Corporate Governance and Compliance
with IFRSs
Corporate Governance and Compliance with IFRSs: MENA Evidence

By

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CAMBRIDGE SCHOLARS
PUBLISHING
Respectfully dedicated to my Dad
All words seem inadequate to thank you.
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Table I.1 Coefficient Estimates and their Significance for Stepwise Regression Excluded Independent Variables
This study examines the influence of corporate governance structures on the levels of compliance with IFRSs disclosure requirements by companies listed on the stock exchanges of two leading MENA countries, Egypt and Jordan. A cross-sectional analysis of a sample of non-financial companies listed on the two stock exchanges for the fiscal year 2007 is employed. Using an unweighted disclosure index, the study measures the levels of compliance by companies listed on the two stock exchanges investigated. Univariate and multivariate regression analyses are used to estimate the relationships proposed in the hypotheses. In addition, the study uses semi-structured interviews in order to supplement the interpretation of the findings of the quantitative analyses. An innovative theoretical foundation is deployed, in which compliance is interpretable through three lenses - institutional isomorphism theory, secrecy versus transparency (one of Gray's accounting sub-cultural values), and financial economics theories. The study extends the financial reporting literature, cross-national comparative financial disclosure literature, and the emerging markets disclosure literature by carrying out one of the first comparative studies of the above mentioned stock exchanges. Results provide evidence of a lack of de facto compliance (i.e., actual compliance) with IFRSs disclosure requirements in the scrutinised MENA countries. The impact of corporate governance mechanisms for best practice on enhancing the extent of compliance with mandatory IFRSs is absent in the stock exchanges in question. The limited impact of corporate governance best practice is mainly attributed to the novelty of corporate governance in the region, a finding which lends support to the applicability of the proposed theoretical foundation to the MENA context. Finally, the study provides recommendations for improving de facto compliance with IFRSs disclosure requirements and corporate governance best practice in the MENA region and suggests areas for future research.
PART I

STUDY BACKGROUND
AND LITERATURE REVIEW
CHAPTER ONE

STUDY BACKGROUND, OBJECTIVES AND STRUCTURE

1.1 Introduction

In a global economy, the financial reporting practices by companies around the world are a key issue. Globalisation of the capital markets has increased the need for high-quality, comparable financial information (Levitt, 1998; Joshi et al., 2008), and consequently, pressure has been increasing for the adoption of a single set of accounting standards worldwide. This explains to a great extent, the efforts of the International Accounting Standards Board (IASB) to produce a set of International Accounting Standards (IASs) for use by private sector entities throughout the world (Levitt, 1998; Al-Shammari et al., 2008; Daske et al., 2008).

The adoption of the International Financial Reporting Standards (IFRSs) by listed companies in many countries around the world is seen as one of the most significant regulatory changes in accounting history (Daske et al., 2008). Proponents of IFRSs suggest that IFRSs adoption improves the reliability and comparability of financial statements, enhances corporate transparency, hence increases market efficiency and encourages cross-border investing (Brown, 2011). For the Middle East and North Africa (MENA) capital markets as emerging economies, compliance with IFRSs may be important in order to attract foreign investors (CIPE, 2003).

One of the main reasons for choosing Egypt and Jordan for this study is that they mandated the adoption of IFRSs by companies listed on their stock exchanges in 1997 (Al-Akra et al., 2010a,b; Samaha and Dahawy, 2011). Consequently, they can be considered as early adopters of IFRSs compared to other countries such as the European Union countries that only required companies listed on their stock exchanges to prepare their financial statements in accordance with IFRSs since 2005 (Joshi et al., 2008; Armstrong et al., 2009). This fact raises the need to investigate the extent of compliance with IFRSs, especially after the introduction of corporate governance requirements for best practices in the MENA region which are supposed to enhance the levels of disclosure and transparency.
Corporate disclosure practices have been a principal research theme in the area of financial accounting research for five decades since Cerf (1961). Beattie (2005) points out that corporate disclosure research accounts for over 25% of all research output published in the field of financial accounting based on a survey of research published over a ten year period. However, the review of prior compliance literature reveals a shortage in the number of financial disclosure studies that have investigated the association between levels of compliance with mandatory disclosures under IFRSs and corporate governance structures, as will be seen in Chapter Two. Consequently, this study will contribute towards filling this gap. Moreover, to the best of the researcher's knowledge, this study is the first to use the institutional isomorphism theory (organisations adopt structures and practices which are considered legitimate and socially acceptable by other organisations in their field irrespective of their actual usefulness) in providing a theoretical foundation for the impact of corporate governance structures on the levels of compliance with IFRSs in the MENA region.

