

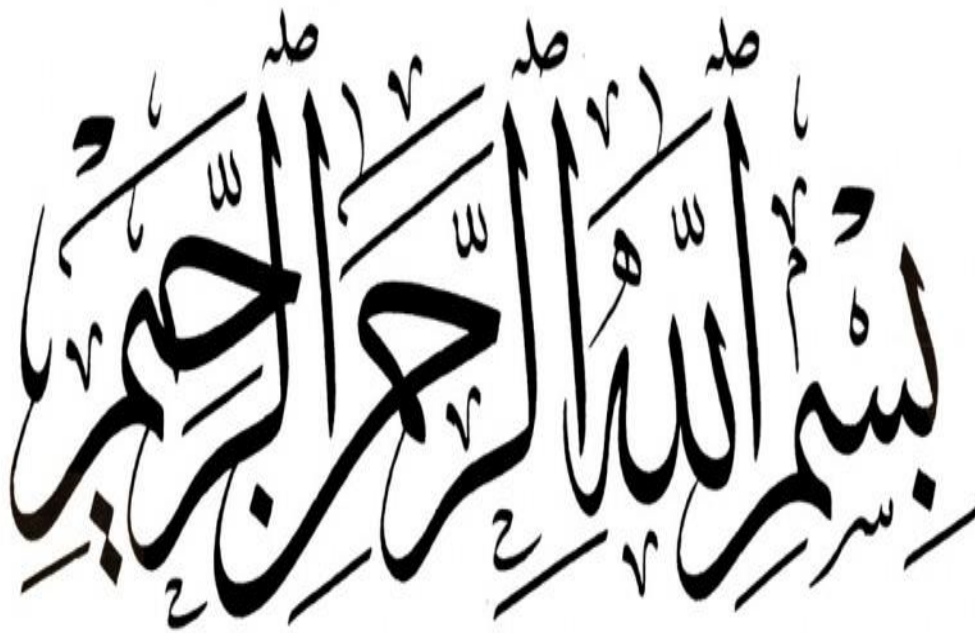
# ***The Determinants and Consequences of Risk Disclosure in Saudi Banks***

A thesis submitted to the University of Gloucestershire in accordance  
with the requirements of the degree of Doctor of Philosophy in the  
School of Business

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2016



***“In the name of Allah (God), the Most Gracious, the Most Compassionate”***

## Declaration

I declare that the work in this thesis was carried out in accordance with the regulations of the University of Gloucestershire and is original except where indicated by specific reference in the text. No part of the thesis has been submitted as part of any other academic award. The thesis has not been presented to any other education institution in the United Kingdom or overseas.

Any views expressed in the thesis are those of the author and in no way represent those of the University.

Signed ..... Date .....

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## Abstract

**Purpose-** The aim of this research is to address the current gap in the disclosure literature by investigating risk disclosure in a developing economy (Saudi Arabia). The current study aims to widen the understanding of risk disclosure levels, determinants and economic consequences, by firstly examining the levels of risk disclosure in the annual reports of both Islamic and non-Islamic listed banks, secondly by empirically exploring corporate governance and the demographic traits of top management teams as the determinants of voluntary risk disclosure practices in and thirdly by investigating whether the levels of voluntary risk disclosure in Saudi listed banks are value-relevant or not.

**Design/Methodology/Approach-** The sample consists of all banks listed on *Tadawul*. All data was collected from the annual reports of the sample banks from 2009 to 2013 using manual content analysis. Other variables were collected using DataStream and Bloomberg. This study develops two holistic risk disclosure indices to measure the levels of risk disclosure in both Islamic and non-Islamic banks. It also uses ordinary least squares regressions analysis to examine the effect of a combination of determinants stemming from corporate governance and demographic traits on risk disclosure. Ordinary least squares regressions analysis is also used in determining whether the levels of voluntary risk disclosure in Saudi listed banks are value-relevant or not.

**Results-** The first empirical analysis shows that Islamic banks report less risk information than non-Islamic banks. However, the analysis also reveals that both Islamic and non-Islamic banks report relatively the same amount of risk information regarding the banks' non-Islamic risk-related items. The second empirical analysis shows that Islamic banks report very low levels concerning Islamic risk-related items. It also shows that external ownership, audit committee meetings, gender diversity, education levels and profitability are primary determinants of risk disclosure practices in Saudi listed banks. Thirdly findings also exhibit that there is no association between the levels of voluntary risk disclosure and firm value as measured by the market to book value (MTBV). But, the results generated from the accounting based measure (ROA) show that there is a positively significant association between the levels of voluntary risk disclosure and firm value.

**Potential Contributions-** This study contributes to the literature on general accounting disclosure and in particular advances and contributes to the literature on risk disclosure in developing economies. It also contributes to the understanding of the role of accounting information in relation to the levels, determinants and market valuation of a firm. Specifically, this study is significant in that it sheds light on the voluntary risk-disclosing practices of banks that operate in an environment that is often considered to be opaque. This investigation makes major contributions to the literature and increases the knowledge on risk disclosure and reporting practices in the annual reports of all listed Saudi banks, namely Islamic and non-Islamic banks. It makes a healthy contribution to the discussion on the levels, determinants, economic consequences and risk disclosure in banks annual reports. To the best of the researchers' knowledge, no prior research has been conducted on the levels or the determinants voluntary of risk disclosure in Saudi Arabia. Also no prior research has been conducted on the relationship between firm value and levels of risk disclosure in general or in emerging markets. Therefore, this is the first study to investigate the levels, determinants and economic consequences of risk disclosure in this context. This study has also pioneered a novel contribution to the field of disclosure by incorporating the upper echelons theory into investigating disclosure. Particularly in this study this theory is extended into exploring the determinants of voluntary risk disclosure.

**Implications-** The reported results should be useful to accounting and regulatory bodies by providing information about the inadequacies of risk reporting in Saudi banking sector. Regulatory institutions should be above all concerned about the disclosure needs of users. Therefore, SAMA, SOCPA and CMA are called upon to find solutions to improve the reporting of risk information in the Saudi banking industry. The study also provides information for managers to keep investors satisfied about the risk that their banks encounter. Investors may use the findings for understanding risk disclosure behaviour of listed banks. It also informs regulators and investors about the importance and current levels of risk disclosure in all Saudi listed banks as well as informing them of the influence voluntary risk disclosure has on the value of the firm. It also calls upon managers who prefer to withhold from offering information to shareholder to be more transparent if they prefer to increase their banks market value and entice more investment. This can be used to increase the value relevance in the banking sector.

**Keywords-** Saudi Arabia, Banks, Risk Disclosure, Upper Echelons Theory, Board Demography, Firm Value

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## **DEDICATION**

*This thesis is dedicated to my entire family. Thank you  
all for your love, patience, sacrifice and support*

## Glossary of Abbreviations

<i><b>Symbol</b></i>	<i><b>Name of Item</b></i>
CMA	Saudi Capital Market Authority
CRD	Corporate Risk Disclosure
CG	Corporate Governance
CRD	Corporate Risk Disclosure
SOCPA	The Saudi Organization for Certified Public Accountants
CGRs	Corporate Governance Regulations
Tadawul	The Saudi Stock Exchange
SAMA	Saudi Monetary Agency
GCC	Gulf Cooperation council
SCGC	Saudi Corporate Governance Code
R&D	Research and Development
OPEC	Organisation of the petroleum Exporting Countries
AMF	Arab Monetary Fund
GDP	Gross Domestic Product
WTO	World Trade Organisation
Sunnah	Teachings of the Prophet Mohammed (PBUH)
Shariah	Islamic Jurisdictions
IFRS	International Financial Reporting Standards
MCI	The Ministry of Commerce and Industry
CPA	Certified Public Accountant
CPE	Continuing Professional Education
FSAP	Financial Sector Assessment Program
ISA	International Standards of Auditing
SCGI	The Saudi Corporate Governance Index
ICAAP	Internal Capital Adequacy Assessment Process
ASB	Accounting Standards Board
ICAEW	The Institute of Chartered Accountants in England and Wales
AAIOFI	Accounting and Auditing Organisation for Islamic Financial Institutions
IFSB	Islamic Financial Services Board

## Conferences and Publications

Paper Title	Conference Name	Journal Name	Submission Date	Status
The Determinants and Consequences of Risk Disclosure in Saudi Listed Banks	Financial Reporting and Business Communication Conference (Bristol University)		02/03/2015	Accepted
The Levels of Risk Disclosure in Listed Banks: Evidence from Saudi Arabia		Corporate Ownership and Control	21/11/2015	Accepted for Publication <i>Vol 13, 2 continued</i>
Corporate Governance and Risk Disclosure: Evidence from Saudi Arabia		Corporate Ownership and Control	15/12/2015	Accepted for Publication <i>Vol 13, 2</i>
Value Relevance of Risk Disclosure: Evidence from Saudi Arabia		Accounting and Taxation	19/01/2016	Accepted for Publication, <i>Spring Issue</i>
Value Relevance of Risk Disclosure: Evidence from Saudi Arabia	The 14th BAFA Special Interest Group Workshop on Accounting and Finance in Emerging Economies (Nottingham University)		27/11/2015	Accepted
Corporate Governance and Risk Disclosure: Evidence from Saudi Arabia	2015 IAABR USA		21/10/2015	Accepted
Corporate Governance and Risk Disclosure: Evidence from Saudi Arabia	International Academic Business conference USA		12/10/2015	Accepted

# 1 Chapter one: Introduction

This chapter discusses the overall structure of this investigation, including the research motivations, research objectives, research questions, Saudi context, importance of the study, contributions of the study, empirical findings and thesis structure

## 1.1 Overview

Over the past few decades, the corporate world has evidenced considerable changes fundamentally driven by changes in society, technology and global politics (Rajab, 2009). For instance, increased global activities of capital and product, development of new country's regulations and with the rapid development of new industries and markets legal systems have become more complicated and competitive, as well as, the increased volatility on a global scale has radically influenced the credit markets (Deumes, 2008). For instance, financial products and services along with corporate changes and structures have even become more complicated. Moreover, the augmented economic and political uncertainty through the entire world has developed major corporate concerns. The sudden failures of some of the world largest organisations such as Lehman Brothers, Northern Rock and Enron to name few have worsened what are already deteriorating and difficult economic conditions globally and have traumatised the confidence of regulatory bodies, investors and all interested groups (Guest 2009; Al-Bassam, 2014; Habbash et al., 2016).

Accordingly, public calls and demands for corporate institutions to make even larger disclosure of business information of a particular relevance to risks and uncertainties have skyrocketed (Beltratti and Stulz, 2012).

Therefore, corporate risk reporting has earned substantial attention resulting in a tremendous increase of examinations of international accounting disclosures. However, majority of the mainstream literature believes that there is limited risk information disclosures provided in firms' annual reports (Schrand and Elliot, 1998, ICAEW, 1997; 1999; Lajili and Zeghal, 2005; Linsley and Shrives, 2006; Abraham and Cox, 2007). Hence, there is a substantial demand for more relevant information in annual reports from various user groups in order to better enable them assess the risk profile of a firm and make informed decisions (Solomon et al., 2000; ICAEW, 2002; Linsley and Shrives, 2005). This augmentation in all interested user groups' calls for more information has inspired an ample discussion on the topic by governing and regulatory bodies, as well as earning an essential part in the contemporary accounting literature. Various proposals have been put forward by professional bodies aiming at the enhancement of corporate reporting have called for additional related risk information disclosures in firms' annual reports (ICAEW, 2002; ASB, 2003, 2006).

The catastrophic corporate failures worldwide have supported this argument where regulatory institutions had to reconsider the basis of corporate regulations due to the global financial crisis. Beltratti and Stulz, (2012); Erkens et al., (2012) argued that this event had resulted in momentous concerns regarding risk disclosures. Due to this catastrophic corporate failure investors and stakeholders' attention has been drawn to the importance of risk reporting (Linsley et al., 2008). These concern are coherent with the arguments put forward by Meier et al., (1995); Schrand and Elliot,



(1998); Beretta and Bozzolan, (2004); Cabedo and Tirado, (2004); Ahmed et al., (2004); Linsley, et al., (2006); Linsley and Shrides, (2006); Abraham and Cox, (2007); Linsley and Lawrence, (2007); Hassan (2009) which is that risk disclosure is a pivotal element to business risks, where reporting offers a greater transparency and enhances investors' confidence. As evident the global crisis also resulted in a deceleration of the global economy and the demand increased for more risk reporting, which had led to a number of regulatory reforms for example the birth of the International Financial Reporting Standard 7 Financial Instruments and BASEL II which includes greater measures on risk transparency and disclosure. It also underlines the significance of informative risk disclosure in the banking industry for the overall enhancement of market discipline. The disclosure of informative risk information in banks has been underlined as a successful instrument for eluding banking catastrophes (Financial Stability Board, 2012).

Over the years a number of theories have been developed in the accounting literature to explicate the general phenomena of disclosure and the variation of disclosure among firms. For instance such theories include information asymmetry theory (Akerlof, 1970), signalling theory (Spence, 1973), agency theory (Jensen and Meckling, 1976), legitimacy theory (Carpenter and Feroz, 1992) and Stakeholder theory (Freeman, 1994). Based on these theories, previous investigation such as Healy and Palepu, (2001); Linsley and Shrides, (2005); Lajili and Zeghal (2005); Marshall and Weetman, (2007); Kothari, Li and Short, (2009); Hussainey and Walker, (2009); Elzahar and Hussainey, (2012); Allegrini and Greco, (2013); Nekhili et al., (2015); Allini et al., (2016) have used them in the provision of explaining different factors influencing disclosure and disclosure variations among firms.

It also has been established that corporations' disclosures about risk and methods on how such risks are identified, managed, analysed and evaluated would support investors and users of corporate annual reports to understand profiles of risk of firms and enables them to form precise valuations of corporations financial conditions and performance (Cabedo and Tirado, 2004; Solomon et al., 2000). Therefore, institutions would realise and reap the benefits of being of high transparency. For instance, augmented disclosure decreases information asymmetry and uncertainty (between internal management and external shareholders), thus positively effecting the market valuation of the firm (Clarkson et al., 1996; Healy and Palepu, 1993; Hassan et al., 2009). Also confident and informed shareholders are a fundamental element in attaining and maintaining a precise assessment of a firm's stock (Deumes, 2008). Disclosure as a whole is also of great importance of the well-being and functioning of capital markets and to a larger extent for the stability of the economy (Akerlof, 1970).

The current study examines the literature on corporate disclosure, risk disclosure and further extends it by undertaking empirical investigations into the corporate voluntary risk disclosure of all Saudi listed banks. The purpose of this is to obtain insights into the amount, type and nature of risk information reported by banks in their annual reports. The current study examines the current risk disclosure practices and variations over a five-year timespan. Moreover, the link between risk disclosure levels and corporate governance and demographic attributes is examined. Additionally, the current study examines the effect of risk disclosure on the market valuation of banks.

This study focused on the banking industry since banks have a fundamental role to play in the businesses and economics of the Kingdom of Saudi Arabia. Also the

banking industry is a vastly confronted industry by risk. Furthermore, this industry is established upon trust hence, the banking industry is heavily regulated. In addition, shareholders and all other interested groups will lose confidence if a bank offers a bad impression. An example of this situation would be the Northern Rock bank which gave a bad impression when they have declared miss-calculations and their insolvency leading to a loss of confidence among the market participants. Moreover, banks main concern should be to maintain the loyalty and trust of their customers and shareholders, accordingly disclosure is a fundamental aspect of the banking industry stability. It is important to note that the disclosure of banks ought to be examined independently from other sectors (Linsley and Shrives, 2006; Barakat and Hussainey, 2013).

In the following sections of this chapter, motivations of the research are provided followed by a discussion of the aims and objectives. This is followed by a Saudi focus section. This is then followed by the importance of the research then a summary of the main contributions of the study. Finally, the structure of the thesis is outlined.

## **1.2 Research Motivations**

The area of financial risk reporting has been of great importance to accounting investigators as a consequence of the contemporary discussion and requirements of it. A wide variety of investigations have examined this area, but the focus of such investigations significantly differs. A strand of prior researches have only investigated quantity of risk reporting in annual statements and concentrated on certain categories of risk (Linsley et al., 2006; Dunne et al., 2007; Deumes and Knechel, 2008; Amran et al., 2009; Hassan 2009). While others strands of previous researches have attempted a more complete examination of risk information and

studied risk disclosure practices in annual reports (Dobler et al., 2011; Elshandidy et al., 2013) and in prospectus and interim reports (Papa, 2007; Deumes, 2008; Elzahar and Hussainey, 2012). Empirical investigations which have examined risk information in this wider perspective still remain limited. For instance, Lajili and Zeghal (2005) explored risk disclosure in annual reports without examining the potential determinants of risk disclosure. Whereas Linsley and Shrives (2005) and Rajab and Schachler (2009) examined risk disclosure reporting in non-financial UK firms. They only examined size, industry leverage and listing status and other determinants are not examined particularly corporate governance and demographic attributes. However, researches which have investigated risk disclosure determinants have yield varies results (i.e. Nitm et al 2013; Elshandidy et al., 2015; Elshandidy and Neri, 2015; Allini et al., 2016).

Prior and present disclosure literature has explored the motives and factors, which could influence the degree of the disclosed information made by corporations and to what extent do such factors influence the choices of disclosing certain information. Whereas a strand of other literature have looked at what risk information is reported however more examinations are required to investigate what risk information is reported, what are the motivates of such disclosures and explore the potential consequences of risk information e.g. the impact of risk disclosure on firm value. The empirical literature offers a limited answer about the practices of risk disclosure, its determinants and consequences. Also, there are no investigations on the potential influences of the levels of risk reporting on firm value. The current study therefore fills this gap.

It has also been debated by previous literature that there is an inadequate amount of examinations on corporate risk disclosures in general and in the banking industry in

particular (Beasley et al., 2005; Lajili, 2009; Farag et al., 2014). Yet, this scarcity of examination is even greater in emerging economies, as all of the risk disclosure investigations are restricted to the developed world e.g. German, Dutch and Anglo-Saxon countries (Linsley, et al., 2006; Lajili, 2009; Elshandidy et al., 2013), Europe and Latin America are led by (Madrigal et al., 2012; Miihkinen, 2013; Maffei et al., 2014). Notwithstanding the work of Amran, et al., (2009), Mokhtar and Mellett (2013), Elkelish and Hassan (2014), and Hassan (2009; 2014) very little attention has been given to the risk reporting practices of publicly listed companies in emerging economies.

Therefore, little is known about the corporate risk disclosure in the Arab world in general and the GCC states in particular, except Hassan (2009); Al-Shammari, (2014) who investigated the determinants of the risk disclosure in the UAE and Kuwait respectively. The focus of this study is Saudi Arabia in particular since risk disclosure has never been examined within the world's largest rapidly growing emerging market; also Saudi Arabia constitutes 25% of the Arab world GDP and 44% of the total Arab stock market capitalization. Therefore, risk disclosure is worthy of investigation in such environment (Alshehri and Solomon 2012; Albasaam, 2014).

