<b>44</b>
> 0.5	23	23	23
= 0.5	18	18	21
<b>&lt; 0.5</b>	<b>9</b>	<b>9</b>	<b>6</b>
<b>Total</b>	<b>50</b>	<b>50</b>	<b>50</b>

Based on figures presented within table 4, we could observe that in 2013 compared with 2012 the disclosure index has not recorded any evolution.

The disclosure index higher than or equal to 0.5 points registered a slight increase in 2014 compared to 2012, while the disclosure index less than 0.5 points recorded a slight decrease. Furthermore, as can be observed from the table 3, the slight increase of the disclosure index higher than or equal to 0.5 points is due to the increase of the number of companies which disclosed related party transactions and transfer pricing aspects in a medium measure (have obtained a disclosure index

equal to 0.5 points). In 2012 and 2013 the disclosure index of 82% of the companies analysed has registered a value higher than or equal to 0.5 points, while in 2014 the number of these companies represented 88% of the total number of companies analysed. Moreover, in 2014 two of the companies analysed obtained the maximum value of the disclosure index. Taking into account these aspects, we could conclude that the disclosure index has recorded a positive evolution during 2012-2014, companies disclosing within the financial reports related party transactions and transfer pricing aspects in a medium to large measure. Appendix 1 presents the value of the disclosure index computed for each company from our sample for the period 2012-2014.

Regarding the items disclosed, based on table 5, we could observe that all companies disclosed information about the related parties (e.g. the name of them, their activity, the percentage of ownership) and most of them disclosed the transaction type (e.g. the sales/acquisition of goods, provision of services, contracting of loans) and the transaction value. As could be noted, only fewer companies disclosed the nature of the transactions performed with related parties (e.g. provision of marketing services, sales of building materials), terms and conditions of the transaction and transfer pricing aspects.

**Table 5. The evolution of the percentage of companies regarding the disclosure of related party transactions and transfer pricing aspects per items**

<i>Year</i>	<i>Presentation of the Related Parties</i>	<i>Type of Transaction</i>	<i>Nature of Transaction</i>	<i>Value of Transaction</i>	<i>Terms and Conditions</i>	<i>Transfer Pricing</i>
<b>2012</b>	100%	94%	20%	80%	22%	28%
<b>2013</b>	100%	94%	18%	82%	24%	28%
<b>2014</b>	100%	98%	22%	84%	22%	30%

If disclosure of information related to the type and value of transaction and transfer pricing aspects recorded a positive evolution during 2012-2014, the disclosure regarding the nature of transaction registered a negative evolution in 2013 compared with 2012 and a positive evolution in 2014 compared with 2013. With regards to the terms and conditions of transactions we could observe a slight increase in 2013 compared with 2012, followed in 2014 by a decrease to the percentage recorded in 2012. Regarding the type of terms and conditions presented, most of the companies disclosed information about the payment terms and the loan grant/repayment period. Regarding the disclosure of transfer pricing aspects, the main remarks performed by companies in relation with this subject are about:

- the period of time in which the company was subject to a transfer pricing tax audit;
- the period for which company prepared a transfer pricing file;

- the general obligation of companies to prepare and submit the transfer pricing file upon the request of the tax authorities;
- the possibility that tax authorities perform transfer pricing tax audits in order to check the compliance with the “arm`s length principle”. In this respect, almost all companies made the following statement “*the management believes that company will not incur losses in case of a transfer pricing tax audit. However, the impact of different interpretations of the tax authorities cannot be estimated reliably and this impact could be significant for the financial position and/or activity of the company*”.

Overall, we could conclude that most of the companies disclose general information about the related parties, type of transaction carried out with its related parties and the value of these transactions, while few of them present the nature of the transactions performed, the terms and conditions and aspects with regards to transfer pricing subject. This means that companies which have obtained a value of the disclosure index higher than 0.5 points are those which have disclosed information about the nature of the transactions performed with related parties, terms and conditions or aspects with regards to transfer pricing subject.

#### **4.1 Regression analysis**

In order to identify the measure in which factors like type of auditor, nature of capital, type of related party, size of the company and sector of activity influence the level of the disclosure index we have used a linear regression model. Taking into account that the disclosure index did not register a significant evolution during the period 2012-2014, we performed the regression analysis only for the year 2014. In addition, for the year 2014 compared with 2012 or 2013, our sample contains more companies which carried out transactions with related parties.

In order to perform the correlation analysis we used from SPSS the Summary Model presented in table 6 from below.