The remaining part of this chapter is organised as follows. Section 1.2 highlights the background and justification for the study, section 1.3 defines the research questions and objectives, section 1.4 describes the research philosophy and methodology, section 1.5 indicates the importance and intended contribution of this study, and finally, section 1.6 presents the structure of the current study.

1.2 Study Background and Justification

The MENA financial reporting environment is seen as a rich area to examine the influence of several corporate governance-related variables on the extent of compliance with IFRSs, for the following reasons.

Firstly, countries in this region have been confronted by a series of changes in their economic environment, followed by extensive efforts to diversify their economies and develop their stock exchanges. For instance, this involved the development of a new legal framework with new financial disclosure requirements being imposed upon companies listed on their stock exchanges such as securities exchange laws and corporate governance codes (CIPE, 2003; Omar, 2007; Dahawy, 2007; Al-Shammari et al., 2008; IFC and Hawkamah, 2008; Al-Akra et al., 2010a,b; Samaha and Dahawy, 2011). Consequently, this stimulates empirical investigation of the outcomes of such reforms given that the reports released by
international institutions claim a *de jure* but not a *de facto* compliance with the requirements of newly developed laws and regulations in the region, that cope with international best practices (e.g., CIPE, 2003; ROSC, 2005; UNCTAD, 2007; IFC and Hawkamah, 2008; ROSC, 2009).

Secondly, the cultural context within the region is characterised by preference for secrecy that is encouraged by low non-compliance costs if any (Abd-Elsalam and Weetman, 2003; Al-Htaybat, 2005; Abdel-salam and Weetman, 2007; Dahawy and Conover, 2007; Al-Shammari et al., 2008; Al-Akra et al., 2009; Al-Omari, 2010; Ismail et al., 2010; Samaha and Dahawy, 2011). Consequently, the growing acceptance of IFRSs by the region's capital markets stimulates an empirical investigation of the extent of *de facto* compliance with the requirements of such standards, as it is acknowledged in the international accounting literature that harmonising national accounting standards with IFRSs would not necessarily lead to harmonised accounting practices and comparable financial reports (Saudagaran, 2004; Nobes, 2006; Dahawy and Samaha, 2010). Research on financial disclosure still reveals the existence of important accounting differences among countries (e.g., Choi et al., 2002; Land and Lang, 2002; Nobes and Parker, 2004; Al-Shammari et al., 2008). Likewise, research on compliance with IFRSs on individual country level reports a lack of complete *de facto* compliance (e.g., Abd-Elsalam and Weetman, 2003; Abdelsalam and Weetman, 2007; Dahawy and Conover, 2007; Samaha and Stapleton, 2008, 2009; Al-Akra et al., 2010a; Alanezi and Albuloushi, 2011).

Thirdly, the pressures from international institutions such as the World Bank (WB), the International Monetary Fund (IMF) and other stakeholders on the governments of developing countries including those in the MENA region, led to mandating the adoption of IFRSs by companies listed on the majority of the MENA region stock exchanges without taking into consideration the necessity of spreading sufficient awareness among different parties affecting and being affected by the financial reporting practices, about the importance of, and the advantages to be gained by following the international best practices. Consequently, there is a need for more research in order to identify the barriers that delay the achievement of complete *de facto* compliance with IFRSs by MENA countries. The same can be said for corporate governance notions, as they are newly introduced in the region and as many corporate governance requirements for best practice may contradict with the native cultural values such as secrecy within the MENA society. Consequently, this may limit its influence on compliance with IFRSs.
The two countries that form the focus of this study (Egypt and Jordan) belong both to the Arab world and to the Middle East classification as well as being part of the MENA region. Both countries were under the UK Protectorate. The Egyptian and the Jordanian stock exchanges were the first to be established in the region (1888 and 1978 respectively). Both countries have strong ties and political importance in the region. Moreover, both countries have similar legal, economic and cultural contexts with minor varying capacities to practise and enforce compliance with IFRSs and corporate governance requirements (CIPE, 2003). In terms of the regulatory framework in these two capital markets, securities exchange laws require that audited financial statements be prepared and submitted to a governmental authority (Capital Market Authority (CMA) in Egypt, and Jordan Securities Commission (JSC) in Jordan). Financial statements of listed companies are audited in accordance with the International Standards of Auditing (ISAs). Enforcement bodies (the CMA in Egypt, and the JSC in Jordan) are in place and non-complying companies may be penalised by delisting according to the Capital Market Law (CML) in Egypt and Securities Law (SL) in Jordan. Both Jordan and Egypt have had firms listed on the International Finance Corporation (IFC) index since late 1970s and 1990s respectively (Ellabbar, 2007). Such institutional and cultural similarities, in addition to the novelty of corporate governance reforms in both jurisdictions may reduce disparities in the influence of corporate governance structures on the levels of compliance with IFRSs by companies listed on the stock exchanges of both jurisdictions. The investigation of the association between compliance with IFRSs and corporate governance structures in two countries that are similar in their economic development stage can best answer the question raised by Dahawy and Samaha (2010) with respect to the possibility of generalising the results of one developing country to others.