This literature gap needs to be filled mainly when the examination is on the responses of firms to enhancing the quantity and quality of information reported in annual financial reports, not only concerning their compliance with rules and regulations, but also in meeting the requirements of various interested user groups. To this end, it is hoped that the current investigation will answer the various calls and demands made for enhancing risk disclosure.

It has also been argued that in order to stabilise the banking industry, transparency of firm performance is critical. Ntim, et al., (2011) claimed that the global financial crisis in 2008 was triggered by low level of risk management capability in banks and a lack of transparency in reporting their performance in their annual reports.

Al-Sahafi et al., (2015) affirmed that poor corporate governance in the banking industry played a key part in the financial crises. According to Alghamdi (2012) the stock failure in the Saudi Stock Market uncovered a number of serious weaknesses not only in the level of compliance of Saudi banks with the corporate governance regulations (CGRs) but the absence of disclosure, transparency and accountability which have a substantial impact on banks stability, market valuation and severely limits risk information disclosure. Al-Turki, (2006) reported in his research that mostly all Saudi Arabian corporations including banks have poor corporate governance practices. The current study links voluntary risk disclosure in relation to a number of corporate governance determinants to examine whether the levels of voluntary risk disclosure are affected by corporate governance or not.

Moreover, investigations of this kind in Saudi Arabia and in the emerging world are scarce (Barth et al., 2001). Even if there are numerous investigations on various aspects of corporate governance in the developed world (Abraham and Cox, 2007; Ntim et al., 2013; Ntim, Lindop and Thomas, 2013; Elshandidy and Neri, 2015) the outcomes of such investigations still cannot be generalized to emerging markets owing to numerous differences such as cultural, social and economic between the two markets. Also Kouwenberg, (2007) stated that owing to the contextual variations between developed and developing markets, such outcomes of such investigations linked to the developed world have only limited applicability in the developing

markets. Thus it is indispensable to study corporate governance, board demography in relation to voluntary risk disclosure in developing economies.

To the best of the researcher knowledge, there are only few investigations examining the determinants of voluntary disclosure in the context of Saudi Arabia; namely Alsaeed (2006), Al-Janadi et al. (2013), Al-Sahafi et al., (2015) and Habbash et al., (2016). However, this study makes major contributions to the research on voluntary risk disclosure in Saudi Arabia; firstly by employing a more recent and longer timespan (2009-2013) than Alsaeed (2006) who only covers the period between 2006-2007, and Al-Janadi et al. (2013) who also only covers a one-year period from 2002 to 2003. Also this thesis covers the same timespan as Al-Sahafi et al., (2015) and Habbash et al., (2016) but more recent (2009-2013). Al-Sahafi et al., (2015) and Habbash et al., (2016) investigated the exact same period (2007-2011). Secondly, Alsaeed (2006) in his study mainly examined the impact of firm characteristics on voluntary disclosure. Whereas Al-Janadi et al., (2013) investigated the effect of corporate governance on voluntary disclosure. While Habbash et al., (2016) studied the effect of both firm characteristics and corporate governance on voluntary disclosure. Also, Al-Sahafi et al., (2015) examined the influence of both firm characteristics and corporate governance on voluntary disclosure, the same as Habbash et al., (2016) but in the Saudi banking industry. Furthermore, the relationship between corporate governance, demographic traits, firm value and risk disclosure has received no consideration at all in Saudi Arabia and in particular in the banking sector. However, the purpose of this research is to examine the impact of corporate governance determinants and board demographic traits on voluntary risk disclosure in all Saudi listed banks. It also seeks to investigate the effect of voluntary risk disclosure levels on the market valuation of all Saudi banks.

Henceforth, the above-mentioned events and discussion on risk disclosure are a motivation for the examination of risk disclosure in annual reports of Saudi listed banks with a view to particularly investigate its levels, determinants and its effect on firm value. Also further insights are expected to develop concerning corporate risk disclosures.

In brevity, this study is also motivated by call for more investigations on the influence of corporate governance determinants on risk disclosure especially in developing markets made by Dobler et al., (2011). As well as by the call for more research into the relationship between the demographic characteristics and risk disclosure made by Abdallah, et al., (2015). Fourthly, this investigation is also motivated by the absolute scarcity of risk disclosure investigating the link between risk disclosure and firm value.

### **1.3 Research Objectives**

There are three main objectives of this investigation and two sub-objectives. The first empirical study will endeavour to answer the first objective as well as the two sub-objective of this research. While the second and third studies will attempt to explore one of the two remaining objectives.

1. To measure the level of risk disclosure in all listed Saudi banks.
  - To show the initial relationships between risk disclosure and firm characteristics.
  - To discuss the impact of Islamic values of risk disclosure.

By identifying the level of voluntary risk disclosure in all listed Saudi banks, this will enable this investigation to establish whether annual reports published by the sample



banks conveyed risk disclosure information, establishing the degree of transparency of these banks and to determine any variations among the sample banks over the investigated period.

This aims at providing a picture of the volume and nature of information reported and evaluate if reporting practices show any changing pattern in banks disclosures, and draws the attention to any restrictions intrinsic in risk disclosing. Though a number of previous risk disclosure investigations have been conducted, no previous investigations have examined risk disclosure levels and variations within the Saudi context.

## 2. To examine the determinants of risk reporting in Saudi listed banks.

Previous research has shown that some factors have an association with risk disclosure, but the results have been different and sometimes contradictory. Therefore, it is important to know what factors affect banks' decision to convey risk disclosure in the Saudi Banking industry.

The relationships between disclosure and corporate governance characteristics and demographic attributes have long been of interest to accounting investigators. The level of voluntary risk disclosure could be affected by numerous corporate governance variables and demographic attributes, for instance ownership structure (i.e. Elshandidy et al., 2013) board size (i.e. Nitm et al., 2013) independent directors (Abraham and Cox 2007) non-executive directors (Deumes and Knechel, 2008) audit committee independence (Oliveira et al., 2011b) audit committee size (Ho and Wong 2001) audit committee meetings (Allegrini and Greco, 2013) gender of the board (Allini et al., 2016) tenure (Chung et al., 2015) education levels (Allini et al., 2016)

diversity (Allini et al., 2016). Still, some of the above-mentioned associations are weak and not tested in the literature of risk disclosure in emerging economies.

Thus, such investigations offer a good opening point to advance the examination of the links between risk disclosure and its principal determinants. The current study links the level of voluntary risk disclosure to all of the above-mentioned variables.

3. To investigate the economic consequences of reported risk disclosure in Saudi listed banks' annual reports.

To see whether banks' annual reports carry potential economic consequences to investor or not. This research will explore whether the risk disclosure in the annual reports submitted by listed Saudi banks is value relevant for users, and whether it provides benefits for stakeholders that are reflected in increased firm value. Such risk information disclosures are of great significance to external investors, since the more they know, the more correctly they will be capable to determine a firm's market value. No previous investigation is known on the association between risk disclosure and firm value. Therefore, this study aims at exploring such relationship.

#### **1.4 Research Importance**

In recent years there have been a number of high profile corporate failures such as Lehman Brothers, Northern Rock and Enron, which have highlighted the importance of transparency and the requirement for strong corporate governance. Accounting irregularities related to corporations' such as the above-mentioned have turned the attention on corporations' risks and questioned the reliability of corporations' accounting and financial reporting systems, particularly in annual reports (Linsley and Shrives, 2005), and the effectiveness of corporate governance disclosures.

The constant changes in business environment make corporations more dependent on financial instruments and international transactions, which raise the importance of risk disclosure (Dobler, 2008). Thus companies have to satisfy the accounting need of users by reporting more information on different risks being faced and the sustainability of their operations. Such reported information helps investors to evaluate the present and future risks of the firm, which is essential in optimising their revenues, by holding well-diversified portfolios (Abraham and Cox, 2007). Solomon et al., (2000) exhibited a strong demand for increased risk disclosure from institutional investors to enhance their portfolio-investment decision-makings. Risk disclosure helps in investors' investment decisions-making process by assessing the information released by companies in order to establish levels of various risks they face, their decision will be taken based on expected return and risk considerations.

Moreover, risk disclosure will lead to a better risk management, as well as improved accountability for stewardship, investor protection, and the usefulness of financial reporting (ICAEW, 1997). This would help financial reports' users to identify potential managerial problems/opportunities and assess management's effectiveness in dealing with such issues (Lajili and Zeghal, 2005).

Stakeholders, investors notably, as users of annual reports need company risk information in order to measure and minimise the risks before they make financial decisions. Nevertheless, due to incomplete, scrappy and mutual exclusiveness of information in financial reports, users cannot easily interpret risk disclosure (Papa & Peters, 2011). The accounting literature also demonstrates that there is a significant risk information gap between firms and their stakeholders (i.e. Linsley and Shrives, 2006)

This research is important since it supplies users with an objective evaluation of the present levels of risk reporting exercises in all Saudi Listed banks. All users of annual reports need to be enabled to perceive and form an opinion of the risks possibly influencing banks and the method in which these risks are managed. Further, risk disclosure would help users to form an opinion on the amount, timing and likelihood of the firm's future cash flows. Such outcomes have the potential to help all interested user groups including standard setters and regulatory bodies (i.e. SAMA) when developing the framework and setting new requirements of corporate risk disclosure in the Kingdom.

Also with regard to risk reporting, the empirical literature provides only partial answers regarding risk disclosure determinants in emerging capital markets. This dearth of risk disclosure prohibited investors from having adequate and appropriate information to evaluate corporations risk disclosure. Therefore, this leaves investors unable to adequately assess a firm's risk profile hence fail to ponder on the scale and categories of risk in their investment decision making process (Linsley et al., 2008). This dearth of risk information in annual report points out the importance of examining the determinates of risk disclosure in different settings, particularly developing markets such as in the case of this study Saudi Arabia.

The current investigation examines a combination of determinants of voluntary risk reporting. This research is of great importance to both investors and regulatory bodies since it recognises the main determinants of risk disclosure reported by all Saudi. In addition, there is no research on the potential impact of risk disclosure on the firm's market value; investors need transparency and accountability in firm's annual report. The disclosure within the annual report has value relevance if corporations communicate signals and report firm performance more transparently. It

is also believed that annual report risk disclosure is beneficial in a way or another to shareholder, is only when they are predicted to have a significant link between firm value and the level of annual reports risk disclosure. Hence, investors can use such information in the annual report for consideration when they make financial decisions. This research is expected to shed more light on the relationship.

### **1.5 Saudi Arabian Context**

Saudi Arabia was a particular focus of this study because of its unique socio-economic context. First, it is a developing market that is different from developed markets in its religion, social, political regimes, tribal systems and traditions (AMF, 2013). For instance, such religious principles influence day to day life, trade, law, economics and political features of the Saudi community. Second, Saudi Arabia is the largest emerging capital market that adopts an open economic philosophy based on the market economy and liberalization of trade (AMF, 2013). Third, Saudi government has initiated several far-reaching reforms at the Saudi Stock Exchange (Tadawul) to mobilize domestic savings and attract foreign capital investment. These measures include privatization of state corporations. Fourth, Saudi Arabia has become one of the largest emerging economies in the world, having the largest stock market in the Middle East (Piesse et al., 2012). Also, the Saudi stock market is now the largest in the Arab world as far as capitalization is concerned and is becoming an important capital market in the region. Where, it counts for 25% of the total Arab GDP and 44% of the total Arab market capitalization (Alshehri and Solomon 2012; Albasaam, 2014). Also, the kingdom of Saudi Arabia has one quarter of the world's oil reserves and is the biggest oil producers in OPEC, where it had about 29% of the total OPEC production in 2013 (OPEC, 2013). Fifth, the ownership structure in the kingdom is divided between family-owned and state-concentrated, where most of the

listed companies are family-owned. They count for about 70% of total listed companies, While the rest of the listed companies which represent the other 30% are state-owned (Baydoun, et al. 2013; Albasaam, 2014). Finally, the Saudi Arabian recent regulatory framework incorporates different legislation that requires the disclosure of risk related information in corporations' annual reports. All these aspects make investigating the extent of voluntary risk disclosure an important issue in Saudi Arabia, an area that remains un-researched.

## **1.6 Research Questions**

Following the research objectives, the following three research questions are formulated. To answer the first Research Objective, namely to measure the level of voluntary risk disclosure in all Saudi listed banks, the following first research question is formulated as:

### ***Q1: What are the levels of voluntary risk disclosure in Saudi banks?***

To answer this research question, the level of risk disclosure is measured by counting the number of predetermined words in the annual reports of both sets of banks in Saudi based on two risk disclosure indexes, which have been developed solely for the purpose of this study. To answer the second research objective, namely to examine the determinants of risk disclosure in Saudi banks, the following research question is formulated:

### ***Q2: What are the determinants of risk disclosure in Saudi listed banks?***

To answer this the research question, the determinants of risk disclosure incorporated in this research come from a combination of two sets of variables firstly: corporate governance attributes which includes ownership structure, board size, independent directors, non-executive directors, audit committee independence, audit committee size, audit committee meetings. The second set of variables stem from

board demographic traits which include education level, tenure, gender diversity of the board and diversity based on nationality. Both set of variables are extracted from banks annual reports as well as some of the variables being collected from DataStream and Bloomberg and the correlation will be tested by ordinary least square (OLS) regressions through the use of SPSS program.

The association between the combination of corporate governance characteristics, board demographic traits and the level of voluntary risk disclosure as shown in the model of the second empirical study is formulated based on agency and the upper echelon theories, and the results of previous studies. To achieve the third research objective, namely to investigate the economic consequences of reported risk disclosure in Saudi listed banks' annual reports the following research question formulated:

***Q3: What are the economic consequences of risk disclosure practices of Saudi listed banks?***

To answer this question, this investigation also uses OLS regression model to directly measure how the level of voluntary risk disclosure affects the market value of the bank. In the first model of this study the dependent variable for firm value in the market based measure which is the natural logarithm of market to book value at end of year (MTBV). For the accounting based measure this study proxy for firm value by the profitability (ROA). Value relevance is the ability of a firm to send signals and detailed firm information that is useful for stakeholders and enables firm value to increase. Meanwhile, the association between the dependent variables in both models and the level of risk disclosure is interpreted from stakeholder, signalling theories and reviewed from previous literatures.

### 1.7 Islamic Financial Techniques:

Islam, as the religion of the Muslim people, provides the guidelines which direct them in their daily life. It is based on two main concepts: the Qur'an<sup>1</sup> and the Sunnah<sup>2</sup>. There is a third concept, which is used when no relevant answer from the Qur'an or the Sunnah can be found, called the Ijma<sup>3</sup>. This tertiary concept operates by having a number of Islamic scholars of a particular age and possessing considerable knowledge of the Islamic religion, analyse the text which carries no mention in the Qur'an or Sunnah. The opinion of the majority is then taken over individual opinion.

The reason for using Shari'aa in banking is to avoid any prohibited aspects or investments, such as interest rates or the financing of prohibited activities. Funding investments in alcohol or casino projects is wholly verboten; in Islam these are pronounced to be prohibited and harmful to the society. (Molyneux & Iqbal, 2005).

From an investor perspective, the risk of such investments could be the involvement of their funds through the bank in unlawful activities and the non-disclosure of such investments. Deception and dishonesty is prohibited in the religion of Islamic therefore, banks have to disclose their position and investment involvement to their investors. Since the Shari'aa is involved in the banking system, there are various financial techniques and models which perform the functionality of the banking system based on Islamic principles thus each mode carry its own risks. These models are defined as follow:

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<sup>1</sup> Qur'an is the holy book that Muslim follow

<sup>2</sup> Sunnah is the rules or the practice applied to the life of the prophet Mohammed (pbuh)

<sup>3</sup> Ijma means the majority of people agree in a specific point or a situation.



### 1.7.1 Mudarabah:

This is a contract made by two partners, the capital owner (called *Rabb Al-Mal*) and an investment manager (called the *Mudarib*). The profit is shared between the two partners as agreed at the time of the contract; if any loss is accrued it is suffered by the capital owner, as the *Mudarib* does not invest anything and the loss for the *Mudarib* is the cost of his/her labour, which failed to generate any income. However, if the *Mudarib* has been negligent or has operated dishonestly, he then becomes liable for the loss caused by his negligence or misconduct.

The capital owner has no right to participate in the management, which is carried out by the *Mudarib* only. On the other hand, the *Mudarib* cannot commit the investment for any sum greater than the capital contributed by the capital owner, as the liability of *Rabb Al-Mal* is limited to the investment and no more. Any expenses of the *Mudarabah* business can be charged to the *Mudarabah* account. No debt is allowed unless the capital owner has granted this to the *Mudarib*. (Al-Omar & Abdulhaq, 1996) and (Molyneux & Iqbal, 2005).

As the capital owner is only limited to the investment and cannot be involved in the management of his/her funds. Reporting risk disclosure information becomes a priority for him/her since this is the only way that can provide *Rabb Al-Mal* information regarding his/her investment and decisions made by the *Mudarib*. This is an essential part of the *Mudarabah* contract since the capital owner has the right to terminate the contract if he/she feels that the investment manager is not acting in their interest.

### 1.7.2 Musharakah:

This is another financing technique, which is similar to the Mudarabah contract but contains a number of differences. '*Musharakah*' is an Arabic word and literally means 'sharing'. In terms of business it means a joint enterprise in which all partners share the profit or loss of the joint venture.

In the case of the *Musharakah* each partner participates in the capital, is involved in the management and shares the profit and loss. Again the profit is shared between the partners as has been agreed in the contract; this profit sharing takes into consideration the ratios for each partner, as the loss is shared according to the distributed share of each in the total capital. The reason the profit sharing ratio is left to the agreed contract is because of the difference in the ratio of shares in the invested project for the partners in the total capital of the project. It is also because the partners share the work of managing the project by a specific, not necessarily equal, amount. However, the partners are permitted to charge a fee or wage of any management and other labour put into the project. (Al-Omar & Abdulhaq, 1996) and (Molyneux & Iqbal, 2005).

Since some investors may choose not to manage in the project there could be some asymmetry gap between active members and non-active members in the management of the project. Thus, the disclosure of risk information is a vital element in informing the non-active members about the riskiness of their investment and decisions made since they can choose to activate their role as a partner and help reduce the gap between both members.

### 1.7.3 Murabahah:

This is a contract agreed between the client and the bank which takes place when the client wishes to purchase equipment or property. At this point the client requests

his/her bank to purchase the item so as to sell it to him/her against deferred payment plus a profit mark-up; this is also known as '*Bai Mu'ajjal*'. In this method, the bank will sell the product to the client at a higher price due to the extra profit but the client will pay the amount of money in installments based on an agreed contract with a fixed mark-up profit at certain times.