**Table 6. Summary Model**

<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>
1	0.710 <sup>a</sup>	0.504	0.453	0.129231644000000

a. Predictors: (Constant), Size, Sector of Activity, Type of Related Party, Type of Auditor, Nature of Capital

Based on the data provided by the Summary Model the correlation coefficient (R) is of 71% which means that there is a direct correlation between the disclosure index and the factors mentioned above. Furthermore, the determination ratio shows that 45.3% of the variance of measure in which companies disclose information about related party transactions and transfer pricing aspects can be explained by the five independent variables (i.e. type of auditor, nature of capital, type of related



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party, size of the company and sector of activity), the difference being explained by other variables.

After we concluded that there is a correlation between the disclosure index and the factors analysed, we proceeded with the check of the validity of the regression model. In this respect, we used the ANOVA Model, presented in table 7 and we applied the “F –test”.

**Table 7. ANOVA<sup>a</sup> Model**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	<b>Regression</b>	.831	5	.166	9.953	.000 <sup>b</sup>
	<b>Residual</b>	.818	49	.017		
	<b>Total</b>	1.649	54			

a. Dependent Variable: DI

b. Predictors: (Constant), Size, Sector of Activity, Type of Related Party, Type of Auditor, Nature of Capital

For the sample analysed, we considered a confidence level of 95% and a significance threshold of 5% (100% - 95%). From the ANOVA table we find that the significance threshold (Sig. = 0.000) is less than 5%. Moreover, the value of the F statistic is of 9.953 > 2.404 (the critical value). Therefore, the regression model is valid and the regression results are not accidental. This means that the impact of the analysed factors (type of auditor, nature of capital, type of related party, size of the company and sector of activity) on the disclosure index is significantly different from the role of chance.

#### 4.2 Results of the regression model

The results of the regression model applied on our sample are presented in table 8 from below.

**Table 8. Results of the regression model<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<b>(Constant)</b>	.469	.037		12.798	.000
<b>Sector of Activity</b>	-.040	.038	-.109	-1.041	.303
<b>Nature of Capital</b>	.082	.042	.237	1.950	.057
<b>Type of Related Party</b>	.101	.045	.274	2.242	.030
<b>Type of Auditor</b>	.095	.039	.273	2.433	.019
<b>Size</b>	-.092	.037	-.263	2.476	.017

a. Dependent Variable: DI

Based on the results of the regression analysis we confirmed or not the research expectations and we identified the impact of each independent variable on the disclosure index. In this respect we applied the “t-test”.

Considering that the t test value of the variables “Type of Auditor”, “Type of Related Party” and “Size” is higher than the t critical value (2.015), and moreover the significance threshold of the variables is lower than 0.05 points, we have confirmed the following expectations:

- *The type of company (Big Four or non-Big Four) which has performed the financial audit influences the information disclosed in relation to the related party transactions and transfer pricing aspects.* More exactly, as we have expected, companies audited by a Big Four disclosed more detailed information in relation to the related party transactions and transfer pricing aspects than companies audited by a non-Big Four. The confirmation of this expectation complies with the results obtained by Corlaciuc and Tiron (2013c).

Moreover, we have noticed that more than 50% of the companies audited by a Big Four disclose information about the nature of the transactions and/or the terms and conditions in which the transactions were performed, while only 6% of the companies audited by a non-Big Four disclose this kind of information. Regarding the disclosure of the transfer pricing aspects, we also noticed that the percentage of the companies audited by a Big Four is higher than that of the companies audited by a non-Big Four. Furthermore, the two companies which obtained the maximum value of the disclosure index in 2014 were audited by a Big Four.

- *Companies which have performed transactions with related parties which are not residents of Romania register a value of the disclosure index higher than that obtained by companies which have performed transactions with related parties which are residents of Romania.* We did not find within the literature reviewed by us a research regarding the influence of the type of the related parties involved in transactions on the disclosure performed by companies in relation to the related party transactions and transfer pricing aspects, and therefore we could not compare our result with the results obtained by other researchers. However, as we already mentioned in this paper, we found opportune to investigate this aspect.

Taking into account that companies which carry out transactions with foreign related parties (especially companies which perform transactions with affiliates situated in tax havens) are more suspicious to manipulate their transfer pricing than the other category of companies, we consider that the confirmation of the expectation mentioned above could represent a good sign for the users of the financial statements. In this respect we consider that

in the case of companies which perform transaction with related parties which are not residents of Romania, the disclosure of detailed information about the transactions performed with their related parties and about transfer pricing aspects could contribute to the increasing of the investor confidence and to the mitigation of the suspicion of transfer pricing manipulation.