Particularly, the choice of these countries' capital markets as the focus of this study is justified for the following reasons:

Firstly, they were early adopters of IFRSs on a mandatory basis in the region (1997), however, evidence provided by prior research reveals a gap between de facto and de jure compliance with IFRSs in both countries (e.g., Abdel-Salam and Weetman, 2007; Dahawy, 2007; Omar, 2007; Samaha and Stapleton, 2008, 2009; Al-Akra et al., 2010a) which are considered as sites of potential extension of European business into MENA markets (CIPE, 2003), making compliance with IFRSs not only a concern for domestic investors but also for foreign ones. This raises the
need to reinvestigate compliance practices in such countries using more recent data.

Secondly, they are good examples of transitional economies that were early adopters of economic restructuring and privatisation programmes in the MENA region since the 1990s to mimic the Western free market economy pattern (CIPE, 2003; Abdelsalam and Weetman, 2007; Omar, 2007; Al-Akra et al., 2009, 2010a,b; Al-Omari, 2010; Dahawy and Samaha, 2010). Furthermore, unlike MENA oil-exporting countries (which includes the Gulf Co-operation Council (GCC) countries), securities markets in Egypt and Jordan were established and revitalised in order to function as the main vehicle for implementing the privatisation programme and to be a source of medium and long-term finance (CIPE, 2003). Consequently, it seems justified to investigate whether such changes enhanced the extent of compliance with IFRSs in scrutinised countries specifically 2007 witnessed an extraordinary economic performance in both of them. Additionally, 2007 was the first year in which all IFRSs except IAS 17: Accounting for Leases became mandatory in Egypt.

Thirdly, the introduction of corporate governance requirements for best practices that are based on corporate governance principles issued by the Organisation for Economic Co-operation and Development (OECD) in both countries as part of the regulatory reform that carried out in parallel with the privatisation programme since the second half of the 1990s (Al-Akra et al., 2009; Samaha, 2010), intended to gain the trust of foreign investors and develop the national capital markets by following international recommended practices which mainly aim at improving transparency and disclosure, enhancing monitoring of management behaviour and protecting investors’ rights (CIPE, 2003; Dahawy, 2009; Al-Akra et al., 2010a; Samaha, 2010). Hence, this raises the need to document the impact of corporate governance mechanisms for best practice on the levels of compliance with IFRSs and explore the applicability of the theoretical foundation proposed in this study to these two emerging capital markets.

The above discussion emphasises the need to conduct this study, being one of the first, to investigate the association between corporate governance best practice as an emerging culture in the MENA region and the levels of compliance with IFRSs in two leading MENA stock exchanges as claimed by international institutions (CIPE, 2003; IFC and Hawkamah, 2008).
1.3 Research Questions and Objectives

The proponents of globalisation of IFRSs among developed and developing countries argue that it will improve the comparability, and hence the usefulness of financial statements for investment decisions (e.g., Daske et al., 2008; Brown, 2011). However, as mentioned already, the introduction of IFRSs in different MENA region countries and the fact that their adoption is mandated is not a guarantee of full compliance with the requirements of such standards. In other words, the mandating of IFRSs adoption in the region does not automatically result in homogeneity between their actual implementation and the standard setters' expectation. This argument implies that de jure compliance (i.e., formal compliance) with IFRSs does not necessarily lead to de facto compliance and de facto compliance may be problematic (Samaha, 2006; Samaha and Stapleton, 2008, 2009). This argument is supported on the grounds that the cultural context in developing countries is unique and the regulatory agencies and professional bodies in those contexts are not as effective as in Western developed countries (Ahmed and Nicholls, 1994; Naser, 1998; Chamisa, 2000; Ball et al., 2003; Ali et al., 2006; Dahawy and Conover, 2007). This raises the need to revisit this issue using recent data in order to assess the progress in the levels of compliance with such imported standards in scrutinised MENA countries. Based on this, the first question and objective of this study are proposed.