The bank here will have two contracts to agree on. The first is a purchase contract, which is made between the bank and the supplier of the item, and the second is a sale contract which is concluded between the bank and the client. Some banks prefer to appoint the client named as the person placing the order and the bank as its agent to receive the item purchased. The point of this is to avoid the '*riba*' (interests and usury), as Islam allows trade (sale, purchase) and yet forbids interest. (Al-Omar & Abdulhaq, 1996) and (Molyneux & Iqbal, 2005).

The bank needs to disclose its position on the purchased item/ property since the risk here is that the bank may disregard or choose not to initiate the first contract which is made between the bank and the supplier of the item/ property but instead buy the item and sell it to the client at a deferred payment. The disclosure of such risk is important since both contracts have to be initiated.

#### **1.7.4 Ijarah: (leasing)**

'*Ijarah*' is an Arabic word that means 'to rent out something'. This kind of rent is used in two different cases. The first type is by hiring human services. The person who pays for the service is called '*Musta'jir*', the person who offers the services is called an '*Ajir*' and the money or the wage paid is called '*Ujrah*'. The second type is the rent of usufruct of assets or properties to another person. This type of *Ijarah* is known in English as 'leasing'.

Islamic banks use the mode of leasing as a financing technique, where a lease contract is presented. The bank may buy the asset and rent it to the client. During the term of leasing, the assets remain in the lessor's name and all the risks, which prevent the use of the rented equipment, are borne by the lessor.

However, the lessee might take on some of the responsibility if this is agreed in the contract, such as day-to-day maintenance. (Al-Omar & Abdulhaq, 1996) and (Molyneux & Iqbal, 2005). The lease contract is for short-term periods and can be renewed by the consent of both parties.

From an investor perspective, as bank shareholders the risk of such *Ijarah* is that their funds may be used in an unlawful activities and the non-disclosure of such investments is important to the investors. Also another risk of the *Ijarah* is that the lessee may not carry out the terms and conditions set out in the contract such as the maintenance of the leased machinery/ property. Thus the disclosure of such risk is vital in the decision making process.

#### **1.7.5 Qard Hasan:**

The word '*Qard*' is taken from Arabic, meaning 'to cut'. In economic terms it means taking a portion of the lender's property by giving it as a loan to the borrower. '*Hasan*' is also an Arabic word, derived from the word '*Ihsan*' meaning 'kindness to others'. So as the Shari'aa does not permit interest, this loan is given to the borrower gratuitously, interest free. (Hossain, 2004). There are two types of *Qard Hasan* loans; the first is '*Ariya*', which is a loan for the use of the usufruct of property temporarily and gratuitously, requiring both the owner of the property and the borrower to sign a contract. The loan can be terminated at will.

The second type is called '*Qard*', which is the most known version; it is the loan of currency or other standard of exchange. If there is any charge to the lender as a result of the provision of this loan, it must be added to the loan and the borrower has to pay it; the Shari'aa allows this as long as it is not interest. The loan has to be returned at an agreed future date. (Al-Omar & Abdulhaq, 1996)

The disclosure of information and risk disclosure of such loans provides investors/shareholder a wider picture on the magnitude of cash loaned out as *Qard Hassan* and any underlying risks in terms of repayment.

#### **1.7.6 Al-Istisna:**

This is another type of Islamic financial technique. It is a modern form of Islamic finance; a contract applied to finance construction and manufacturing projects. It is based on an agreement between two parties, where one party makes an order for a commodity to be manufactured and the other makes and delivers this at a future date for a specific price.

This type of technique, as explained by Al-Omar & Abdulhaq, (1996), allows cash payment in advance and future delivery; it also permits future payment and future delivery. Furthermore, Molyneux & Iqbal, (2005) show that there are two types of *Al-Istisna* contracts. The first is a contract in which the beneficiary and the bank agree that the payment is payable by the purchaser in the future in installments and the bank will take responsibility for delivering the requested manufactured commodity at an agreed time. The second type is a subcontract between the contractor and the bank to manufacture the product in respect to the agreed specifications.

The bank needs to disclose its position on such contracts since the risk here is that the bank may choose not to report about contracts with third parties. Also investors

need to know the risk of unpaid or unmet contracts between the banks and the party making the order or between the bank and the supplier. The disclosure of such risk is important since both contracts have to be honoured.

#### **1.7.7 Salam:**

This form of financing is a forward sale contract in which the payment is made in advance at the time of contracting and the delivery of the products is made at a future date. The contract involves the bank, the client and the supplier.

The client has the right to investigate the products and might reject them if they do not match the specifications agreed to at the time of contracting (this would only apply to fungible products). The bank can make two *Salam* contracts; the first is that the bank will buy the product by making an advance payment to the seller at a future delivery date desired by the client. The bank then sells the product to the client on an installments sale basis. The second contract is for the delivery of the product as it is specified in the first *Salam* contract. (Al-Omar & Abdulhaq, 1996) and (Molyneux & Iqbal, 2005)

The bank needs to disclose its position on such contracts since the risk here is that the bank may choose not to report about contracts with third parties. Also investors need to know the risk of unpaid or unmet contracts between the banks and the party making the order or between the bank and the supplier.

#### **1.7.8 Wakalah:**

This is an Arabic word that means '*on behalf*', and is an official term used for a contract in which somebody gives the authority to someone else to act on his/her behalf for a specific mission or task. In English terms, it can be described as an 'agency' where in the Islamic banking system the client gives funds to the bank

that serves as his/her investment manager, and the loss and the profit is passed to the client; the bank only cuts fees for its managerial service (Molyneux & Iqbal, 2005).

Since, the investor is only limited to the investment and cannot be involved in the management of his/her funds. Reporting risk disclosure information becomes a priority for him/her since this is the only way that can provide investors information about his/her investment and decisions made by the agent (bank). This is an essential part of the *wakalah* contract since the investor needs know that the agent is acting in their interest and their money is no misused or involved in unlawful activities.

#### **1.7.9 Sukuk:**

Sukuk commonly refers to the Islamic equivalent of bonds. However, as opposed to conventional bonds, which merely confer ownership of a debt, Sukuk grants the investor a share of an asset, along with the commensurate cash flows and risk. As such, Sukuk securities adhere to Islamic laws (Shari'aa principles), which prohibit the charging or payment of interest (Riba).

The emergence of Sukuk has been one of the most significant developments in Islamic capital markets in recent years. Sukuk instruments act as a bridge. They link their issuers, primarily sovereigns and corporations with a wide pool of investors, many of whom are seeking to diversify their holdings beyond traditional asset classes. (Islamic Development bank, 2010).

Sukuk are exposed to different types of risks. The most important is Shari'aa compliance risk. And the challenge for Sukuk issuing entities becomes to devise an effective risk management strategy congruent to Shari'aa principles. Thus, investors choosing to invest in Sukuk are normally looking for investments which comply with Islamic laws so as to avoid any unlawful investments. Hence, the risk of such

investments could be the non-compliance with Islamic laws and the investment of their Sukuk in unlawful activities. Therefore, risk disclosure is an important element in the process of decision making for investors since they need to know of the compliance of their Sukuk with the Shari'ah principles.

## **1.8 Research Methodology**

The current study is descriptive and empirical in scope. A detailed description of research methodology used (selection of research methods, sample selection, research model and statistical tests) is provided in each of the three empirical studies below. For the purpose of the first study, this thesis examines the levels of voluntary risk disclosure in both sets of banks listed in Saudi based on two risk disclosure indexes, which are checklists of different disclosure items included in banks' annual reports (Arvidsson, 2003). Thereafter, two risk disclosure indices were developed (Islamic and non-Islamic) solely for the purpose of measuring the level of voluntary risk disclosure in Saudi listed banks. The current method used in exploring the first objective is descriptive in scope. A content analysis technique was required, which is categorising a written piece of work, words, phrases and sentences against a certain schema of interest based on the selection criteria, (Bowman, 1984; Weber, 1988). In this study the level and nature of voluntary risk disclosure was measured according to the number of words disclosed in annual reports and variations were considered over a five-year period.

Secondly, this study uses an ordinary least square (OLS) regression model to examine the relationship between voluntary risk disclosure in the annual reports of all Saudi listed banks and a combination of corporate governance and demographic traits. In this model, the dependent variable was the risk disclosure score generated through the use of a content analysis, this is in line with (Elzahar and Hussainey,



2012; Abdullah et al., 2015) and is the totality of the scores attained from the risk disclosure index. Whereas, the independent variables are corporate governance and demographic traits, which were collected from the annual reports with some of the variables being collected from DataStream and Bloomberg. (See Table 9), which summarizes the measurement and definition of those variables. The current model used in investigating these relationships is empirical in scope.

Finally, this investigation also uses OLS regression model to directly measure how the level of voluntary risk disclosure affects the market value of the bank. In this model the dependent variable for firm value in the market based measure is the natural logarithm of market to book value at end of year (MTBV). For the accounting based measure this study proxy for firm value by the profitability (ROA). Two measures examinations have different theoretical implications (Hillman and Keim, 2001). These models measure how the level of voluntary risk disclosure affects the market value of the bank. It has been argued that increased levels of disclosure positively influence the market value of the firm. Both models are empirical in its scope.

The fundamental reason for electing annual reports as the key source of information of this study is because they are the fundamental mean that organisations' employ to communicate and convey messages to their investors (Lang and Lundholm, 1993; Holland, 1998). Moreover, Gray, Kouhy and lavers (1995a; 1995b) affirm that constitutional regulations mandate corporations to publish their annual reports periodically, due to their significance and the provision of their consistent historical image of a corporation. Campbell (2000) presents two more grounds to back the employment of annual reports. Firstly, annual reports are broadly distributed of all other documents made public of a corporation. Secondly, the corporation

management has a complete editorial power of the voluntary disclosure of information in the published annual reports. Tay and Parker (1990) confirm that genuine disclosure practices could be measured more accurately from annual reports. Also most of the accounting rules and codes of corporate governance are aimed at the disclosures in the annual reports.

The current study will provide an in-depth investigation of risk disclosure in all listed banks by investigating Saudi Arabia banking Industry on its own. This approach does not provide explicit comparisons between countries, but under certain circumstances it is possible to draw implicit conclusions from such studies regarding the way institutions provide risk information which can influence other individual institutions or “countries” (Del Boca, 1998). This can be done either by contrasting the unique characteristics of one single country with a more generalised case (Del Boca, 1998).

“...a single-country study is considered comparative if it uses concepts that are applicable to other countries, and/or seeks to make larger inferences that stretch beyond the original country used in the study” (Lor, 2012, p.28).

Moreover, there will always be great single country studies. Those are particularly effective in capitalizing on their explanatory leverage by exploiting the availability of comparable units of analysis, whether over time, space, or some other organisational dimension of variation (Culpepper, 2005). This is particularly important in the case of this study since it compares the reporting variations among the sample banks over the examined period which evidently has revealed interesting and insightful results which carry some potentially importing implications for regulatory institutions and investors in Saudi Arabia.

The main advantage of this research strategy is that it provides comprehensive analysis of the examined phenomena in order to tap cross-bank variations, explicitly identify what drives risk reporting and demonstrate what are the aftermath of this

practices a feature that is impossible when analyses involve many countries (Van del Lippe and Van Dijk, 2002). Because of variations in culture (Gray 1988), religion (Guiso et al. 2003), political institutions (La Porta et al. 1997), and legal environment (Salter and Douppnik 1992), all of which influence the levels, determinants and consequences of disclosure and the applicability of accounting standards (Douppnik and Salter, 1995). Such challenges are not present in a single setting study.

Most importantly, a single country research allows researcher to provide in-depth insights into the research phenomena and provide new insights of the accounting methods and choices of disclosure practices. This fact can strengthen the contribution of the researched phenomena (Gordon et al., 2013). Further, single country accounting research can provide a comprehensive and detailed understanding of the disclosure activities in a capital market that is regarded as the biggest and most rapidly developing emerging market. Such study could determine any changes which can affect the demand for accounting information, and banks need to meet the demands by changing or implementing new accounting and disclosure policies (Gordon et al., 2013). Also, a single country study provides an excellent mechanism for confirming or infirming theories and provides insights for refining it (Landman, 2008).

## **1.9 Contributions**

This study will bridge a gap between the three broad strands related to existing body of literature on risk disclosure (measures the levels of risk disclosure; explores the determinants and investigates the consequences of risk disclosure). To the first strand, to the best of the researcher knowledge, there is not a single study examining the levels of voluntary risk disclosure in the context of Saudi Arabia in general or in both type of banking systems namely Islamic and non-Islamic. This investigation employs two comprehensive risk

disclosure indices which were developed solely for the purpose of measuring the level of voluntary risk disclosure in Saudi listed banks (see appendix).

The current study is also of great significance since it differs from Mousa and Elamir (2013); Mokhtar and Mellett, (2013) and Abdallah, et al., (2015), who studied a single attribute of corporate governance characteristics. And differs from Amran et al., (2009); Hassan, (2009); Abdallah and Hassan, (2013); Al-Shammari, (2014) who did not explore corporate governance nor demographic attributes by comprehensively examining corporate risk disclosure and exploring demographic characteristics. Additionally, not a single study has examined corporate governance as a determinant of risk disclosure in the Saudi context. Also, not a single study of the above-mentioned has investigated the demographic traits of the top team management in emerging markets. This study differs from all of the above-mentioned studies by examining the demographic characteristics of the top board of directors as well as incorporating the upper echelon theory into the field of risk disclosure practices in the banking industry.

Furthermore, this research differs from (Amran et al., 2009; Hassan, 2009; Abdallah and Hassan, 2013; Mousa and Elamir, 2013; Mokhtar and Mellett, (2013); Al-Shammari, 2014; Abdallah et al., 2015) by being the first study to examine risk disclosure over a period of five years in developing economies.

To the third strand, previous studies focused on the impacts of increased disclosure on the cost of capital (Elzahar et al., 2015); analysts' forecasts (Wang et al., 2013); financial performance (Wang et al., 2008); and share price anticipation of earnings (Hussainey and Walker, 2009). This stream of literature is focused mainly on the international firms and conventional banks in developed countries such as the UK (Elzahar et al., 2015). There have been very few studies that measured the association between disclosure and firm value (Uyar and Kilic, 2012). Risk disclosure investigations in relation to firm value are still

missing. Exploring this form of economic consequences on risk disclosure has not yet been examined in general or in Saudi.

This study also differs from all previous risk disclosure studies (Rajab and Schachler, 2009; Elshandidy et al., 2015; Abdallah et al., 2015; Hassan et al., 2009; Konishi and Ali, 2007) by being the first study to examine the level of voluntary risk disclosure in relation to firm value. Also, the current research differs from all of the above-mentioned studies by being the first study to examine voluntary risk disclosure in relation to firm value in listed banks over a five-year period.

In brevity, this investigation makes a major contribution to the literature, knowledge on risk disclosure and reporting practices in the annual reports of all listed Saudi banks, namely Islamic and non-Islamic banks. It also makes a healthy contribution to the discussion on the levels, type, determinants, economic consequences and risk disclosure in banks annual reports. Augmentations in risk reporting in the annual reports could be seen as evidence of the international effort to regulate risk reporting in banks.

### **1.10 Empirical Findings**

The outcomes of the research established that the amount of voluntary risk disclosure tended to increase over the period, reflecting the increasing pressure from regulators and users during this time. There were variations in the reporting practices across the sample banks in terms of the total voluntary risk disclosure scores. This could be attributed to the absence of any kind of comprehensive standards or particular regulations regarding risk reporting and management in Saudi Arabia. Some banks did not report risk information as such but rather reported it as a part of their regular financial disclosure requirement. They were thus not completely following appropriate risk reporting procedures. This research used a content analysis approach that incorporated a checklist of items as a means of capturing the level of voluntary risk disclosure.

In particular, the empirical findings of this study show that Islamic banks report less risk information than non-Islamic banks. However, the analysis reveals that both types of banks report approximately the same amount of risk information regarding the banks' non-Islamic risk related items. Further, the empirical analysis shows that Islamic banks report very little concerning Islamic risk related disclosure items. Based on this, the following conclusion can be made: Islamic banks disclose less risk information than their non-Islamic counterparties. This outcome could be a reflection of the inherently conservative nature of the principles that guide Islamic financial institutions, which provide financial products that aim to serve the interests of society more broadly than do non-Islamic banks, which are more likely to focus upon profit maximization.

The empirical findings also show that banks of high outsider ownership, high profitability, high regularity of audit committee meetings and a mixture of gender diversity on the board are more likely to demonstrate higher levels of voluntary risk disclosure. Contrastingly, voluntary risk disclosure is negatively affected by the levels of education of board members. As can be seen from the empirical findings, external ownership, audit committee meetings, gender diversity, education levels, profitability are primary determinants of voluntary risk disclosure practices in Saudi listed banks, while the rest of the independent variables of both corporate governance mechanisms and demographic traits are insignificantly correlated with the levels of voluntary risk disclosure practices in Saudi.

Additionally, the findings also show no association between voluntary risk disclosure levels and firm value as measured by the market to book value at the end of the year (MTBV). However, based on the accounting based measure (ROA) the findings demonstrated a positively significant association between the levels of voluntary risk

disclosure and firm value. In terms of the control variables in the MTBV model, the findings indicate that CHS, BSIZE, PROF and DIVID are statistically significant and positively associated to FV, while EDUC is statistically significant and negatively correlated to FV. While, the findings in the second model control variables show that board independence, audit committee independence, diversity and type of bank (Islamic vs non-Islamic) have positively significant association with FV. Where, external ownership reported a negatively significant link with FV. However, the rest of the control variables are split between two groups, the first group being negatively insignificant and the second group being insignificantly associated with firm value for both models.

These findings indicate that the association between voluntary risk disclosure and all of the variables (governance characteristics, demographic traits and firm-specific attributes as control variables) cannot be the same in all capital markets since it relies on a number of factors: first, theoretical justification, where different investigations use different theories and a set of different hypothesis; second, the measure, where some variables can be measured using different measures; third, sample size, for example, small vs. large; and fourth, sector, for example financial vs. non-financial. It can accordingly be concluded that the association between risk disclosure and all of the variables remains worthy of investigation. This conclusion is supported by the mixed outcomes of previous researches.

### **1.11 Structure of the study**

This section outlines the structure of the thesis, which contains seven chapters. Each empirical study contains a review of the relevant literature. Hence, there is no need for an additional chapter for a literature review. Where chapter one provided an introduction to this thesis and outlined the key aims and findings of the research.

**Chapter Two** provides an overview of the Saudi context and financial reporting as well as regulations of the Saudi capital. In this chapter the unique characteristics of Saudi Arabia are highlighted; these include the legal system, capital market structure and culture. It also provides an overview of the Saudi Banking system in order to understand factors which might influence Saudi banks' risk disclosure practices.