Furthermore, the two companies which obtained the maxim value of the disclosure index in 2014 were those which have performed transaction with related parties which are not residents of Romania.

However, we consider that in case of companies which perform transactions with related parties which are not residents of Romania, and not only, the disclosure of detailed information about the transactions performed and about transfer pricing aspects is not useful for sophisticated decision making.

- *Large companies disclose more information about the related party transactions and transfer pricing aspects compared with the small or medium ones.* The confirmation of this expectation complies with the results obtained by Utama (2014).

In addition, taking into account that the t test value of the variables “Nature of Capital” and “Sector of Activity” is lower than the t critical value (2.015) and furthermore, the significance threshold of these two variables is higher than 0.05 points, we have also confirmed the following expectations:

- *The nature of the capital (foreign or local) does not influence the disclosure of the related party transactions and transfer pricing aspects performed by companies.* The confirmation of this expectation complies with the results obtained by Corlaci and Tiron (2013c).

Companies which have a foreign capital could perform transactions either with resident related parties or non-resident related parties. The same affirmation is also valid for the companies which have a local capital. During our research, we noticed that almost all companies which have a foreign capital and performed transactions with non-resident related parties obtained a disclosure index higher than 0.5 points. In addition, most of the companies which have a foreign capital, but carried out transactions with resident related parties obtained a disclosure index equal to 0.5 points. On the other hand, companies which have a local capital and performed transactions with resident related parties obtained a disclosure index equal to or less than 0.5 points. Regarding the companies which have a local capital and performed transactions with non-resident related parties (may be the case in which companies are related parties due to the fact that there is a

third person who owns the both legal persons), obtained a disclosure index higher than 0.5 points.

Given the above, the nature of the capital does not significantly influence the value of the disclosure index, the level of this index being rather influenced by the type of the related party. Therefore, we totally agree that the nature of capital does not have a significant impact on the evolution of the disclosure index and we consider that the impact of the “Nature of Capital” should be analysed together with the impact of the “Type of Related Party”.

- *The company`s sector of activity should not influence the disclosure of related party transactions and transfer pricing aspects performed by companies.* In other words, a company will disclose the same information in relation to the related party transactions and transfer pricing aspects, irrespective it is a manufacturer or a service provider. The confirmation of this expectation complies somehow with the research performed by Utama (2014). However, Utama found that the industry regulations may influence different components of the related party transactions disclosure.

## **5. Conclusions**

Due to the financial scandals occurred in the last 15 years, the related party transactions have begun to be considered „a powerful instrument of financial frauds”. Taking into account this consideration, investors ‘confidence in a company which performs many transactions with its related parties has begun to falter, these transactions being regarded harmful for the financial position of that company. Moreover, in the literature review the related party transactions are regarded as an instrument through companies could distort the true and fair view of the financial statements. A distortion of the fair view of the financial statements could be achieved through the manipulation of transfer pricing. In this context, we have considered that a disclosure of information about the related party transactions and transfer pricing aspects could assist investors in analysing whether there is a risk with regards to the related party transactions and could be a starting point for the increasing of the investors ‘confidence.

Our study shows that during 2012-2014 companies listed on Bucharest Stock Exchange disclosed within the financial reports related party transactions and transfer pricing aspects in a medium to large measure, this meaning that the information disclosed by these companies could contribute to the increasing of the investors ‘confidence. Regarding the information disclosed, most of the companies presented general information about the related parties (e.g. the name of them, their

activity, the percentage of ownership), type of transaction carried out with its related parties (e.g. the sales/acquisition of goods, provision of services, contracting of loans) and the value of these transactions, while few of them presented the nature of the transactions performed (e.g. provision of marketing services, sales of building materials), the terms and conditions and aspects with regards to transfer pricing subject.

Furthermore, our study shows that disclosures made by companies in relation with transfer pricing aspects and related party transactions are influenced by the type of the auditor and the size of the company analysed. In this respect, we have concluded that companies audited by a Big Four and large companies disclose more information compared with companies audited by a non-Big Four entity and small or medium companies. The results obtained by us comply with the results of other researchers.