Prior research investigating compliance with IFRSs suggests that differences in the levels of compliance among companies reflect their country of origin (Tower et al., 1999; Street and Bryant, 2000; Street and Gray, 2002; Al-Shammari et al., 2008). Although developing countries in general share similar characteristics, they are not homogeneous in terms of their levels of economic, accounting, professional and institutional development (Chamisa, 2000; Chand, 2005; Hassan, 2008; Samaha, 2010). The same argument applies to the selected MENA capital markets. Although, they have similar legal, economic and cultural contexts, they have some differences in terms of each capital market's capacity to practise and enforce compliance with IFRSs and corporate governance principles (CIPE, 2003). Hence, comparing the results between the two exchanges can answer the question whether the results of investigating compliance practices on the level of one developing country can be generalised. On the other hand, although improved disclosure and transparency are the heart of effective governance (Haniffa, 1999; Samaha, 2010; Samaha and Dahawy, 2011), the recognition of corporate governance best practices by the MENA region countries will result in
better compliance with IFRSs only if those practices become part of the cultural values within the scrutinised contexts. Egypt and Jordan regulatory reforms following the commencement of the privatisation programmes in both countries since the mid 1990s support better Board of Directors (BOD)’ monitoring function and investor protection, hence improved disclosure and transparency. Thus, it is important to explore the current influence of corporate governance structures on the levels of compliance with IFRSs disclosure requirements in both countries as leading MENA stock exchanges (CIPE, 2003; Al-Aakra et al., 2010a; Samaha and Dahawy, 2011). Also, given the lack of consensus among researchers regarding the theoretical foundation of financial disclosure practices, and the findings of prior research that investigated Egypt and Jordan which showed that financial disclosure theories fail to explain all financial disclosure practices in such contexts (Abd-Elsalam, 1999; Al-Htaybat, 2005), it is deemed necessary in this study to employ an innovative theoretical framework. This will be a step forward in filling the gap in the theoretical foundation of financial disclosure and corporate governance research particularly on the level of emerging exchanges. Founded on this, the second and third questions and objectives of this study are proposed.

Based on the above, the main research questions are identified as follows:

1. What is the extent of compliance with IFRSs disclosure requirements by companies listed on the two selected stock exchanges?
2. How could differences in the levels of compliance with IFRSs be explained by BOD independence, BOD leadership (i.e., whether the Chief Executive Officer (CEO) and the Chair positions are held by the same person or by two different persons), BOD size and ownership structure?
3. To what extent do institutional isomorphism theory, secrecy versus transparency as one of Gray (1988) accounting sub-cultural values, agency theory and cost-benefit analysis help to explain the levels of compliance with IFRSs disclosure requirements within the MENA context?

Consequently, to answer this study questions and drawing on a comprehensive review of accounting and business environments in the Egyptian and Jordanian contexts, compliance literature and financial disclosure studies
that have investigated these two stock exchanges as well as corporate governance literature, the study objectives can be stated as follows:

Objective 1: To investigate the level of compliance with IFRSs disclosure requirements for the fiscal year 2007 by companies listed on the stock exchanges of the selected two countries in order to evaluate the progress in compliance levels compared to prior research as well as to enable objective comparison of compliance behaviour between the two countries.

Objective 2: To examine the relationship between BOD independence, BOD leadership, BOD size and ownership structure, and levels of compliance with IFRSs by companies listed on the stock exchanges of the selected two countries.

Objective 3: To investigate the underlying theoretical rationale of corporate financial disclosure practices within the MENA context.

1.4 Research Philosophy and Methodology

This study is undertaken within the functionalist research paradigm, the research being based on investigating the current status and establishing the factual existence of structures (Burrell and Morgan, 1979; Hopper and Powell, 1985; Al-Htaybat, 2005). Consequently, levels of compliance with IFRSs by companies listed on the selected MENA region capital markets will be measured in order to define and analyse the extent of such compliance. This step will be followed by examining the relationship between the chosen corporate governance variables (BOD independence, BOD leadership, BOD size and ownership structure) and levels of compliance with IFRSs. The researcher investigates a sample of annual reports of non-financial companies listed on the two selected stock exchanges for the fiscal year ending 31, December 2007. The extent of compliance is measured using a disclosure index based on IFRSs disclosure requirements for 2007. The model of hypotheses explaining the extent of compliance is defined as the interplay of contradictory forces: inducements deriving principally from the institutional isomorphism theory and secrecy versus transparency as one of the accounting values identified by Gray (1988). Furthermore, the notions of two financial