**Chapter Three** discusses the theoretical framework of the study, where relevant disclosure theories are discussed to explain the motives and the extent of corporate risk disclosure practices.

**Chapter Four** focuses on measuring the voluntary risk disclosure levels in both set of banks namely Islamic and conventional.

**Chapter Five** measures the determinants of voluntary risk disclosure. It investigates whether or not corporate governance attributes and board demographic traits have any influence on the levels of voluntary risk disclosure.

**Chapter Six** measures the economic consequences of risk disclosure. It examines the effect of the level of voluntary risk disclosure on firm value.

**Chapter Seven** provides the concluding remarks of this thesis. It provides a summary of this study's overview. It also presents a summary of the key findings of the research and discusses their implications. It includes a summary of possible limitations of the study and highlights several avenues of potential future research.



## 2 Chapter Two: Overview of Saudi Arabia, Banking History and Regulations

This chapter presents an overview of Saudi Arabia in order to reveal insights into the country's background, legal system, banking history, regulating and supervising institutions, accounting and auditing profession, SAMA, listing rules and disclosure regulations and reporting. An understanding of the fundamental underlying issues in Saudi Arabia helps with the employment of some measurements to obtain an understanding of risk disclosure practices in listed banks.

### 2.1 Overview

Saudi Arabia has recently pursued comprehensive monetary reforms by (1) establishing the Capital Market Authority (CMA) in 2003; and (2) releasing the Saudi Corporate Governance Code (SCGC) in 2006. The Saudi government is also working to re-organise and strengthen the Saudi Stock Exchange (*Tadawul*). Generally, such reforms are often pursued with the aim of improving the methods by which listed corporations are governed through encouraging greater board accountability, discipline, fairness, independence, responsibility, transparency and disclosure of information (Filatotchev and Boyd, 2009; Samaha et al., 2012).

Financial reporting regulations in Saudi Arabia are formed and managed by the government. It focuses on protecting investors and other users of financial reports. The main institutions issuing rules are the Ministry of Commerce and Industry, The Capital Market Authority (CMA), The Saudi Stock Exchange (Tadawul), The Saudi Arabian Monetary Agency (SAMA) and The Saudi Organisation for Certified Public Accountants (SOCPA). They are all considered to be the main governmental institutions monitoring publicly traded Saudi companies. Regulating, supervising and

registering are some of the most important responsibilities of the all above-mentioned bodies, which ensure that Saudi companies comply with national regulations. Moreover, the Ministry of Commerce and Industry indirectly performs a supervisory role to many monitoring devices, such as the Saudi Capital Market Authority (CMA), the Saudi Stock Exchange and the Saudi Arabian Monetary Agency (SAMA).

Furthermore, the role of the CMA is to regulate and develop Saudi companies by providing appropriate rules and regulations that contribute to increasing investment and enhancing transparency and disclosure standards as well as protecting investors and dealers from illegal activities in the market (CMA, 2007). Transparency and disclosure is one of the most important areas to be dealt with by the Capital Market Authority. Saudi Arabia has become one of the largest emerging economies in the world, and it has the largest stock market in the Middle East (Piesse et al., 2012). Also, the Saudi stock market is now the largest in the Arab world as far as capitalization is concerned, and Saudi Capital Market growth between 1996 and 2005 was high, with a huge increase in the number of transactions, volume and value trading. For example, listed firms increased in number from 77 firms in 2005 to 145 firms in December 2010. Today, there are 171 listed firms in Saudi with a market capitalization of about \$564bn, representing nearly half of the total Arab stock market capitalisation (SFG, 2009; Hearn et al., 2011; Tadawul, 2015). Accordingly, the Saudi market may not be active in corporate risk disclosure and may suffer from greater information deficits in comparison with established markets, such as the US, the UK and Europe. Although the Saudi stock market is very large compared to the markets of other developing countries, recent studies have found that, like those of most developing countries, it is not efficient (Dahel, 1999; Onour, 2004).

## 2.2 Islamic Banks

Islamic banking and finance have emerged due to the Islamic commands associated with everyday dealings in terms of the economy, business, trade and finance. The term of Islamic banking means that conduct of banking operations is in line with the guidance of Sharia law (Islamic jurisprudence laws). Sharia law which governs the operations of Islamic banks originates from four sources, namely the Quran (holy book), Sunnah (teachings of the prophet Mohammed P.U.H), Ijma' (scholars agreements and consensus). While the Quran and Sunnah are the primary source of Sharia, ijma' is considered secondary and only applied when no solution on the matter in question neither found in the Quran nor Sunnah. There are many verses in Quran indicating the principles used as guidance for Islamic banks in their operational affairs (Haron and Shanmugam, 1997). The crucial prohibition in Islamic banking is payment and receipt of *riba* (interest/usury) at a fixed or predetermined rate, *maysir* (gambling), *gharar* (speculation), fraud, exploitation and extortion (Damak et al., 2009). Hence, the restriction of certain sources of earnings is particularly a distinctive plank that distinguished the Islamic economic system from the conventional financial system (Asutay, 2010).

The prohibition of usury in the Islamic banking system is only one part of the Islamic economic principles. As an Islamic business institution, all Islamic banks not only have to run their business to achieve their goal of making profit, but at the same time, they are expected to adhere to the rules and laws of Sharia. The Quranic position, hence, is that it is compulsory for Muslims and they are strongly advised not to deal in *riba*. Islamic moral economy has implications for the nature of business and financial transactions, as certain sectors and economic activities are not considered lawful; such as companies producing tobacco, alcohol, drugs, weapon, or engaged

in the business of gambling, casinos, nightclubs and prostitution are also not allowed. These transactions are considered haram (unlawful) because they can affect human health and instigate moral problems. Beside of the prohibition of riba, the Islamic financial system encourages risk sharing, equity based transaction, and stake-taking economic system (Asutay, 2010). Muslim jurists have recommended various principles to be adopted by Islamic banks in delivering their product and services. These principles are broadly divided into four categories namely, profit-loss sharing, fees or charges based, free service and ancillary principles.

### **2.3 Growth of Muslim population and Islamic finances**

The importance of this research emerges from the continues growth of the Islamic banking and estimations for its investments around the world as well as the growth the number of Muslims around the world. The world's Muslim population<sup>1</sup> is expected to increase by about 35% in the next 20 years as presented in Figure 2-1, rising from 1.6 billion in 2010 to 2.2 billion by 2030, according to new population projections by the Pew Research Centre's Forum on Religion & Public Life. If current trends continue, Muslims will make up 26.4% of the world's total projected population of 8.3 billion in 2030, up from 23.4% of the estimated 2010 world population of 6.9 billion. This growing has a reflection on increasing demand for Islamic banking's services which support them in finding ways to invest their money in compliance with *Sharia* laws.

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<sup>1</sup> In a religious sense, the Islamic *Ummah* refers to those who adhere to the teachings of Islam, referred to as Muslims. As of 2012, over 1.6 billion or about 23.4% of the world population are Muslims. By the percentage of the total population in a region considering themselves Muslim, 24.8% in Asia-Oceania do, 91.2% in the Middle East-North Africa, 29.6% in Sub-Saharan Africa, around 6.0% in Europe, and 0.6% in the Americas (Pew Research, 2015).

### Muslims as a Share of World Population, 1990-2030

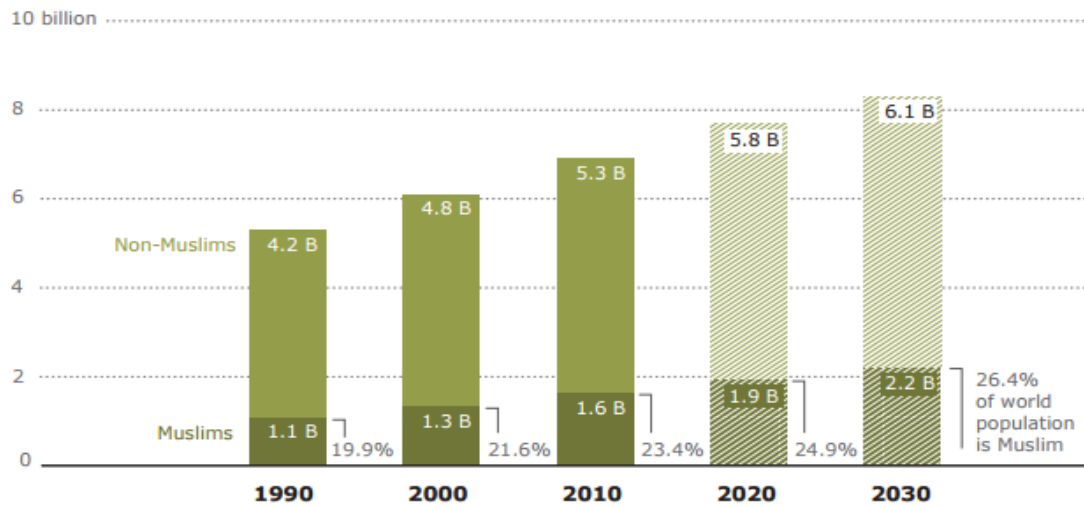


Figure 2-1: Growth of Muslim Population (Pew Research centre, 2015)

Normally synonymous with ‘interest-free’ banking, Islamic Banking has become a growing force in global financial circles over the past three decades, with Islamic banks found in over 70 countries worldwide (Warde, 2000). The Islamic finance industry has expanded rapidly over the past decade, growing at 10-12% annually (World Bank, 2015). Today, Sharia-compliant financial assets are estimated at a \$2.1 Trillion, with a compounded annual growth rate (CAGR) of 17.3% between 2009 and 2014 covering bank and non-bank financial institutions, capital markets, money markets and insurance (*Takaful*) (World Bank, 2015). In many majority Muslim countries, Islamic banking assets have been growing faster than conventional banking assets. There has also been a surge of interest in Islamic finance from non-Muslim countries such as the UK, Luxembourg, South Africa, and Hong Kong (World Bank, 2015). Ernst & Young estimates that Islamic banking assets grew at an annual rate of 17.6% between 2009 and 2014, and will grow by an average of 19.7% a year to 2018 (Economist, 2015).

## 2.4 Background of Saudi Arabia

It is essential to provide a general background on various elements (politics, economics and culture) in Saudi Arabia so as to study its business environment. This section will briefly discuss the most important elements of the Saudi business environment in relation to this study. Saudi Arabia is one of the most rapidly emerging countries in the Asian continent, and Riyadh is its capital city. The modern state of Saudi Arabia dates back to 1932 when King Abdul Aziz Ibn Saud (1880-1953) announced the foundation of the Kingdom of Saudi Arabia (Al-Angari, 2004; Al-Turaiqi, 2008). Saudi Arabia is the largest Arab country in the Middle East in terms of area. However, the country is 95% desert (Ministry of Economy and Planning, 2007).

Furthermore, the Kingdom is ruled by a monarchy, which is restricted to the male descendants of King Ibn Saud. The monarchy ruling system in Saudi is centralised, which means that the ruling King has wide reaching authorities, encompassing the governing and management of internal and external affairs. Sensitive political and defence positions i.e. internal affairs, foreign affairs and defence minister are also restricted to the male descendants of King Abdul Aziz. In 1991, Saudi Arabia founded the Consultative Council, which plays a limited role in the legislative system in the Kingdom. The Consultative Council acts as an advisory body to the King and any decisions are solely implemented once the final approval has been issued by the King (Alghamdi, 2012).

Prior to 1937, the Kingdom of Saudi Arabia was a very poor country that primarily depended on farming. However, in 1937, a huge amount of oil was discovered, and nowadays, Saudi is the world's leading producer and exporter of crude oil. This massive exploration of oil has brought about steady changes to Saudi Arabia's

societal and economic life as well as to the political position of the Kingdom in the Middle East and worldwide. Today the Kingdom's economy is mainly based on petroleum exports, which are regarded as the prime source of national income, which makes up approximately 90-95% of the total national income and 35-40% of gross domestic product (GDP). Furthermore, the Ministry of Economy and Planning (2007) stated that the Kingdom of Saudi Arabia is believed to have roughly 1 quarter of the world's confirmed petroleum reserves. Also, it is believed that it will continue to be the world's biggest producer of crude oil for the foreseeable future (Falagi, 2008). Moreover, as shown in Figure 2-2, the Kingdom controls a huge percentage of oil production amongst OPEC members, with 29% of the total output, which means it plays an important role in influencing oil prices in the whole world (OPEC, 2013). Also, according to the Ministry of Petroleum and Mineral Resources, the Kingdom has massive reserves of crude oil, which will enable the country to produce and export oil for the next 100 years. The reserves are estimated to be approximately 266,578 billion barrels (Annual Statistical Bulletin, 2015).

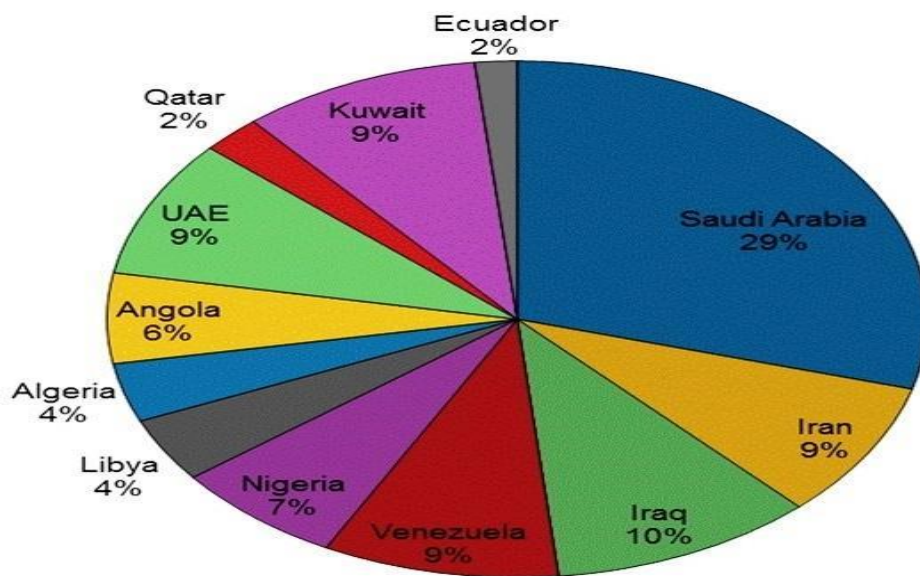


Figure 2-2:OPEC Production Breakdown (2013)

The Kingdom of Saudi Arabia has witnessed many reforms to its systems, including its social, business, legal and political systems. For instance, in 2005, after implementing various regulations, especially to its legal system, Saudi Arabia became a member of the World Trade Organisation (WTO) (Ministry of Commerce and Industry, 2006). Furthermore, due to these numerous reforms, the Saudi Arabia General Investment Authority was founded. This organisation's main objective is to improve the investment environment in the country and entice local and foreign investors by removing impediments and tackling deficiencies (Falgi, 2009). Also, it has been announced that the largest Arab stock market, which is called the Tadawul and is worth more than \$564 billion, is opening to foreign investors in a bid to internationalise the stock activities. Generally, the country's business environment has observed a number of gradual developments that have contributed to the reinforcement of the country economy, such as the Saudi Stock Exchange (*Tadawul*), SAMA and the accounting and auditing profession. However, many consider the reforms to be very slow and believe it cannot cope with the changes being observed



in the international business environment (Saudi Journal of Accountancy, 2009, p.13).

## **2.5 The Legal System**

The legal system of a country plays a significant part in the creation of its regulations and practices. The constitution of Saudi Arabia is based on the Holy Quran, the Traditions of the Prophet Mohammed PUH (Sunnah) and Islamic law (Shariah), which is the code of conduct or religious law. Thus, in terms of its legal system and in general terms, Saudi Arabia is an Islamic state, and it abides by Islamic regulations (Al-Harkan, 2005). Saudi Arabia is of foremost importance among Arabic and Islamic countries because it is home to the holiest of Muslim sites, Mecca (the direction of prayer and a place of pilgrimage for over one billion Muslims) and Medina, where the Prophet Mohammed (PUH) was buried (Falgi, 2009). Islam influences all areas of life in Saudi Arabia, including the constitution and social behaviour. It has a significant effect on businesses, emphasising high ethical standards, strong beliefs and human equality (Moustafa, 1985). Therefore, Saudi Arabia tries to ensure that any standards or practices it adopts, such as accounting and auditing standards, corporate governance practices or disclosure and transparency practices, are in compliance with the Saudi environment and Islamic law (Al-Harkan, 2005).

As a result of Saudi Arabia's strong historical relationship with the US and Britain, the local business environment has been affected by the legislation of those countries in terms of accounting practices, for example, company law systems, accounting standards, auditing standards and auditor independence standards (Al-Angari, 2004). All banks and financial companies must comply with international accounting standards; however, those listed on the Saudi Stock Market must also

follow and use the national accounting standards (IFRSs, 2011). King Saud University has played a key role in the evolution of accounting standards via hosting a series of symposiums on accounting methods in Saudi Arabia in order that any obstacles can be overcome. Moreover, it formed an Academic Board in order to exchange ideas on accountancy, carry out research and generally progress the area.

Overall, the areas of the Saudi legal system that relate to the business environment are a combination of rules and regulations from the legislation of America, Britain and other countries that must comply with Islamic regulations and the character of the Saudi environment.

## 2.6 Banking History in Saudi Arabia

There were no banks during the pre-oil period in the kingdom of Saudi Arabia. The Ottoman Bank, a Franco-British institution which had expanded throughout the Arab world in the late nineteenth century and established a branch in Alexandria, Egypt in 1867, did not see it as worthwhile to expand its branch network to the Heijaz or al-Hasa, the major centres of Ottoman commerce in the west and the east of the Arabian peninsula. Barter and cash transactions were widespread and prevailed, but supplier credits were normal in trade and money changers often provided loans on an unofficial basis. The latter were an established part of the *souk* (Market) economy, particularly in the cities of the Heijaz area, Jeddah, Makkah and Medina, where there was much demand from pilgrims performing Hajj to change coins and valuable metals, primarily gold, into Saudi Arabian silver riyals (Al-Salamah et al. 2004).

The Kingdom's founder (King Abdul-Aziz), was doubtful of banks and saw little need for such institutions, and the *Sharia* (Islamic jurisprudence law) scholars were both aware of the prohibition of *riba* (usury) and hostile to the notion of foreign institutions serving local Muslims. By the early twentieth century there was in any case an

expansion in the number of money changers in the Heijaz with an increasing volume of pilgrims visiting Makkah and Medina as transportation by road, rail and sea became easier and cheaper. Most money changers operated from a single company, but some - remarkably the Mahfouz and Musa Kaki families - had several outlets in different geographical locations. Like many of the money changers and traders in the Heijaz, they originated from Yemen (Wilson, Al-Salamah et al. 2004).