In addition, our study shows that disclosures made by companies in relation with transfer pricing aspects and related party transactions are influenced by the type of related party involved in transactions, companies which perform transactions with non-resident related parties disclosing more information compared with companies which perform transactions with resident related parties. We did not find within the literature reviewed by us a research regarding the influence of the type of the related parties involved in transactions on the disclosure performed by companies in relation to the related party transactions and transfer pricing aspects, and therefore we could not compare our result with the results obtained by other researchers. Given this, we consider that this results contributes and rich the literature, filling the gap in this domain.

On the other hand, we have concluded that factors like sector of activity and nature of capital (foreign or local) do not significantly influence the disclosure of related party transactions and transfer pricing aspects. Also, these results comply with the results of other researchers.

Taking into account the fact that the disclosure of related party transactions is very important for investors because these transactions have the potential for distorting the financial information, as well the fact that Romania is considered an attractive country for foreign investors, we consider that our study could be useful for both, local or international investors.

A limit of our research is represented by the fact that only 45.3% of the variance of measure in which companies disclose information about related party transactions and transfer pricing aspects could be explained by changes recorded in the independent variables of the research model.

A future research direction might imply the introduction in the regression model of more indicators that could influence the value of the disclosure index (e.g. the number of related party transactions performed). It would also be interesting to use a larger sample of companies and even orientation on other regulated markets such as stock exchange from New York, Tokyo, London or Paris.

With all of these limitations, we consider that our research could improve the existing literature and could provide new insights regarding influencing factors and their actual impact over the disclosure of related party transactions and transfer pricing aspects.

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## Appendix 1

*Value of the disclosure index*

<i>Symbol</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>Symbol</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
<b>ALBZ</b>	0.67	0.67	0.67	<b>SNN</b>	0.50	0.50	0.50
<b>ALR</b>	0.67	0.67	0.67	<b>PEI</b>	0.33	0.33	0.50
<b>ALU</b>	0.83	0.83	0.83	<b>OLT</b>	0.67	0.50	0.50
<b>ARM</b>	0.67	0.67	0.67	<b>PREH</b>	0.50	0.67	0.67
<b>ARS</b>	0.50	0.50	0.50	<b>SNP</b>	0.83	0.83	1.00
<b>ART</b>	0.83	0.83	1.00	<b>RMAH</b>	0.50	0.50	0.50
<b>BCM</b>	0.33	0.33	0.33	<b>RPH</b>	0.50	0.50	0.50
<b>BRM</b>	0.33	0.33	0.33	<b>RTRA</b>	0.83	0.83	0.83
<b>CAOR</b>	0.33	0.33	0.33	<b>SCD</b>	0.83	0.83	0.83
<b>CBC</b>	0.50	0.50	0.50	<b>SCPS</b>	0.83	0.83	0.83
<b>CEON</b>	0.67	0.67	0.67	<b>ROCE</b>	n.a.	n.a.	0.83
<b>CMCM</b>	n.a.	0.50	0.50	<b>SNG</b>	0.50	0.50	0.50
<b>CMF</b>	n.a.	n.a.	0.67	<b>PTR</b>	0.83	0.83	0.83
<b>CMP</b>	0.33	0.33	0.33	<b>RRC</b>	0.67	0.67	0.67
<b>COFI</b>	0.50	0.50	0.50	<b>SNO</b>	0.83	0.83	0.83
<b>COMI</b>	0.67	0.67	0.67	<b>SOCP</b>	0.50	0.50	0.50
<b>COS</b>	0.33	0.33	0.50	<b>SPCU</b>	0.50	0.50	0.50
<b>COTE</b>	0.67	0.67	0.67	<b>STIB</b>	0.83	0.83	0.83
<b>COTR</b>	0.50	0.50	0.50	<b>STZ</b>	0.50	0.50	0.50
<b>DAFR</b>	0.67	0.67	0.67	<b>TRP</b>	0.67	0.67	0.67
<b>EL</b>	0.83	0.83	0.83	<b>UCM</b>	0.50	0.33	0.33
<b>ECT</b>	0.50	0.50	0.50	<b>UZT</b>	0.33	0.33	0.50
<b>ELMA</b>	n.a.	0.67	0.67	<b>VESY</b>	0.50	0.50	0.50
<b>ENP</b>	0.50	0.50	0.50	<b>EFO</b>	0.50	0.50	0.50
<b>EPT</b>	0.50	0.50	0.50	<b>TEL</b>	0.67	0.67	0.67
<b>IMP</b>	0.67	0.50	0.50	<b>TGN</b>	0.67	0.67	0.67
<b>MECE</b>	0.17	0.17	0.17	<b>VNC</b>	n.a.	0.50	0.50
<b>MECF</b>	0.17	0.67	0.67				