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1 Secrecy versus transparency refers to a preference for confidentiality and a restriction of information about business only to those who are closely involved with its management and financing as opposed to a more transparent open and publicly accountable approach (Gray, 1988).
economics theories; namely, the agency theory\(^2\) and cost-benefit analysis\(^3\) that employed in prior research will be used to some extent, in deriving the research hypotheses. The selected corporate governance variables include proxies for board independence, board leadership, board size, government ownership ratio, management ownership ratio, private ownership ratio, and public ownership ratio. Also, control variables include proxies for company size, profitability, gearing, liquidity, type of business activity, and type of audit firm. Statistical analysis is performed using univariate and multivariate analyses. Furthermore, the study employs semi-structured interviews in order to supplement the interpretations of the findings from the quantitative data analysis and to explore the extent to which the institutional isomorphism, cultural theories, and financial economics theories provide the theoretical foundation of compliance practices within the MENA context. Thus, to accomplish this study's objectives, the researcher employed a sequential explanatory triangulation design, employing both quantitative and qualitative data collection and analysis.

### 1.5 Study Rationale, Significance and Intended Contribution

This study is motivated by a belief that achieving *de facto* compliance with IFRSs by the MENA region listed companies is not an easy task. It is an ongoing process which requires strong support from researchers, capital market authorities, accounting regulators, business firms, accounting practitioners and other stakeholders. Hence, continuous assessment of the levels of compliance with IFRSs is important in order to evaluate the progress in compliance behaviour and diagnose barriers to *de facto* compliance over time. The capital markets investigated in this study have been early mandatory adopters of IFRSs. This implies that companies listed on these capital markets have considerable experience with the use of IFRSs on a mandatory rather than on a voluntary basis. This will add to the compliance literature whereas most prior IFRSs/IASs\(^4\) compliance studies examined developed jurisdictions that apply the IFRSs on a voluntary basis (e.g., Street et al., 1999; Tower et al., 1999; Street and Bryant, 2000; Glaum

\(^2\) Agency theory is a contract under which one or more persons [the principal(s)] delegate another person [the agent] to run the business on their behalf (Jensen and Meckling, 1976).

\(^3\) Cost-benefit analysis is based on the notion that management decision to disclose business information is influenced by the trade-off between the costs and benefits of providing such information (Bhusan and Lessard, 1992; Tricker, 2009).

\(^4\) IASs and IFRSs are used interchangeably in the book.
and Street, 2003). On the other hand, scrutinised countries witnessed a change in the ownership structures of companies listed on their stock exchanges as a result of privatising government owned enterprises. In addition, the Egyptian and the Jordanian governments introduced corporate governance mechanisms that are based on the OECD corporate governance principles as a means to enhance transparency and disclosure, by empowering boards, to enable them to carry out an effective monitoring of management behaviour (Al-Akra et al., 2010a; Samaha, 2010; Samaha and Dahawy, 2010). All of this lends support to carrying out this study in order to investigate the impact of corporate governance mechanisms for best practices on the levels of compliance with IFRSs in scrutinised stock exchanges. At the time of commencing this study, in 2008, it was the first to investigate the association between compliance with IFRSs disclosure requirements and corporate governance structures in the MENA region. However, during the time of this study to the best of the researcher's knowledge there are only two studies investigated this issue in the region; Al-Akra et al. (2010a) and Alanezi and Albuloushi (2011). Al-Akra et al. (2010a) investigate the influence of accounting disclosure regulation, governance reforms and ownership changes, resulting from privatisation, on the levels of compliance with mandatory disclosures under IFRSs in Jordan in 1996 and 2004 respectively. Alanezi and Albuloushi (2011) investigate the impact of the existence of a voluntary audit committee on the level of IFRSs required disclosure practices in Kuwait. This study extends both studies in being comparative as well as being the first to investigate the impact of corporate governance structures on the levels of compliance with IFRSs disclosure requirements in Egypt. On the other hand, although there is a number of prior studies that investigate the levels of compliance with IFRSs in the Egyptian context (Abd-Elsalam, 1999; Abd-Elsalam and Weetman, 2003; Samaha, 2006; Abdelsalam and Weetman, 2007; Dahawy and Conover, 2007; Samaha and Stapleton, 2008, 2009; Dahawy, 2009; Ismail et al., 2010), none of them has investigated such issue using a disclosure index that is based on the mandatory IFRSs disclosure requirements for 2007. The same argument applies to Jordan as IFRSs were amended between 2004 (the recent year for Al-Akra et al. (2010a) study) and 2007 (the year of this study). In addition, compared to Al-Akra et al. (2010a) and Alanezi and Albuloushi (2011) studies, this study is the first to investigate the association between board leadership and management ownership ratio, and the extent of compliance with IFRSs disclosure requirements in the MENA region. Furthermore, this study is one of the first comparative studies to investigate the influence of corporate governance structures on de facto compliance with IFRSs
between two leading MENA emerging capital markets using a disclosure checklist that is organised by standard. This enables objective comparison between levels of compliance with disclosure requirements in total as well as per standard. Hence, enables identification of the requirements whereas compliance is problematic in each jurisdiction. On the other hand, comparing the results between scrutinised countries will enable getting a conclusion with respect to whether MENA developing countries are homogeneous. Finally, this study provides recent evidence on the theoretical foundation of financial disclosure practices in the MENA region in addition to being the first to employ the notions of the institutional isomorphism theory in explaining the influence of corporate governance structures on the levels of compliance with IFRSs disclosure requirements in the MENA countries being studied. In addition, this study provides an overview regarding the perceptions of different parties involved in the financial reporting process in Egypt and Jordan regarding the barriers to full compliance with IFRSs and the impact of corporate governance structures on compliance behaviour of publicly listed companies.