The first foreign banking institution in Saudi Arabia was Dutch and opened in 1928 largely to provide money-changing facilities for pilgrims setting out from Java in the then Dutch East Indies, it was referred to as a trading company - the Netherlands Trading Society - rather than a bank as the King objected to that designation, because of its *riba* connotations, though it actually performed a range of banking functions including trade-financing facilities. The financing of imports from Britain was handled from the Jeddah office of the trading firm of Gellatly Hankey, which from the 1920s acted as agent for the British overseas banks. In 1936 Bank Misr of Egypt applied for permission to open a bank in Jeddah to serve both Egyptian pilgrims and Red Sea trade, however its request was rejected due to suspicions among the ruling family regarding Egyptian intentions; it was felt that if a banking licence was to be granted for a substantial operation this should be to Saudi Arabian nationals (Wilson, Al-Salamah et al. 2004).

The Mahfouz and Musa Kaki families petitioned the King for permission to establish the first locally owned bank in 1937, with the result that the following year the Kaki Salih Company (later renamed the National Commercial Bank) opened for business in Jeddah, with 51.5 per cent of its capital owned by Bin Mahfouz and the remaining share by the Musa Kaki family, in many respects the new institution was similar to the traditional money changers with whom it competed, but as a formal bank it was

able to issue letters of credit on behalf of Saudi Arabian merchants which represented guarantees to Western exporters that payments would be made, either by the importers or by the bank itself in case of default. Although the bank was unregulated, foreign banks, knowing it had the King's support, were prepared to accept its letters of credit on behalf of their exporting clients (Al-Salamah et al. 2004).

The government of Saudi Arabia itself conducted much of its foreign exchange business through the Netherlands Trading Company, mainly because it was able to secure longer deferred payments terms, as in the early years of oil production revenues were not large. However, oil revenues increased noticeably in the late 1940s, and although some payments were received in the form of silver and gold there was an increasing supply of dollar notes. The French Banque de l'Indochine, which had extensive dealings in precious metals in South-East Asia, offered to exchange the dollar notes for gold sovereigns and silver riyals at favourable rates of exchange for the King. The bank already had offices in Djibouti on the African side of the Red Sea, as well as in Lebanon and Syria, and in 1947 the King gave his permission- to its representative, Christian Delaby - to open a branch in Jeddah the following year (Wilson, Al-Salamah et al. 2004; SAMA, 2015).

King Abdul-Aziz's Finance Minister (Sheikh Abdullah Sulayman) gradually realised that this random approach of relying on foreign banks for the government's own financing needs was insufficient, but there was also a disinclination to favour one group of local financiers such as the Bin Mahfous family, over others. The main problem facing the government was the variation in the price of silver, on which the riyal was based, and gold, on which the Saudi sovereign was based. Britain's ambassador advocated the setting up of a currency board similar to those existing in many British colonies, and a treasury official was dispatched from Whitehall to make

the case for a Saudi dinar, to be a parity with the British pound, with the Kingdom - like its neighbours, Iraq and Egypt - as part of the sterling area (Wilson, Al-Salamah et al. 2004; SAMA, 2015).

The King distrusted the British, and was not keen about either paper money or links to the sterling area that would have curtailed convertibility. He, therefore, turned to the Americans for advice as they provided much of the oil revenue and was already heavily involved in the Kingdom. The financial expert from California (Mr. Arthur Young) arrived Saudi Arabia in 1951 to head a mission on currency reform. Based on the reports of Mr. Young and after consultations with HR Prince Saud, who later became King Saud Bin Abdul-Aziz, to define the suggested institution, a name was selected for the desired financial institution in addition to specifying its functions and objectives. Consequently, the two Royal Decrees No (30/4/1/1046) and (30/4/1/1047) dated 25/7/1371H (20/4/1952G) were issued ordering the creation of the Saudi Arabian Monetary Agency (SAMA), and establishing its Statute to confirm its important role in the stabilization of the value of the Saudi currency, strengthening this currency domestically and abroad, supporting the Ministry of Finance by centralizing the reservation of government's revenues, providing necessary consultation to the Government on matters related to coinage and circulation of currency, supervising commercial banking system and money exchangers dealing in foreign exchange. Under the Statute, SAMA was not allowed to give advances to government or private parties nor to issue paper currency. The Statute included other further items as stated by the two Royal Decrees. He also recommended that the Saudi Riyal, to be linked to the dollar and hence directly to gold. This proved much more attractive to the King and Sheikh Abdullah Sulayman than the British plan as sterling was not linked to gold and sterling had just been devalued (from 4

dollars to 2.8 dollars to the pound). The Saudi Arabian Monetary Agency (SAMA) opened in 1952 and functioned successfully along the lines envisaged by Young (Wilson, Al-Salamah et al. 2004; SAMA, 2015).

It is clear from these developments that the King was mainly concerned with not being exploited by foreign colonial interests, but also that a degree of practicality was involved when it came to securing deals with Dutch and French institutions plus a willingness to listen to American advice. Nevertheless, Islamic rules on the haram or unlawful nature of interest transactions were respected, and there was much debate on how the new monetary agency advocated by Young should be designated. Sheikh Sulayman indicated to Young that the King would need to be assured that the new agency would not deal in interest, and that the designation 'bank' could not be used. Young suggested the term 'financial agency' but the King rejected this proposal, and in the end 'monetary agency' was agreed upon. Under Article 3.7 of the new agency's charter all paying or receiving of interest was prohibited as was the issue of currency notes, though the latter was subsequently dropped (Wilson, Al-Salamah et al. 2004; SAMA, 2015).

## **2.7 Financial and Accounting Monitoring Bodies in Saudi Arabia**

Five major bodies regulate, supervise and monitor listed companies in Saudi Arabia: the Ministry of Commerce and Industry, the Saudi Organization for Chartered Public Accountants, the Capital Market Authority, the Saudi Stock Exchanges (*Tadawul*), and SAMA (Central Bank), all of which are described below.

### **2.7.1 The Ministry of Commerce and Industry (MCI)**

The Ministry of Commerce and Industry is the main body monitoring Saudi companies. It regulates and supervises the industry to ensure that Saudi companies comply with national regulations. Moreover, the Ministry indirectly supervises many

monitoring devices, such as the Saudi Capital Market Authority, the Saudi Stock Exchange and the Saudi Organization for Certified Public Accountants.

### **2.7.2 The Saudi Organization for Certified Public Accountants (SOCPA)**

The Saudi Organization for Certified Public Accountants (SOCPA) is a professional organization that was created in 1991 by the Ministry of Commerce. Its members are responsible for promoting and improving the practices of the accounting and auditing profession, developing the profession and upgrading its status. The responsibilities of the SOCPA are as follows:

- “Reviewing and developing accounting and auditing standards.
- Monitoring the performance of certified public accountants to ensure compliance with CPA regulations and standards.
- Preparing and establishing SOCPA fellowship examination rules and managing CPE courses.
- Undertaking research in relation to the accounting and auditing profession.
- Organizing accounting conferences and attracting professional expertise and academics.
- Encouraging accounting researchers to conduct studies in the accounting and auditing profession by offering funding or reward incentives.
- Publishing accounting and auditing standards and current topics through the release of journals and books” (SOCPA, 2006).

### **2.7.3 The Saudi Capital Market Authority (CMA)**

The Capital Market Authority, which reports directly to the Prime Minister, began as an unofficial organization in the 1950s and performed successfully until the Saudi government created its basic regulations in the 1980s (CMA, 2007). It came into existence officially in 2004, when it became fully independent. The CMA’s role is to

regulate and develop Saudi companies by equipping them with appropriate rules and regulations that promote increased investment and enhanced transparency and disclosure standards. In addition, it aims to protect investors and dealers from illegal activities in the market (CMA, 2007). The CMA is managed by a board with five members, who are appointed by the Prime Minister. These members are not permitted to take part in any commercial activities or be involved in any profitable projects. Corporate governance practice is one of the most significant regulations the Capital Market Authority has issued. It started as a recommended regulation in 2006 and was transformed into a compulsory regulation in 2010.

The CMA is in charge of issuing regulations and instructions and making sure that these are implemented correctly. The following are the duties of the CMA:

- “To progress and regulate the Saudi Stock Market (*Tadawul*) and improve standards and transactions.
- To enhance security by protecting investors and the public from unfair, unsound and illegal practices, including fraud and manipulation.
- To improve the efficiency of the market and make transactions of securities more transparent.
- To diminish the risks associated with transactions through the creation of appropriate measures and standards.
- To monitor how committed Saudi listed companies are to disclosing the required information.
- To oversee all activities and transactions on the Saudi Market.
- To improve and oversee the issuance of securities and under-trading transactions” (CMA, 2015).



In general, the CMA plays a key role in developing and regulating the Saudi Stock Exchange by issuing the required regulations and instructions to make it possible for companies to perform more efficiently. Furthermore, it aims to protect investors, thus enhancing stability and security in the Saudi market. However, many investors have a negative view of the CMA and question its ability to protect investors and constrain illegal activities, especially in financial crises.

#### **2.7.4 The Saudi Stock Exchange (Tadawul)**

Tadawul is an Arabic term that refers to the exchange of stock on the market. The Saudi Stock Exchange (Tadawul) is considered necessary for the attainment of significant growth in the Saudi economy. It is a self-regulated authority that is governed by a board with nine members, who are nominated by the Saudi Capital Authority and appointed by the Prime Minister. The board members represent different governmental organizations, for example, the Ministry of Finance, the Ministry of Commerce and Industry and the Saudi Arabian Monetary Agency (Central bank). Two members are from listed companies and four are representatives of licensed brokerage firms (Saudi Stock Exchange Law, 2009).

Saudi listed companies started to operate in the mid-1930s. The first joint stock company on the Saudi Stock Exchange was the Arab Automobile Company (Saudi Stock Exchange Law, 2009). In 1975, the Saudi economy expanded exponentially due to an increase in the price of oil, and the Saudisation (buying shares from foreign investors) of foreign banks' capital contributed to a rise in the number of large companies and joint stock banks. The Saudi market at that time was informal and not organized. Thus, throughout the 1980s, the Saudi government launched trading regulations along with the required systems. In 1984, it tried to regulate the market by creating a committee that incorporated the Ministry of Commerce and the Saudi

Arabian Monetary Agency. This government body was responsible for regulating and controlling market activities until the emergence of the CMA in 2004.

In recent years, the Saudi government's scheme to privatize many of its vital economic sectors has led to a large number of private and family companies going public. Thus, the number of Saudi listed companies has increased dramatically from 81 in 2005 to 171 in 2015 (Tadawul, 2015). There are currently 171 listed companies across the various industries on the Saudi market, with different percentages of ownership. The Saudi market is now more attractive to foreign investors due to it having become more stable and secure. The Stock market is the only body with the authority to trade in securities in Saudi, and thus it has the following responsibilities:

- “To increase and ensure fair and efficient activities in the market.
  - To ensure market integrity, quality and fairness.
  - To support investor education and awareness efforts.
  - To develop and enhance excellence of service for all customers, including brokers, issuers, investors, vendors, etc.
  - To improve the exchange's capabilities and competencies.
  - To issue and enforce professional standards for brokers and their agents”
- (Tadawul, 2015).

#### **2.7.5 Saudi Arabian Monetary Agency (SAMA)**

The Saudi Arabian Monetary Agency (SAMA), the central bank of the Kingdom of Saudi Arabia, was established by two royal decrees issued on 20/4/1952. The first was Decree No. 30/4/1/1046, and this established the Saudi Arabian Monetary Agency. The second was Decree No. 30/4/1/1047, and this approved of the Charter

of the Saudi Arabian Monetary Agency, which was attached to the decree, and ordered its implementation. SAMA started practicing on (04/10/1952).

SAMA has been playing an important part in the consolidation and development of the Saudi financial system. At the time of its establishment, the Kingdom of Saudi Arabia did not have a monetary system exclusively of its own. Foreign currencies circulated in the Kingdom as a medium of exchange; along with Saudi silver coins Saudi banknotes had not yet been issued. There was no Saudi bank in existence and the banking business was being conducted by foreign bank branches. One of the foremost tasks of SAMA in its early stage was the development of a Saudi currency (SAMA, 2015).

SAMA has also played a fundamental role in the creation of and paid special attention to the need for promoting the development of a national banking system. From 1960 to 1972, SAMA focused on banking regulations against the background of enlarging the banking industry and the Kingdom's acceptance of full convertibility of the Riyal in March 1961 in accordance with the Article VIII of the Articles of Agreements of the IMF (SAMA, 2015). From 1973 to 1982, SAMA's main concern was to restrict inflationary pressures in the booming economy, expansion of the banking system and manage the massive foreign exchange reserves. Then from the mid-1980s, SAMA's main concerns were to reform the Saudi financial market. Over the years, due to the growth of the economy and expansion of the financial system, SAMA's responsibilities have expanded (SAMA, 2015). Some of these responsibilities are stated below:

- “Dealing with the Government’s banking affairs.

- Minting and printing the national currency (the Saudi Riyal), strengthening the Saudi currency and stabilizing its external and internal value as well as strengthening the currency's cover.
- Managing Saudi's foreign exchange reserves.
- Managing monetary policy in order to maintain the stability of prices and the exchange rate.
- Promoting the growth of the financial system and ensuring its robustness.
- Overseeing commercial banks and exchange dealers.
- Overseeing cooperative insurance companies and the self-employment professions related to insurance activity.
- Overseeing finance companies.
- Overseeing credit information companies" (SAMA, 2015).

Significant improvements in banking regulation and supervision have occurred since the 2004 (IMF, 2013). SAMA introduced Basel II and used the Pillar 2 requirements to promote improvements in the risk management and capital planning of banks. In terms of supervision, risk-based approaches were introduced and large resources were assigned to supervision, with overall staffing currently being approximately 200 people (a one hundred percent increase over the past five years). SAMA also started the introduction of Basel III requirements (IMF, 2013).

Saudi Arabia implements International Financial Reporting Standards (IFRS) for banks and insurance companies. The major accounting firms have a presence in Saudi. Listed companies use local generally accepted accounting principles and the auditing standards set by the Saudi Organization for Certified Public Accountants, which are not as extensive as International Financial Reporting Standards (IFRS)

and International Standards of Auditing (ISA). In the following section, two of the key functions SAMA has introduced to the Saudi banking industry are discussed.

The first is prudential regulations and requirements. SAMA has gone to some trouble to introduce Basel II, which ought to complement recent improvements in banks' risk management, leading to a better regime for large exposures and connected parties. Most of the risk management guidelines can be found in the Basel II documents (which are not applicable to foreign branches). A framework circular ought to be issued containing all aspects of risk management and the requirements in relation to market risk and internal controls that have been introduced over the previous ten years. Widespread bank losses that resulted from the 2009 failure of Al-Gossaibi and Bros. Co. and the Saad Group suggest the possibility of poor credit risk management. SAMA has responded to this by ensuring that losses were fully accounted for and by initiating a conversation with the banking industry to identify the lessons that need to be learned. In a system characterized by high single-name concentration, individual large exposures should receive more attention, especially during on-site inspections. The possibility of SAMA allowing exposures of as much as 50 percent of capital should be removed, with exposure being capped at 25 percent of capital. Furthermore, the definition of related parties needs to be made stronger to ensure that close family relationships are recognized (IMF, 2013)

SAMA has advocated that banks build prudent capital and create buffers based on reliable financial statements. These buffers have decreased the impact of the global crisis and meant that the default of two large groups could be absorbed without threatening any bank. Capital buffers are now an integral part of the ICAAP process, with SAMA's senior management endorsing them. Moreover, SAMA has now launched international accounting and auditing standards (IFRS and ISA) for banks

and their auditors with some success. It also brought in Pillar 3 disclosure requirements in 2008 as part of the implementation of Basel II (IMF, 2013).

## **2.8 Important Regulations and Laws in the Saudi Business Environment**

Saudi Arabia is an emerging market that has expanded exponentially in recent years. However, when compared with established markets, such as the US and the UK, the Saudi market may not be so active in terms of corporate control and the information deficit may be larger. The Saudi Government is attempting to create and improve regulations that may contribute to increased corporate control, disclosure and transparency of information. This section reveals the regulations and laws that play a key role in regulating Saudi listed companies' operations and structures and are related to the current study.

### **2.8.1 Companies' Law (1965) and Company Structure**

Companies' Law, which was derived from the British Companies' Law, is without doubt a significant regulation as well as the first formal attempt to regulate Saudi companies. It was issued by Royal Decree in 1965 and represented a basic system for all Saudi companies, which were obliged to comply with its instructions and rules. Despite the law having been altered to keep up with the rapid changes in Saudi companies, many now consider it out dated and unable to meet current requirements (Al-ghamdi and Alangri, 2005).

A company's structure plays a big part in determining its legal shape and organizational system. Generally, each company initially sets out a number of simple regulations, such as how directors to the board are elected, termination rules and shareholders rights. However, these regulations should accord with Saudi Companies' Law.

### **2.8.2 Accounting and Auditing Standards**

In 1986, Saudi Arabia implemented national accounting and auditing standards, which were based on American standards. Despite the banking sector and financial companies applying international accounting standards, most Saudi listed companies use Saudi national accounting standards (IFRSs, 2010). As mentioned previously, the responsibility for developing and reviewing accounting and auditing standards in Saudi Arabia lies with the Accounting Standards Committee of the Saudi Organization for Certified Public Accountants (SOCPA). Recently, SOCPA has attempted to merge the national standards and international financial reporting standards (IFRSs). Thus, most banks and financial companies have started applying the international financial reporting standards. However, SOCPA has encountered some obstacles that have constrained the application, although it has not publically identified the potential hindrances (Alghamdi, 2012).

In general, national accounting standards play a key role in Saudi in terms of developing disclosure and improving financial transaction procedures. They consist of 23 standards, such as disclosure requirements, revenues standard and inventory standard. In addition, national auditing standards help to increase the ability of external auditors and improve audit quality. 17 of the standards are associated with auditor competence, independence, audit plans, audit reports, etc. (Alghamdi, 2012).

### **2.8.3 Listing Rules and Disclosure**

Since 2003, the CMA has attempted to develop and improve corporate governance regulations in Saudi. The 2004 Tadawul's Listing Rules were key in terms of reforming corporate governance regulations. Therefore, the Saudi Corporate Governance Index (SCGI), which examines the degree of compliance with corporate governance standards, utilizes these rules. Part six of the regulations, 'Continuing

Obligations', contains 15 articles that deal with disclosure and transparency in corporate annual reports in order to reduce asymmetric information, (Albassam, 2014). Article 25a makes clear that listed firms must immediately inform the CMA and shareholders about any major changes in their operations. The notification should be put on the Tadawul website no more than two hours prior to the first trading period in the stock market. The purpose of this is to let stakeholders know about any potential effects on the firm's assets, liabilities or general business procedures.

Article 26d states that the company has to put its quarterly and annual financial results on the stock market website straight after board approval. The CMA makes clear that the financial results must be announced within 15 days for quarterly results and 40 days for annual results. Furthermore, the annual report has to be approved by the board of directors and signed by the authorised directors, the CEO and the CFO before it can be published and circulated to shareholders (Article 26a).

Article 27a states that listed firms must publish their annual report in the key national newspapers and also on the Tadawul website. All listed firms must review their operations during the last financial year. Furthermore, they should include the factors that can help investors to assess the company's future. Thus, the board of directors' report must contain the following: (i) a description of the company's main activities; (ii) a description of the company's key plans, decisions taken, future prospects and potential risks faced; (iii) a summary of the company's assets, liabilities and business results over the last five financial years; (iv) an explanation for any major differences between the operational results of the present and previous financial years; (v) information on the company's dividend policy; and (vi) a detailed description of the company's loans and debt commitments.



As ownership structure is important and closely related to agency problems, Article 27/10 instructs companies to make public the board's report on the ownership structure, naming shareholders who own 5% or more of the company's shares. This rule applies to directors, managers, outsiders and their associates. In addition, they must tell shareholders about any relevant changes during the last financial year. In order to increase transparency in companies' contracts and avoid exploitation by insiders, Article 27/17 states that the board report must reveal any information on the interests of board directors, the CEO the CFO or their relatives in the firm's commercial transactions and business contracts. In order to show the board's importance, Article 27/16 states that the report should detail the number of board meetings and who attended each meeting.

According to Article 27/22, the board report ought to contain statements affirming that: (i) a proper accounting system has been used; (ii) the internal control system is well designed and has been implemented correctly; (iii) there are no serious doubts regarding the company's ability to continue and evolve; and (iv) the reasons for a change in the external auditors are provided. Finally, according to managerial signalling theory, managers (agents or insiders) are privy to more inside information than are ordinary shareholders (principals) (Morris, 1987; Bebchuk and Weisbach, 2010). Thus, Article 33 forbids trading by agents within a reporting window. Specifically, directors, executive managers and their associates are not permitted to trade in any of the company's securities during the following periods: (i) the 10 days before the end of the financial quarter up until the date the quarterly results are announced (ii) the 20 days before the end of the financial year up until the date the company's annual results are announced. Furthermore, in order to control executives and directors of listed firms remuneration packages, Article 36 insists that

the company should allow the general assembly to vote on a written policy for remuneration or compensation. (Albassam, 2014)

As the above mentioned articles have highlighted the importance of disclosure rules and regulations in Saudi Arabia, it is important to contextualise the above discussed regulations as they lay the foundations of the current study by setting out the rules and regulations influencing the disclosure of risk information in the Saudi banking industry.

#### **2.8.4 Disclosure act in Saudi Arabia**

Article 42 of the Capital Market Law (2009) issued by the CMA states that the prospectus should contain the following (CMA, 2015):

“Information needed by the Authority’s rules which describes the issuer, the nature of its business, the individuals overseeing its management, such as members of the board of directors, executive officers, senior staff and major shareholders”.

“Information needed by the Authority’s rules which describe the securities to be issued, their number, price and related rights along with the preferences or privileges of the issuer’s other securities, should there be any. The description will explain how the issue proceeds are to be disbursed and the commissions charged by anyone associated with the issue”.

“A clear statement regarding the financial position of the issuer and any relevant financial data, including the audited financial balance sheet, profit and loss account and cash flow statement according to the rules of the Authority”.

“Any other information needed by the Authority that it deems investors and their advisers will need to make decisions about investing in the securities to be issued”.

Article 45 of the Capital Market Law (2009) issued by the Capital Market Authority states that:

“a. Every issuer that offers securities to the public or trades securities on the exchange must submit quarterly and annual reports to the authority. Annual reports have to be audited according to the rules of the authority. These reports must contain:

1. The balance sheet
2. The profit and loss account
3. The cash flow statement
4. Any other information required according to the rules of the authority”

“B. In addition to the information required in paragraph (a) of this article, the annual report must contain:

1. A sufficient description of the issuing company, the nature of its business and its activities, as needed according to the rules of the Authority.
2. Information regarding the members of its board of directors, executive officers, senior staff and major investors or shareholders, as needed according to the rules of the Authority;
3. An evaluation of the issuing company’s management of current developments and any possible future plans that may have a significant effect on the business results or financial position of the company, as needed according to the rules of the Authority.
4. Any other information required by investors and their advisers to make a decision to invest in the issuer's securities, as needed according to the rules of the Authority”.

“c. All the information and data set out in paragraphs (a 1, 2, 3,) and (b 3) of this Article are deemed confidential. Prior to disclosing such information and data to the Authority, the issuing company is forbidden to disclose such information to parties not bound by a confidentiality agreement to protect such information” (for a comprehensive view of the disclosure act, please see chapter seven of the capital market law attached in the appendix).

## **2.9 The Development of Corporate Governance in Saudi Arabia**

Corporate governance issues are significant in emerging markets due to these markets not having features like well-established financial institution infrastructures to deal with corporate governance matters (McGee, 2010). Corporate governance ought to ensure the timely and specific disclosures of all material matters concerning the company, including performance, financial position, ownership and management. Up until 2005, when the Saudi CMA drew attention to problems with companies' performance, corporate governance mechanisms were not deemed significant in Saudi Arabia. Moreover, the 2006 market crisis in Saudi Arabia highlighted serious issues and weaknesses in financial reporting, specifically a lack of transparency, disclosure and accountability (Saudi Journal of Accountancy, 2006). Thus, corporate governance has since received notable support from the Saudi government. Furthermore, it is becoming a key issue in the Saudi business environment and is now much debated. In Saudi Arabia, corporate governance mechanisms include essential rules and standards, such as those that relate to the rights of shareholders, disclosure, transparency and board composition, and they regulate the management of joint stock companies listed on the Exchange. This ensures best practices are complied with and that the rights of shareholders and stakeholders are protected.

The laws governing the legal framework that affects corporate governance in Saudi Arabia fall into three groups: first, the company law system, which was derived from British Companies' Law; second, the Saudi Organization for Certified Public Accountants; and third, the Saudi Capital Market Authority (Alghamdi, 2012).

Corporate governance was first established by the Capital Market Authority Board in 2006 and revised in 2010 to regulate and develop the Saudi capital market and improve the credibility and transparency of financial reporting. Despite the code being merely a guideline and not a mandatory regulation prior to 2010, Saudi listed companies were obliged to disclose the provisions that had been implemented and those which had not and to explain any reasons for non-compliance in the annual report. The code is comprised of five main parts. The first part is preliminary provisions, and this explains and defines some key terms, such as 'independent member', 'non-executive' and 'shareholders'. The second part discusses the rights of shareholders and the General Assembly. The third part focuses on disclosure and transparency in relation to company policy. The fourth part discusses the functions and responsibilities of the board of directors. The final part includes publications coming into force and involves implementation (Code of Corporate Governance, 2006).

## **2.10 Financial Reporting Requirement in Saudi Arabia**

The financial reporting requirements of banks in Saudi are mostly set by SAMA. Such requirements are in line with the international accounting standards. In addition to this, banks are also required to follow other standards and regulations set by the ministry of commerce. Banks as companies have to follow the ministry of commerce regulations and as banks they have to follow SAMA regulations (Al-Mehmadi, 2004).

SAMA has over the years developed eight accounting standards for commercial banks (SAMA, 2009). SAMA also approves of the adaption of the accounting standards issued by the ministry of commerce for any other accounting issues that are not incorporated in their standards by banks (Al-Abdullatif, 2007). The Ministry of Commerce Accounting Standards are issued by SOCPA. Hence, compliance with SOCPA accounting standards is obligatory for all corporations excluding banks. Though, Alrajhi bank has mentioned that their bank use SOCPA standards along with other regulations and standards. The rest of the banks never mentioned SOCPA accounting standards. Al-Mehmadi (2004) mentioned that SOCPA argues that there should be only one accounting organization in the country responsible for issuing accounting standards for commercial organization including banks.

“(i) The Banking Control Law (BCL) issued and monitored by SAMA.

(ii) The Regulations for Companies: the Company Act Law (CAL) was introduced by royal decree number M6 in 1965 which is also considered the bases for accounting standards.

(iii) International Accounting Standards (IAS) issued by the International Accounting Standards Committee.

(iv) The financial statements presentation and disclosure requirements of the ministry of commerce Standards for Presentation and Disclosure (SPD).

(v) The Bank's Article of Association (BAA) with respect to the preparation and presentation of financial statements. These are the internal preparation and presentation requirements within each bank” (Al-Mehmadi 2004).

As it stands today banks financial reporting regulations are enforced by such institutional bodies to enhanced transparency in the banking sector in Saudi Arabia. However, where local reporting regulations are lacking international reporting regulations are employed as demonstrated in the discussion.

Furthermore, Essayyad and Madani (2003) documented that all Saudi banks have to comply with the International Accounting Standards (IAS). Also, Al-Mehmadi (2004) studied the accounting practice of nine Saudi Banks as reported in their annual reports from 1997 to 2001 and showed that all Saudi Banks had adopted SAMA accounting standards, the BCL, and the Regulation for Companies (Company Act Law). Plus from 1999-2001 all banks followed the International Accounting Standards (IAS). While, the Islamic accounting guidance developed by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are not implemented by any of the Saudi banks including Islamic banks in the Kingdom. Even though, banks such as Alrajhi Bank, Aljazira Bank, and Bank Albilad were midst the Founding Members of the AAOIFI, and all of them have the desire to implement the AAOIFI standards. It could be argued that the problem in accounting regulations in Saudi Arabia arise from the fact that there are two government ministers concerned with financial disclosure, namely, the Ministry of Commerce and the Ministry of Finance. Banks have to follow the accounting standards for banks issued by SAMA, which is a part of the ministry of finance. Though, the accounting standards in Saudi Arabia are issued and enforced by SOCPA for all companies including banks. However, banks do not implement these standards because SAMA does not require them to do so (Al-Mehmadi 2004).

### 2.11 Summary

Chapter 2 presented an overview of Saudi Arabia in order to reveal insights into the country's background, legal system, banking history, regulating and supervising institutions, accounting and auditing profession, SAMA, listing rules and disclosure regulations and financial reporting requirements. An understanding of the fundamental underlying issues in Saudi Arabia helps with the employment of some measurements to obtain an understanding of risk disclosure practices in listed banks. The following chapter discusses the theoretical framework of the study, where relevant disclosure theories are discussed to explain the motives and the extent of corporate risk disclosure practices as well as its relationship to the main theme of this researcher.



### **3 Chapter Three: Theoretical Framework**

#### **3.1 Overview**

This chapter starts by explaining what disclosure is and providing definitions of risk and risk disclosure. It also provides a brief discussion of the importance of types of disclosure. Then theoretical discussions on disclosure theories and their relationship to risk disclosure theories employed in this study. There will be an explanation of agency theory, its connection to risk disclosure and importance of agency theory in relation to this investigation. Secondly it considers the signalling, its relationship to risk disclosure and importance to the current study as well as considering the information asymmetry theory its connection to risk disclosure and importance to this research. Thirdly, it explains stakeholder theory, its connection to risk disclosure and importance in relation to this study. Fourthly, this study considers the legitimacy theory, its connection to risk disclosure and importance in relation to the levels of voluntary risk disclosure. Finally, this chapter discusses a new theory “the upper echelon theory” which this study has incorporated into the field of disclosure. This theory is firstly explained then a fourth dimension added to the original framework in order to suit the purpose of investigating disclosure in light of this theory. Also the importance of this theory in relation to investigating risk disclosure is explained. It has been argued that there is not a single theory which can explain the phenomena of disclosure as a whole therefore, researchers tend to choose the most articulated theory with their hypotheses (Linsley and Shrives, 2000) thus this study employs six theories to explain the phenomena of risk disclosure and why managers sometimes observe this practice and sometimes do otherwise.

#### **3.2 Definition of Disclosure**

Disclosure in its broadest sense incorporates the exposure of any information regarding a particular entity, from everything that is included in that entity’s annual

report, information announcement, press releases, and newspapers and on the internet. Company's disclosure of information is publicly conveyed to different interested user groups in the company. Therefore, they must report financial information to satisfy the user's different needs (FASB, 2001). There is no doubt that the published information is not intended to satisfy the interest of the shareholders, since they are the capital providers of the companies. Though, there are other interested groups such as employees, lenders, the public and government, which the company need to consider in their disclosure.

The instability and uncertainty of capital markets signify that shareholders demand more high quality information when considering investment decisions. Thus, to make a good assessment of a particular firm shareholders and all interested user groups require firm information to be comprehensive, precise and transparent. Furthermore, disclosure has been defined by the Securities and Exchange Commission (1997) as the act of releasing all relevant information pertaining to an organisation that could affect an investment decision making process. Disclosure is all sorts of relevant information regarding firms' market activities and performance. Moreover, disclosure is a vehicle used to persuade shareholders and other interested user groups that the firm is appropriately managed and is accountable to them. Hence, it exposes firms' performance and whether the internal management is administering the firm in the best interest of investors or not (Healy and Palepu, 2001).

Furthermore, the Basel Committee on Banking Supervision (1998 p.15) defines

"...transparency as public disclosure of reliable and timely information that enables users of that information to make an accurate assessment of a bank's financial

condition and performance, its business activities, and the risks related to those activities”.

The reports also specified for banks that their disclosure must be comprehensiveness, relevant, timely, reliable, comparable and material. This signifies that all relevant information must be disclosed on timely bases so as to meet shareholders demands. The information contained within these reports must be reliable and are easy to compare with other institution within the same industry. Also this information must be material in order for investors to consider in the process of investment decision makings. These criteria are considered large enough to matter to influence the economic decision makings of users. Thus it is necessary to apply such criteria in order to be able to evaluate banks financial performance which then leads to a more accurate assessment of risks by all interested user groups.

### **3.3 Risk Definitions**

Linsley and Shrives (2006) claimed that a major difficulty in undertaking any risk disclosure research is pinpointing risk information. Therefore, it is essential to clearly define risk. However, defining risk is problematic as the level of management control over risk differs according to the kind of risk, for instance financial risks could be administered by financial instruments and other risks are operational (Schrand and Elliott, 1998). Risk has been defined by Dobler, Lajili and Zeghal (2011), as the occurrence of natural events, while Linsley and Shrives (2006) defined risk as the positive and negative outcomes of events and Solomon et al. (2000) described risk as potential gains and losses. Watson and Head (1998) defined risk as a set of outcomes occurring due to a decision that can be allocated probabilities, while uncertainty occurs when probabilities cannot be allocated to the set of outcomes. Beretta and Bozzolan (2004) gave a broad description of risk as the communication

of elements that have the possibility of influencing the expected results upside (opportunities) and the downside (events that might go wrong), while Cabedo and Tirado, (2004) defined risk as a succession of internal and external elements that indicate a company's wealth, challenges, opportunities and threats. Also, Cabedo and Tirado (2004) described risk as the probable loss or potential improvement in companies' wealth that occurs due to the interaction of these elements. Similarly, Schrand and Elliott (1998) described risk as potential for loss or gain. Abraham and Cox (2007) put risk into three categories: firstly, variation (i.e. volatility), secondly, uncertainty (i.e. contingency) and thirdly, opportunity (i.e. upside).

On the other hand, risk has also been defined professionally. The ASB (1998) defined risk in FRS 5 as uncertainty as to the amount of benefits, which incorporates both potential for enhancement and loss. Moreover, the ICAEW (2002) distinguished between downside and upside risk, affirming that downside risk is the risk that something will go wrong and volatility risk is the risk related to uncertainty, which allows for gain as well as loss. In addition, the ICAEW (2002) clearly indicated that risk reporting should specify that there could be a wide variety of different consequences with upside as well as downside potential.

### **3.4 Definitions of Risk Disclosure**

Academics have defined risk disclosure differently. Therefore, it is important to adopt a fit for purpose definition since different definitions might lead to different results and analysis. Risk reporting practices heavily depend on a number of social and economic factors, such as the cultural, legal, political, economic and historical backgrounds of financial markets and regulations. Further, the ICAEW (1999) stated that risk disclosing in annual statements should incorporate "information about risks in the broadest sense, about actions to manage them and relevant measures". A

number of academics have defined risk disclosure as a set of information news in financial reports dealing with managers' estimates, judgments and reliance on market based accounting policies, such as impairment, derivative hedging, financial instruments, economic, political, financial, management of risks, and internal control of risks (Hassan 2009 and Miihkinen 2012). This definition is in line with Schrand and Elliott (1998), who affirmed that risk reportage is all kinds of information news reported in financial reports dealing with business uncertainties.

Consequently, for the purposes of this study, the researcher adopted two well-defined and fit for purpose risk disclosure definitions. The first definition is by Linsley and Shrives (2006, p.3), who define risk reporting as "If the reader is informed of any opportunity or prospect or of any hazard, danger, harm, threat, or exposure, which has already impacted upon the company or may impact upon the company in the future or of the management of any such opportunity prospect, hazard, harm, threat or exposure". The second definition is by Hassan (2009, p.669), who defines risk disclosure as "the financial statements' inclusion of information about managers' estimates, judgments, reliance on market based accounting policies such as impairment, derivative hedging, financial instruments and fair value as well as the disclosure of concentrated operations, non-financial information about corporations' plans recruiting strategy and other operational, economic, political and financial risks".

### **3.5 Types of Disclosure**

To assist investors and all user groups evaluate a company's current situations they have to report broad and complete information in their annual reports. As argued in the first empirical study of this thesis, annual reports are a central mean of communication between the bank and investors. Thus, it is a fundamental part of

financial reporting to report adequate, precise and complete information since such information is needed by investors making investment choices.

Reported disclosure in annual reports has always been distinguished based on whether they are mandatory or voluntary. Mandatory disclosure is information required by law, regulatory bodies and authorities to be disclosed in company's annual reports. Whereas, Voluntary disclosure is information disclosed beyond what is required by law, regulatory bodies and authorities (Diamond and Verrecchia, 1991; Gernon and Meek, 2001). While, there is a non-existence of specific risk regulations or guidance on risk disclosure as it is the situation of most emergent economies, company directors will then reflect on broad risk information disclosures, which are suggested by professional accounting institutions as guidance for effective methods of voluntary risk disclosure. Generally, company directors will only disclosure risk information where they believe that they will benefit from such disclosures, and then they could be expected to disclosure voluntarily. But, there seems to be a lack of encouragement to report any material voluntarily due to the costs accompanying the exposure of risks particularly when the costs of risk exposure outstrip the benefits (Shrives and Linsley, 2003). Also, disclosure decreases agency conflicts and information asymmetries when reported voluntarily, this could sometimes tempt company directors to report more voluntarily.