In broad terms, the findings of this study will be of interest to the national as well as the international community, and particularly stakeholders of the MENA region capital markets who are keen to know the strengths and weaknesses in disclosure practices in the region's capital markets. The findings of this study are not only of importance for current and potential investors but will also provide regulators and policy-makers in Egypt and Jordan with recent comprehensive evidence that is expected to enhance their knowledge of the status of their capital markets. This will help them to develop new approaches to overcome weaknesses and strengthen enforcement mechanisms in order to improve financial disclosure practices within their markets, and meet international best practices. Moreover, this study will stimulate more research regarding the issues under investigation in other countries.

With respect to the IASB, the findings of this study will provide a recent evidence regarding the levels of *de facto* compliance with disclosure requirements of IFRSs by two leading emerging capital markets in the MENA region that adopt IFRSs on mandatory basis. The same argument applies to the OECD as a sponsor of corporate governance reforms in scrutinised countries. The findings of this study will provide recent evidence regarding the extent to which the requirements for corporate governance best practices in Egypt and Jordan that are based on the OECD corporate governance principles enhance compliance with IFRSs disclosure requirements.
1.6 Study Structure

Figure 1.1 indicates the general structure of the chapters in this book.

Chapter One: This chapter presents the study background and justification. It highlights how this study will fill the theoretical and empirical gaps in prior literature. In addition, the chapter identifies the study's objectives and the research questions, and gives an indication of the methodology employed, the rationale for the research, and its perceived importance and contribution.

Figure 1.1 Study Structure

Chapter Two: Chapter Two provides an overview of financial disclosure practices, discussing the concept of financial disclosure, disclosure scope, the relationship between mandatory and voluntary disclosure, and how disclosure practices are explained in light of relevant theories. It highlights
the issue of compliance with IFRSs, and then provides a review of prior empirical financial disclosure studies that investigated the influence of different corporate attributes on aggregate, mandatory and voluntary disclosure. This review identifies the gaps in prior research that this study intends to fill.

Chapter Three: The third chapter discusses the concept of corporate governance, its importance, and various models associated with it. Additionally, it sheds light on the role of the OECD in raising awareness about the importance of corporate governance and the relevance of the OECD corporate governance principles to the MENA region capital markets. It then addresses the corporate governance variables that are employed as explanatory variables in this study namely, board independence, board leadership, board size and ownership structure.

Chapter Four: Chapter Four provides a general background about the scrutinised MENA region capital markets and their financial disclosure environments indicating capital market development and the financial disclosure regulatory framework in each. In addition, the chapter sheds light on the recent developments in the financial reporting environment which make the selected MENA countries a suitable context for the current study.

Chapter Five: The fifth chapter explains the research philosophy and methodology, how the levels of compliance with IFRSs disclosure requirements are to be assessed, how the disclosure index is constructed, the research samples, research hypotheses and a description of the statistical analyses chosen to analyse the data in the subsequent chapters.

Chapter Six: This chapter presents the descriptive analyses of the levels of compliance with IFRSs by all non-financial companies listed on the selected MENA region stock exchanges. The mean, standard deviation, minimum and maximum values are used to interpret the levels of compliance with IFRSs within each country and between them. Additionally, descriptive statistics of independent variables are presented. The second part in this chapter investigates whether there are significant statistical differences between the Egyptian and the Jordanian contexts. In addition, the variations in the levels of compliance with IFRSs disclosure requirements in 2007 are explained by using corporate governance-related variables through univariate and multivariate statistical analyses.