A strand of people maintain that corporations have always disclosed some form of risk related materials which meet the terms of accounting regulations and standards. Thus, corporations do not have to explicate supplementary risks they encounter and how certain risks are administered and it is for the market to penalize what it does not like. Although, given the agency conflicts, some company directors might not disclose certain risk information to increase their monetary fortune at the cost of the

financiers' wealth. However, The ICAEW (1999) contends that comprehensively informed shareholders are essential in running capital markets well. Furthermore, to take good investment decisions; comprehensive and useful information should be reported. As mentioned above some sort of voluntary disclosure is essential since it could potentially influence their investment decisions. In addition, there are numerous potential benefits of voluntary disclosure, for example improving company's image, reputation, lower cost of capital, higher stock liquidation and thus leads to higher company valuation (FASB, 2001; Eccles, 2001; Oliveira et al., 2006; Tsakumis et al., 2006).

### **3.6 Theories of Disclosure**

A theory is knowledge that reveals or intends to reveal a set of phenomena (Christensen and Demski, 2003). It is necessary to take a theoretical stance when researching disclosure prior to the commencement of the process (Spira and Page, 2008). Preceding researches on disclosure have employed a variety of theoretical frameworks in their investigations to expound why companies involve themselves in different levels of disclosure. Nevertheless, there is no single theory available to explain the phenomenon of disclosure as a whole and researchers tend to choose whichever theory articulates best with their investigation's hypotheses (Linsley and Shrives, 2000). Some of the most common theories used in preceding disclosure investigations to interpret and rationalize disclosure practices are, agency cost theory, signalling theories, information asymmetry theory, stakeholder theory and legitimacy theory. Also, this study is a pioneer in the employment of the upper echelon theory in disclosure research. The explanations for these theories are as follows.

Disclosure theories are employed to shape research hypothesis and form conceptual development and expectations of the research at hand. Cooke (1998) stated that there is another difficulty when carrying out empirical work in accounting and finance, which is that the appropriate theoretical form of the relationship between the dependent and independent variables is unknown. Also, more than one relationship could be justified by a number of theories. This could lead to difficulties in the associations between variables. Nonetheless, this investigation will employ disclosure theories to unfold the risk disclosure exercises of listed Saudi banks. Previous literature has concentrated on explaining risk disclosure using a number of disclosure theories, which will be explained as followed.

### **3.6.1 Agency Costs Theory**

Agency cost theory, proposed by Jensen and Meckling (1976) could help in explaining manager's incentives for voluntary disclosure. They affirmed in their study that an agency relationship can be considered to be a contract among investors (the principal) and managers (the agent) so that the agent performs some services on the principals' behalf, which involves delegation of some decision-making authority to the agent. However, the separation of ownership from control in public shareowner corporations that may cause stakeholders' interests and managers' interests to differ is associated with the agency problem. Furthermore, agency costs theory demonstrates that owners, as principals, could decrease any possible disagreement by managers, who are referred to as agents acting on behalf of principals, by offering the agent a motive to act in the principal's best interest and by implementing monitoring costs, which could hinder any irregular activities of acting agents since both parties attempt to maximise their own interests and the agent won't always act in the best interests of the principal. Accordingly, the principal can restrict divergence



by incurring monitoring costs and in some cases will pay the agent to expend resources (bonding costs). There are other agency costs, such as residual loss, which is accumulated by declining benefits experienced by the principal. It is unrealistic for the principal or the agent at a zero cost to confirm that the agent will perform optimal decisions from the principal's point of view. However, this led to Watts and Zimmerman's (1978) Positive accounting theory, which believes that individuals work to increase their own benefits. For instance, company managers act to enhance their own prosperity. Hence, they are motivated to select certain accounting practices.

It has been highlighted in the agency literature that the problem is not purely among owners, managers and outside shareowners but has now stretched out to encompass the demand for contracts among owners, managers and debt-holders and outside capital suppliers. Watts and Zimmerman (1986) pinpoint that accounting numbers are employed in the firm's contracts that are intended to reduce agency costs. For example, debt/ equity ratios are deployed in debt contracts to limit managers' actions that transfer wealth from debt-holders. Additionally, accounting earnings are employed in bonus plans to reduce manager avoidance

#### ***3.6.1.1 Risk Disclosure in relation to Agency Theory***

Agency cost theory postulates disclosure as a vehicle, which reduces such conflicts, e.g. by providing annual reports and increasing the amount of information in such reports (Kelly, 1983; Marston and Shrivies, 1996). Also, Healy and Palepu (2001) argued that there is an agency cost problem in view of disclosure. The authors proposed four resolutions for agency problems. First, disclosure of appropriate information, which allows investors to inspect compliance with contractual agreements and assess whether agents have administered the corporation's

resources in the best interest of outside owners. Second, corporate governance with a great amount of stress on the board of directors' responsibility, which ought to monitor and discipline management in the best interest of outside owners. Third, information intermediaries who involve in private information production to expose any mismanagement of company's resources. And fourth, corporate control fillings that may include the risk of hostile acquisition and proxy contents and mitigating agency cost problem amongst corporate internal and external shareowners. There are number of academics whom have proxied agency costs in the disclosure literature by a number of variables, for instance firm size, financial leverage, audit type and ownership (Lopes and Rodrigues, 2007; Abraham and Cox, 2007; Deumes and Knechel 2008; Mohobbot 2005).

Furthermore, Linsley and Shrives (2000) gave an explanation of the association between agency costs theory and risk disclosure. The authors implied that disagreements are a result of the level of information, which needs to be reported by internal management to outsiders. Nowadays, investors and other information clients are receiving a small amount of information regarding risks and their management by managers, which might urge investors to monitor agents' activities to make sure that they are acting in their best interest. This then in turn might encourage agents to report additional information including risk disclosure as a process of maintaining investors satisfied. Also, Linsley and Shrives (2003) claimed that agency costs theory could unfold why managers could opt to voluntarily release risk communication so as they could reassure stakeholders that they have risk management facilities in place. Yet, it might as well signify a negative reason for firms to voluntarily release risk news.

A study, which was completed by Elzahar and Hussainey, (2012) confirmed that agency costs raises with high leverage ratio. Moreover, Management reporting risk could illustrate a fundamental role in mitigating creditors' concerns on the solvency of their company and its abilities to produce enough cash flows in the future (Rajab and Schachler, 2009). Also having a high leverage ratio encourages voluntarily risk reporting, which signals the capacity of a company to arrange short and long term obligations to investors (Elzahar and Hussainey, 2012). It has been empirically evident by Khang and King, 2006; Hussainey and Walker, 2009 that companies which hold high levels of information asymmetry are prone to signal to investors by disbursing higher dividends. On the contrary, other investigations hold that companies with low levels of information asymmetry are prone to disburse higher dividends (e.g., Deshmukh, 2005; Li and Zhao, 2008).

#### ***3.6.1.2 The importance of agency cost theory in relation to this investigation***

The agency theory will act as an underpinning theory for the purpose of this study. Linsley and Shrives (2006) suggested that in unfolding voluntary risk disclosure the agency theory should be used as the underpinning theory. This theory will be the foundation in interpreting the results of the current study's questions to further explain why banks are reporting such information. Therefore, this theory is essential in explaining the levels and practices of risk disclosure in the annual reports of all listed Saudi banks. Agency cost theory has been previously employed to elucidate the relationships between risk disclosure and its determinants. Hence, in this study it will be employed for the same purpose but in the banking industry.

Furthermore, Barako et al., (2007) asserted that voluntary disclosure in annual reports can be employed as an example of the application of agency theory. Thereby, voluntary disclosure is a vehicle used to persuade shareholders and other interested

groups that the firm is appropriately managed and is accountable to them. Which then lead to shareholders confidence and thus decreases information asymmetrical gap between them. The employment of this theory in this study is important to explain the motives for voluntary risk disclosure in relation to corporate governance attributes and other variables such as banks size, profitability, liquidity and leverage. Agency theory could be perceived as a dominant theory which can explain most of the explanatory variables. Nevertheless, more than one theory can be applied to the same variables, however the motive for disclosure from each theoretical perspective is different. Henceforth, the findings can illustrate the importance of risk disclosure in annual reports. Whereby, reporting such information will reduce the agency problem between bank insiders and investors.

### **3.6.2 Signalling theory**

Spence (1973) developed signalling theory as a means to describe people conducts in the labour market. It has a general phenomenon, which is applicable in any market with information asymmetry (Morris, 1987). In this paper the author rationalized the signalling practice in regards to education. Where, the author disputed that the level of education of a job applicant was a reliable signal of their fundamental competency. Also he disputed that managers might not note their staff productivity and that staffs with superior skills would signal their skills to the employer with the purpose of obtaining benefits. Moreover, Ross (1977) argued that directors with good news or with high quality products might give a warranty as a means to strengthen their signal and singularize their-selves from bad news and lower quality. This is in line with a latter argument put forward by, Strong and Walker (1987) who claimed that variations in information amid insiders and outsiders of a company can trigger markets meltdown. Since buyers (outsiders) in the market are incapable of

differentiating between the qualities of different products since, sellers (insiders) have not informed them about the product quality in a perfect manner. Henceforward, there are not any variations in prices between good quality and bad quality products.

Voluntary disclosure is regarded as a method of signalling in relation to information asymmetry in the market (Akerlof, 1970). Therefore, signalling theory can address such problems of information asymmetry and moderates this asymmetry gap by the party with more information signalling it to the other.

#### ***3.6.2.1 Risk Disclosure in relation to Signalling Theory***

There are a number of academic researchers whom have employed signalling theory in previous empirical disclosure investigations to explain why managers have the motivation to report more information news in annual report narratives (Strong and Walker, 1987; Suwaidan, 1997; Haniffa and Cooke, 2002; Watson et al., 2002). Also, it has been used by many researchers in explaining variations in voluntary risk disclosure levels (Marston, 1999; Weetman, 2003; Oliveira et al., 2006).

Furthermore, the literature on disclosure pinpoints a number of variables as a representative of signalling process, which are leverage, profitability and liquidity. The signalling process affirm that firm executives who trust that their firm can perform better than other firms will desire to signal this to investors as a means of enticing more capital and investments. They could carry out this signalling process in a form of disclosure additional to any disclosure mandated by law. Moreover, this theory indicates that when a firm's performance is good, directors will signal their firm's performance to their investors and the rest of the market by reporting information, which bad performance firms cannot report. In fact this improvement of disclosure by managers is to obtain more advantages, good reputation and increase firm value, whereas keeping silent would lead to misinterpretations by investors and

the rest of the market as withholding the worst possible information (Spence 1973; Verrecchia, 1983; Strong and Walker, 1987; Mohobbot, 2005; Linsley and Shrives, 2000; 2006; Hassan, 2009).

Lopes and Rodrigues (2007) strongly believed that signalling theory offers a connection for risk disclosure and industry type association. For example, similar industry participants are interested in maintaining similar levels of disclosure so as to circumvent any negative appreciation by the market. While, Linsley and Shrives (2000) in connection to signalling argued that firms, which offer more good disclosures are not only notifying shareholders and the market that the firm is in a good position with regards to having a strong risk management and internal control systems intact. But also are increasing anticipations that similar disclosures will be performed in years to come hence making management more accountable.

Managers' decisions on the provision of voluntary reportage are established on a cost-benefit analysis, for example; Cooke, (1992) compared between the costs of information presented and the benefits, which may occur from reporting such information. Also, Cooke (1992) claimed that organisations' reportage is an expensive matter, which requires several steps and preparations like information collection costs, auditing costs, supervision costs and legal fees. An argument led by Meek et al. (1995) stated that insiders have to maintain an equilibrium between benefits of lower capital costs, extra information and the costs related with such reportage. Accordingly, managers are prepared to report such information only when advantages surpass total costs.

All in all, Linsley and Shrives (2005) posited that signalling and agency costs theories are most relevant in illuminating voluntary risk disclosures. Additionally,

Linsley and Shrives (2003) asserted that directors might wish to indicate to the market that their firms are more developed in their risk management than others and their administrators are superior risk administrators than other firm managers, which would consequently offer a reason for some corporations to decide to report risk information.

### ***3.6.2.2 The importance of signalling theory in relation to this investigation***

As discussed above the signalling theory emphasises that annual reports information are important in the investment decision making process for investors. Such users of such reports believe that the information reported by banks insiders will communicate essential signals since this information will supply opinions and explanations in regards to the organisation's past, present and future positioning. Hence, shareholders demand precise, relevant and comprehensive information in order for them to make correct investment decisions. Therefore, banks annual reports should incorporate such measurements and enhance the transparency of such reports.

The signalling theory will also act as a supporting theory in this investigation. This theory will also be the foundation in interpreting the results of the current study's questions to further explain why banks are reporting such information. The signalling theory is employed since it helps in explaining the relationship between firm value and the level of voluntary risk disclosure in this study. A considerable volume of previous investigation has stressed the association between firm value and voluntary disclosure based on signalling theory (Gordon et al., 2010; Anam et al., 2011). In essence, signalling theory implies that a company is attempting to signal good news to investors and other interested groups by disclosing more voluntarily (Oliveira et al., 2006). Signalling theory is vital in explaining the levels of risk disclosure in the

annual reports and provides signals which will be value relevant for all user groups. This investigation also will employ signalling theory to explain the links between the determinants of risk disclosures in banking sectors and its economic consequences. This is confirmed by researchers such as Sheu et al. (2010) Gordon et al., (2010); Anam et al., (2011) who used signalling theory for explaining the reason why corporations provide voluntary information. It also make sense for this study to employ this theory since it has been argued by the literature that communicating clear messages to the capital market is likely to increase a firm's present net value and in turn its stock market value (Gordon et al., 2010). Also it helps in explaining the variations of voluntary risk disclosure in the sample banks (Linsley and Shrives, 2006; Hassan, 2009; Al-Shammeri, 2014).

### **3.6.3 Information Asymmetry Theory**

Akerlof (1970) in his work developed the asymmetry theory and referred to it as the "Lemon Problem". This implies that buyers in the market are imperfectly informed about the quality of the product. Also, Cooper and Keim, (1983) described the lemon theory as one party commissioning some business transactions might have more information than the other party commissioning the exact transactions. Further, Akerlof (1970) employed his theory in regards to the automobile market, where there are good and bad quality cars. In this environment a buyer does not know the quality of a car until he owns it for a particular period of time. Therefore, the lemon problem occurs among sellers and buyers since it is impossible for buyers to know the difference between good and bad quality cars and the only people who know this kind of information are the sellers. Consequently, internal management of a firm has more information about the firm's current condition and its upcoming future strategies than external investors.



Furthermore, Healy and Palepu, (2001) affirmed that information asymmetry exists due to differences and conflicting motivations of sellers (managers/providers) and buyers (investors). Owing to investors' inability to differentiate between good and bad business ideas put forward by entrepreneurs hence investors will value both ideas at an average level. Inevitably, the capital market will underrate some good business ideas and overrate some bad business ideas based on the information available.

#### ***3.6.3.1 Risk disclosure in relation to Information Asymmetry Theory***

Disclosure of both positive and negative financial information can result in a reduction of information asymmetry (Von Albrecht-Alhtaybat, et al 2012). Scott (2003) claimed that financial accounting and reporting could be perceived as a mechanism to control asymmetrical information problems by transferring internal information into external information. Moreover, Kothari (2000) stated that the theoretical literature demonstrates that both mandatory and voluntary exposure decrease the lemon problem between informed and uninformed market users. Also, Kothari (2000) argued that a decrease in information asymmetry has enticing consequences on the cost of capital and security prices volatility that results in the encouragement of regulators to aim for accounting standards of high quality.

A study completed by Kothari, Li and Short, (2009) argued that since disclosure systems have developed in size together with the significance of evaluation of reported disclosures by other information agents such as financial analysts, business press and investors, information asymmetries and agency conflicts among different interested market groups generate greater demand for reporting and assurances of disclosures. Moreover, Dobler, (2008) debated that firm directors are expected to hold more information about risks encountered by their firm and their potential effects

on the performance of the firm than external investors who have no access to inside information. Henceforth, managers' accessibility to company information is greater than investors, which to a certain extent impacts investors' investment decision-making. Thus, there are three different steps, which can reduce this informational gap. According to Hassan (2009) companies with high-risk levels will attempt to enlarge risk reportage to decrease uncertainties between investors. Secondly, Iatridis (2008) claimed that reporting risk relevant information in critical conditions could ensure investors about companies' future cash flows and finally, managers have different motives to communicate risk relevant information and how they manage them to signal to investors their managerial skills, which will consequently translate into compensations (Abraham and Cox, 2007). The last step is in line with signalling theory. However, Lajili and Zeghal (2005) stated that promotion of transparency and enhanced disclosure quality by decreasing information asymmetry and risks can potentially benefit analysts, investors and other market users.

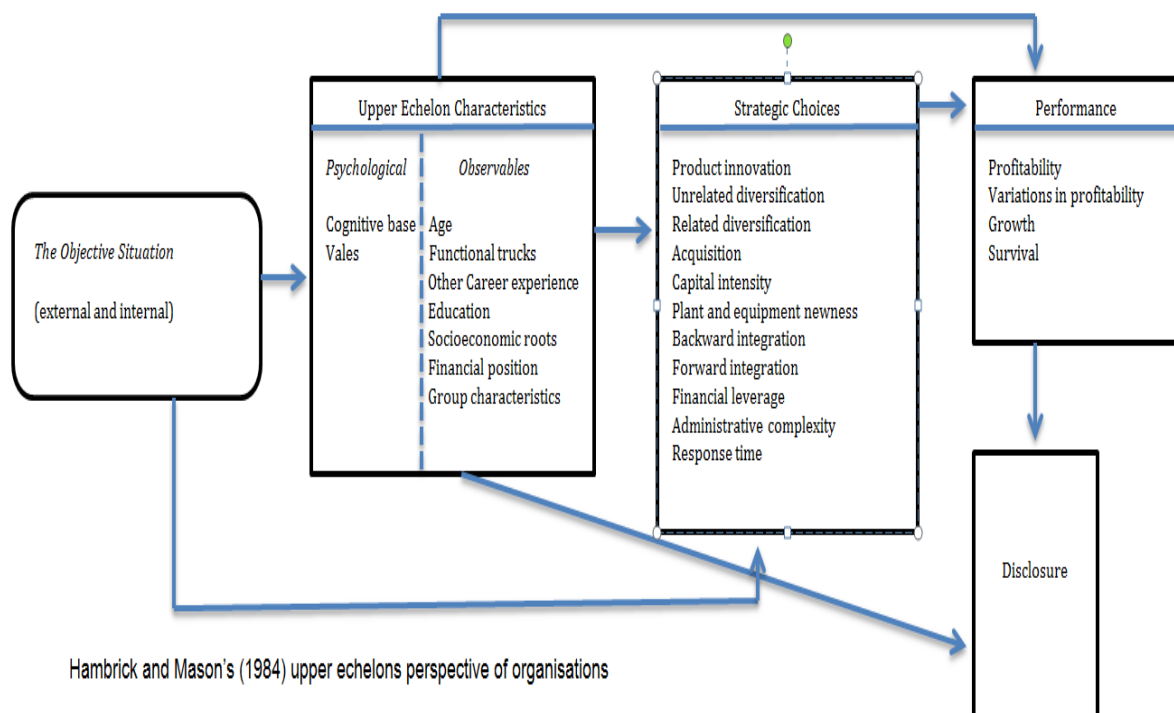
### ***3.6.3.2 The importance of asymmetry theory in relation to this investigation***

The asymmetry theory implies that buyers in the market are imperfectly informed about the quality of the product. Thus, internal management of a firm has more information about the bank's past, current condition and its upcoming future strategies than external investors. Healy and Palepu, (2001) affirmed that information asymmetry exists due to differences and conflicting motivations of sellers (managers/providers) and buyers (investors). This leads to shareholders having difficulty appreciating managers' efforts to counter risks. Yet, managers could reduce information asymmetries by using their discretion to provide more information on internal control and risk management, potentially benefitting investors and other market users (Lajili and Zeghal, 2005; Deumes and Knechel, 2008). This theory will

also assist this investigation in interpreting the findings of the current study's questions to further explain why banks are reporting such information. This theory will also be employed for supporting answers to the second research question. The information asymmetry theory is also used in explaining the association between a number of explanatory variables and the level of voluntary risk disclosure in this study. Also it helps in explaining the association of the levels of voluntary risk disclosure and its determinants. By disclosing signals in the form of enhancement in the communication of a firm's information, it is possible to decrease information gaps, and increase the accuracy of decision making process by the supplied information.