Chapter Seven: This chapter presents a summary and analysis of the findings of the interview data.

Chapter Eight: This chapter summarises the overall findings, and implications thereof, and concludes the study. The limitations of the study are addressed, and recommendations for future research proposed.
CHAPTER TWO

FINANCIAL DISCLOSURE PRACTICES: AN OVERVIEW

2.1 Introduction

The need for compliance with one set of accounting standards, namely the IFRSs, is increasing day by day as many groups worldwide such as multinational companies, international investors, governments, regulating bodies and capital markets, all recognise that they will benefit from the globalisation of accounting practices (Basoglu and Goma, 2002; Brown, 2011). However, *de jure* compliance is not a guarantee for achieving *de facto* compliance, and a need exists for more research in this area, particularly within the context of emerging capital markets in order to diagnose those factors that influence the levels of *de facto* compliance with IFRSs. This chapter provides a general overview of financial disclosure practices, and is organised as follows. Section 2.2 presents the concept of financial disclosure, disclosure scope and the relationship between mandatory and voluntary disclosure. Section 2.3 discusses the theoretical framework of financial disclosure and how disclosure practices are explained in light of the theoretical foundation employed in this study (the institutional isomorphism theory, secrecy versus transparency as one of Gray (1988) accounting sub-cultural values, and two financial economics theories: the agency theory and cost-benefit analysis). The issue of compliance with IFRSs is highlighted in Section 2.4. Section 2.5 provides a review of prior empirical financial disclosure studies that investigate the influence of corporate attributes on aggregate, mandatory and voluntary disclosure. These studies are classified as developed capital market studies, emerging capital market studies, and cross-national comparative studies. The review of such studies is essential to identify the appearing gaps and the position of the current study among prior ones. Additionally, it provides a background that will help in formulating the research hypotheses in Chapter Five as well as in understanding and explaining the findings of the empirical analysis that appear in Chapter Six. Finally, section 2.6 concludes.
2.2 Corporate Financial Disclosure

Companies' annual reports are considered as the primary regular official medium in which listed companies communicate their audited financial information to the public and other stakeholders specifically in emerging capital markets (Marston and Shrives, 1991; Yeoh, 2005; Naser et al., 2006; Al-Razeen and Karbhari, 2007). Financial disclosure influences the actions of different decision-makers by providing them with the information they need to make rational economic decisions (Solomons, 1986; Haniffa, 1999; Al-Hajraf, 2002; Al-Htaybat, 2005; Atrill and McLaney, 2008).

Gibbins et al. (1990, p.122) refer to financial disclosure as "any deliberate release of financial information, whether numerical or qualitative, required or voluntary, or via formal or informal channels". Also, Hendriksen and Van-Breda (1992, p.851) highlight the importance of financial disclosure by stating that "disclosure in financial reporting is the presentation of information necessary for the optimum operations of efficient capital market".

In general, corporate financial disclosure can be referred to as either mandatory (required by laws, regulations and/or formal authorities such as stock exchange regulatory bodies) or voluntary, that is additional (optional) disclosures motivated by management attitude. Akhtaruddin (2005, p.404) refers to mandatory disclosure as "the presentation of a minimum amount of information required by laws, stock exchanges, and the accounting standards setting body to facilitate evaluation of securities", while voluntary disclosure is defined by Meek et al. (1995, p.555) as "disclosures in excess of requirements, representing free choices on the part of a company's management to provide accounting and other information deemed relevant to the decision needs of users of the annual reports".

According to proponents of mandatory disclosure, mandating disclosure can be seen as a tool that enforces companies to disclose the information that they otherwise would be reluctant to disclose (Darrough, 1993). This argument applies more to developing capital markets (Al-Htaybat, 2005; Yeoh, 2005), and possibly be due to the cultural values in the majority of developing societies which prefer secrecy and which are not accustomed to voluntary codes (soft laws) (Dahawy, 2007; Al-Omari, 2010).

The regulatory system affects financial disclosure practices through the development of regulations (e.g., CML in Egypt and SL in Jordan), and is expected to result in better investor and creditor protection (Jaggi and
Low, 2000). Regulations help to reduce information asymmetry between informed (e.g., management), and uninformed users such as naive (i.e., non-professional) investors (Healy and Palepu, 2001) as listed companies may prefer to comply with such regulations to avoid paying fines, delisting or even to protect their reputation and gain legitimacy. Thus, regulatory bodies should sort out the disclosure incentives of firms in order to promote efficient disclosure policies (Darrough, 1993). This action is more required in developing countries where there is a possibility of non-compliance with mandatory disclosure requirements due to inadequate regulatory frameworks, weak enforcement mechanisms, ineffectiveness of the capital market, and inefficiency of the accounting profession (Ahmed and Nicholls, 1994; Abd-Elsalam and Weetman, 2003). Furthermore, it is important to spread awareness among different parties that are involved in the financial reporting process concerning the benefits of improving disclosure. This is especially important in developing societies where a transparency culture contradicts with their native culture of secrecy (Gray, 1988). The effective enforcement of mandatory disclosure requirements can also be achieved by independent and expert auditing, and an oversight regulatory system with sufficient power and expertise to achieve effective enforcement (Brown and Tarca, 2005; Owusu-Ansah and Yeoh, 2005).

2.3 Theoretical Framework of Financial Disclosure

Many scholars suggest that disclosure is influenced by the political and socio-economic environment within the country (e.g., Archambault and Archambault, 2003; HassabElnaby et al., 2003; HassabElnaby and Mosebach, 2005; Nobes, 2006; Qu and Leung, 2006; Dahawy, 2007; Ben Othman and Zeghal, 2008, 2010; Mir et al., 2009; Al-Akra et al., 2009, 2010a,b; Al-Omari, 2010; Samaha and Dahawy, 2010). To date there is no single theory that can comprehensively interpret or predict corporate financial disclosure practices (Verrecchia, 2001; Al-Htaybat, 2005), a circumstance which may be attributed to the complexity of this issue (Hope, 2003; Al-Htaybat, 2005). Managers' incentives may differ from one company to another due to the differences in company characteristics as claimed by prior studies (e.g., Haniffa and Cooke, 2002; Abd-Elsalam and Weetman, 2003; Al-Htaybat, 2005; Omar, 2007; Samaha and Stapleton, 2009). Each theory tries to interpret the reasons behind management financial disclosure practices which are influenced to a great extent by the trade-off between the costs and benefits of providing such information (Cooke, 1992; Haniffa and Cooke, 2002; Al-Htaybat, 2005).
Further to the theories that are employed as part of the theoretical foundation in this study, there are many other theories that used to explain financial disclosure practices by prior researchers (e.g., Cooke, 1992; Abayo et al., 1993; Inchausti, 1997; Suwaidan, 1997; Abd-Elsalam, 1999; Haniffa and Cooke, 2002; Abd-Elsalam and Weetman, 2003; Al-Htaybat, 2005; Samaha, 2006; Omar, 2007; Samaha and Stapleton, 2009). The most commonly used are signaling theory, capital need theory, political costs theory, legitimacy theory, resource dependency theory, stewardship theory and stakeholder theory.

Signaling theory has been developed to explain problems of information asymmetry in labour markets and how this can be reduced by the party with more information signaling to others (Morris, 1987; Abd-Elsalam, 1999; Haniffa, 1999). Thus, to reduce signaling costs managers will disclose all information that is material to investors (Ross, 1979; Haniffa, 1999). Consequently, managers with good news will disclose more to signal company success, thereby increasing the value of the firm's stocks (Verrecchia, 1983; Kasznik and Lev, 1995; Abd-Elsalam, 1999; Haniffa, 1999). On the other hand, managers with no news will signal this by stressing on the stability of the company performance to avoid being confused with firms with bad news (Ross, 1979; Haniffa, 1999; Vlachos, 2001). Even managers with bad news will effectively signal this to avoid legal disputes (Ross, 1979; Okcabol and Tinker, 1993; Vlachos, 2001). However, signaling theory is criticized on the grounds that it does not explain certain management disclosure practices such as window dressing to opaque bad news (Seligman, 1983; Okcabol and Tinker, 1993; Vlachos, 2001). Furthermore, Okcabol and Tinker (1993) argue that it does not take into consideration that non-disclosure does not necessarily imply bad news or hiding of poor performance as it may be to protect valuable information from competitors.

The capital need theory is based on the assumption that disclosure reduces investor uncertainty and risk, consequently required rates of return will be reduced. This in turn, results in a lower cost of capital. Thus companies can raise capital at the lowest possible cost by making disclosures that will reduce information asymmetry. This will enhance the company's image and reputation in the eyes of potential investors (Mueller et al., 1987; Gray and Roberts, 1998; Diamond and Verrecchia, 1991; Haniffa, 1999; Omar, 2007). However, capital need theory is criticized on the grounds that finding a link between disclosure level and the cost of equity capital is difficult since both variables cannot be observed directly (Hall, 2002).