#### **3.6.4 The Upper Echelons Theory**

In pioneering work by Hambrick and Mason (1984), the two concepts of the dominant coalition and demographic research were combined. The authors suggested that certain organizational effects are linked to top management teams having specific demographic profiles. Moreover, the upper echelons theory proposes that the characteristics of top management, in particular demographic characteristics, might affect strategic decision-makings and hence performance. At the centre of this theory is the notion that the background knowledge and values of corporate directors impact upon the essential strategic decisions made by these central corporate managers. Hambrick and Mason also claimed that observable attributes, e.g. age, practical experience and tenure, could function as practical proxies for the cognitive base that directs top directors' decisions. Moreover, the upper echelons theory is categorized according to several important elements. As highlighted by Hambrick and Mason (1984), demographic features influence strategic decision making and performance. Thus, in this study the concept is extended to the determinants of risk disclosure, investigating whether such features of the top board could impact upon the determinants of risk reportage in the banking sector.



**Figure 3-1: Upper echelons model**

Figure 3-1 is the adapted upper echelons framework, which is based on three fundamental principles: first, the strategic choices taken by institutions (the representations of the cognitive bases and values of the dominant players, the top board members); second, the cognitive bases and values of such players (the ramifications of their observable characteristics, such as functional trucks and education); and third, significant institutional consequences that are related to the observable characteristics of such players. In fact, this theory proposes that institutional performance is only a representation of its top board directors. However, the fourth dimension (disclosure) added to the above framework can be directly influenced by the upper echelons theory characteristics or indirectly by the ramifications of the overall performance of the company, where sometimes risk disclosure would mean survival for an institution. This model also plays a vital part in determining key institutional effects, such as the provision of risk disclosure. It also grants this study the opportunity to investigate the core determinants of board demography in relation to risk disclosure.

#### **3.6.4.1 *The importance of the upper echelon theory in relation to this investigation***

This theory implies that certain organizational effects are linked to top management teams having specific demographic profiles. Moreover, the upper echelons theory proposes that the characteristics of top management, in particular demographic characteristics, might affect strategic decision-makings and hence performance. At the centre of this theory is the notion that the background knowledge and values of corporate directors impact upon the essential strategic decisions made by these central corporate managers. Moreover, this theory incorporates several important elements such as the demographic features, strategic decision making and performance. Thus, in this study the concept is extended to the determinants of risk disclosure, investigating whether such features of the top board could impact upon the determinants of risk reportage in the banking sector. Such demographic traits play an important role in determining key institutional effects, such as the provision of risk disclosure in the annual reports. This theory will also assist this investigation in interpreting the findings of the current study's second question to identify what determines risk information in the annual reports. This theory will also be employed for reinforcing the results to the second research question. It also grants this study the opportunity to investigate the core determinants of board demography in relation to risk disclosure.

#### **3.6.5 Stakeholder Theory**

Freeman initially came up with the idea of the stakeholder theory in 1978 when he was organising an executive education program (Freeman, 2004). Freeman (1994, p.46) defines this theory as “any group of individuals who can affect or is affected by the achievement of the organization's objectives”. This broader definition of stakeholder encompasses adverse groups such as interested groups and regulatory

authorities. Despite the criticisms of this definition researchers have always used it when exploring the link between stakeholders and an organisation.

Tencati et al., (2004) state that stakeholders incorporate employees, shareholders, the financial community, customers, suppliers, financial partners such as banks, insurance companies, government, local authorities and public administration, communities, even the competitors. Solomon (2010, p.15) explains the theoretical basis of stakeholder theory as follows: "Firms are so large, and their impact on society so pervasive, that they may discharge accountability to many more sectors of society than solely their shareholders.... Not only are stakeholders affected by companies, but they in turn affect companies in some way". Unlike agency theory which concentrates only on the relationship between managers (agent) and shareholders (the principal), stakeholder theory considers the relation between managers and all stakeholders of the company (see Figure 3-2). Also this theory postulates that directors are accountable to all stakeholders (Chen and Roberts, 2010). Donaldson and Preston (1995) claim that stakeholders are all parties that have an interest in a firm and can exercise power influencing its activities.

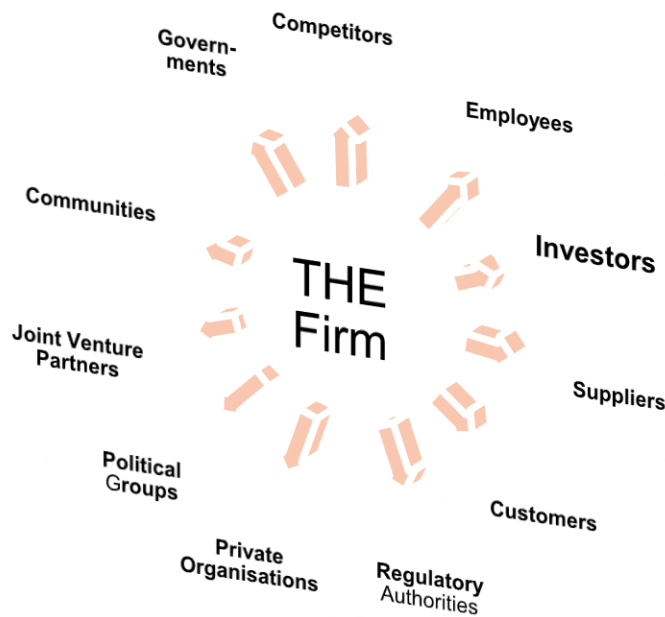


Figure 3-2: Stakeholder Theory (Donaldson and Preston, (1995); Freeman (2010))

Sachs et al, (2009) affirm that stakeholders are essential for firm existences therefore a firm should know its stakeholders' interests; in order to attempt to meet their interests. Stakeholders contribute to the well-being and value of the firm, and in return acquire profit from such a firm, but stakeholders confront risks and in some cases can mean risks to the corporation. It is a fact that firm cannot maintain themselves without their broad base of stakeholders. An example of this would be that companies won't function without the support of their staff and employees. Another example of this would be that banks cannot accumulate deposits if stakeholders did not trust them enough to entrust them with their money.

Moreover, when a firm attain a profit and has a plan to distribute dividends, the shareholders could obtain a profit from these dividends. Also they can acquire capital gains when the share price increases and vice versa. However, at times

when stakeholders are not content or do not trust the firm any more, they could then complain and cause damage to the firm. Stakeholders can vociferously announce the issue to the public via mass media, which will subsequently result in causing a firm to have a bad image. Stakeholders are like assets of companies, which must be administered and which are a source of wealth to the company (Post et al., 2002).

Furthermore, stakeholder theory has been widely used in accounting disclosure literature to explain the phenomenon of risk disclosure, corporate social and environmental disclosure (e. g. Deegan, 2000; Amran et al., 2009; Solomon 2010). Stakeholders who exist in a society are generally concerned with the way that an organisation is managed. Therefore, as it has been established above this theory is based on the assumption that a firm requires the support of its stakeholders for its operations and requires their support to guarantee the continuity of its functionality (Gray et al., 1997).

Companies require resources for their operations. However, these resources are affected (directly or indirectly) by the control power of stakeholders. The more powerful the stakeholders, the more the company must adapt (Gray et al., 1995a). For example, banks cannot collect deposits if the stakeholders did not trust them enough to entrust them with their money. In this case, the controlling power is determined by the level of control they have over the resources. Moreover, Ullmann, (1985) states that when stakeholders exercise their control power, the company is more likely to react in a way that satisfies the demands of the stakeholders.

#### ***3.6.5.1 Risk disclosure in relation to Stakeholder Theory***

This theory was chosen on account of its strength in explaining the interrelatedness of a company and its stakeholders. Moreover, the theory has also been used in previous risk disclosure studies (i.e. Amran et al., 2009; Oliveira et al., 2011b) in



explaining the linkage between risk disclosure, size, leverage, ownership structure, and board directors.

Henceforth, it is in the stakeholders' best interest that risk is disclosed in a timely manner. Given the importance of risk disclosure to stakeholder in terms of investment decision-makings and wealth creation. This theory could also provide some meaningful insights into the reasons for annual report risk disclosure. The attitudes of some of the external stakeholders could apply an important pressure in views about risk (Hellier et al., 2001). Firms disclose risk information in order to meet the demand of their shareholders. Research has also shown that disclosure provides a way of controlling and minimizing conflict of interest among stakeholders (Chow and Wong-Boren, 1987).

#### ***3.6.5.2 The importance of stakeholder theory in relation to this investigation***

For the sake of knowing whether the disclosure in annual reports can offer beneficial information to stakeholders, and whether risk disclosure is value relevant for stakeholders or not, it is necessary to make clear the definition of stakeholders. In term of the current study, banks should consider who their stakeholders are. Because without understanding who their stakeholders are, companies might not know how to offer the information which meets stakeholders' interests.

Stakeholder theory asserts that a company always deals with many users as their stakeholders. Stakeholders incorporate employees, shareholders, banks, insurance companies, government, local authorities and public administration, communities, environment, even competitors, depositors, creditors, and borrowers. In addition, a community can also be a stakeholder which has the power to force a company to disclose its position. Therefore, corporations must uphold good communication channel with their stakeholders by revealing their performance timely and

transparently. The information might not properly be accepted by all users (stakeholders), and noises may disturb the communications between sender (Bank) and users (stakeholders); resulting in stakeholders receiving inadequate/incomplete information that does not meet their needs. This theory will be used to support the analysis in order to answer the third research question, is risk disclosure value relevant or not? If the information is rewarding for stakeholders, it means information is value relevant for stakeholders and meets with their interests.

### **3.6.6 Legitimacy Theory**

Numerous scholars have debated that social legitimacy is one of the underlying forces behind adopting certain disclosure regime (see Carpenter and Feroz, 1992; Hassan, 2008b). Carpenter and Feroz (1992) affirm in their paper that the decision of New York's State to implement accrual-based accounting was an effort to retain the State legitimacy. The authors also state that the New York financial crisis in 1975 drove various parties, e.g. the accounting profession, regulatory agencies and users of accounting reports, to question the adequacy of the state's cash-based accounting exercises. Hence, government officials elected to enforce the implementation of accrual-based accounting so as to retain legitimacy for the State's accounting exercises. Carpenter and Feroz (1992, p. 637) proclaim that:

The state of New York needed a symbol of legitimacy to demonstrate to the public and the credit market that the state's finances were well managed. GAAP, as an institutionalized legitimated practice, serves this symbolic purpose. Furthermore, Hassan (2008b) discusses that legitimacy is a process in which certain disclosure exercises follow the international security markets' requirements rather than serving domestic needs. Directors are motivated to align the information included in their firms' annual reports with the international and/or domestic requirements. Hassan

(2008b) also claims that such alignment allows directors to indicate that their firms implement state-of-the-art practices and therefore obtain social legitimacy.

Legitimacy theory is based on the notion that organisation has a social contract; with its society; where it agrees to act according to socially desired actions (Guthrie and Parker, 1989). That means organisation's actions are monitored by the public. Legitimacy theory argues that organisations can only continue to exist if the society recognises it as acting within acceptable value system (Rizk, 2006). Based on this theory, organizations social approval, in other words to legitimize their actions (Deegan, 2002).

#### ***3.6.6.1 Risk disclosure in relation to Legitimacy Theory***

Oliver (1991) states that seeking social legitimacy, leads to economic gains. The author suggestion, assumes that the analysis of economic consequences of adopting new practices such as risk disclosure will lead to some economic gains.

By reporting more discretionary risk information, directors can interconnect with the wider community and their shareholders. For example, top management teams will attempt to legitimise their corporate actions and at the same time legitimise their managerial conditions. The legitimacy theory has been used in risk disclosure literature to explain such disclosure practices (Hassan, 2009). Because of the idea of social acceptance, various studies on disclosure have drawn on this theory. The evidence provided from these studies support the notion of using disclosure as a means for legitimacy (e.g. Guthrie and Parker, 1989; Deegan, 2002).

Legitimacy theory endeavours to explain risk disclosure and aspects of the business-society relationship. Prior studies have employed a number of variables to show the association between this theory and such variables. Hence, legitimacy theory, found

that larger firms release less risk disclosure to satisfy the information needs of shareholders. But found a positive association with leverage (i.e. Hassan, 2009). In terms of ownership structure, Hassan (2008a) Oliveira et al., (2011b) debate that firm executives respond to pressures from their institutional environments through adopting some practices (e.g. risk disclosures) in order to obtain social legitimacy.

Thus, top management teams of corporations with higher levels of public visibility have motivations (via the legitimization process) to increase transparency of risk disclosure as a means of building a good corporation image/reputation with important stakeholders in the firm. This legitimization process reduces information asymmetries, reduces litigation costs and reputational costs, attracts crucial resources, and strengthens the trust of appropriate stakeholders through the practice of disclosure (Toms, 2002; Bebbington et al, 2008).

#### ***3.6.6.2 The importance of legitimacy theory in relation to this investigation***

Legitimacy theory is established upon the idea that all corporations have a social contact; with their community; where they come into an agreement to conduct their activities in a manner acceptable and desired by the larger community. Legitimacy has come to stress how firms will react to community expectations. Corporations could offer to report more information to legitimise their conditions and behaviour (e.g. Tilt, 1994; Patten, 1992).

Hence, this theory is used in the current study to explain the levels of voluntary risk disclosure. As discussed above banks will attempt to disclosure more risk related information when they need to legitimise their actions and obtain the approval of their stakeholders and the wider society, and even perhaps to avoid additional regulations. Also, directors have personal interests in divulging risk disclosure for example

signalling their competencies to investors and how they administer such risks efficiently in order to win their trust and maximise their gains.

### **3.7 Summary**

The above debate has revealed that there is no specific theory which can explain risk disclosure practices. Each theory looks at the disclosure phenomenon from a different perspective. In this context, Gray et al., (1995) stated that different theoretical perspectives need to be seen as sources of complementing each other in explaining different factors, at different levels of resolution, not as competing with one another. In line with this conclusion, Beattie and Smith (2012) documented that adopting more than one theories will enable us to explain the incentives of managers to disclose information. Notably, the type of relationship between principals and agents is still ambiguous in the Saudi Arabian banking industry due to the dearth of research in this domain. It can be concluded that agency, legitimacy and the upper echelon theories are the most relevant theories to the research questions of this study related to the risk disclosure levels and determinants. On the other hand, signalling and the stakeholder theories are the most appropriate for measuring the economic consequences of voluntary risk disclosure. The above arguments still need to be verified empirically, which this study will attempt to endeavour. The following chapter focuses on measuring the voluntary risk disclosure levels in both set of banks namely Islamic and conventional.

## **4 Chapter Four: The level of Risk Disclosure in Listed Islamic and non-Islamic Banks: Evidence from Saudi Arabia**

### **4.1 Overview**

Recently, considerable attention has been paid to investigating and improving corporate risk disclosure (CRD) (Oliveira et al., 2013). The goal of a great number of companies is to disclose sufficient information in their annual reports to satisfy their various shareholders' needs. However, there is a developing debate on the inadequacy of risk disclosure and the lack of full transparency from companies in this respect (Oliveira et al., 2011a; 2013). There have been demands for even greater disclosure to reduce asymmetries of access to corporate information and ensure shareholders are fully able to assess information on a company's performance (Oliveira et al., 2013). Risk disclosure is one aspect of these disclosure demands. Shareholders have become more interested in risk profiles to better understand the risks a company faces and how the managers are dealing with those risks as well as to improve the measurement and disclosure of risk-related matters (Beretta and Bozzolan, 2004; Konishi and Mohobbot, 2007; Oliveira et al., 2013).

To date, there has been an inadequate amount of research on corporate risk disclosures (Beasley et al., 2005; Lajili and Zeghal, 2005; Lajili, 2009). However, this lack of research is even greater in developing countries since all of the risk disclosure investigations have been restricted to the developed world, for example, German, Dutch and Anglo-Saxon countries (see Rajgopal, 1999; Linsmeier et al., 2002; Jorion, 2002; Solomon et al., 2000; Dhanani, 2003; Lajili and Zeghal, 2005; Linsley, et al., 2006; Linsley and Lawrence, 2007; Abraham and Cox, 2007; Deumes and Knechel, 2008; Iatridis, 2008; Lajili, 2009; Elshandidy et al., 2013) and Europe and Latin America (see Beretta and Bozzolan, 2004; Thuelin, Henneron and Touron, 2006; Lopes and Rodrigues, 2007; Oliveira, Rodrigues and Craig, 2011; 2013;

Madrigal et al., 2012; Miihkinen, 2013; Maffei et al., 2014). Notwithstanding the work of Amran et al. (2009), Mokhtar and Mellett (2013), Elkelish and Hassan (2014) Hassan (2009; 2014) and Al-Shammari (2014), who investigated the determinants of risk disclosure in the UAE and Kuwait, very little attention has been given to the risk reporting practices of publicly listed banks in emerging economies. Therefore, little is known about the CRD in Arab countries in general and Saudi in particular. This study seeks to investigate the levels of risk disclosure in Saudi listed banks in an attempt to fill the gap.

As discussed above, most previous risk disclosure work has concentrated on developed economies. However, it would be beneficial to investigate risk disclosure practices in a developing economy since developing markets have larger behavioural variations, and thus any research on them would contribute to the disclosure literature. Developed economies are efficient, have greater compliance, robust regulatory structures, developed corporate governance structures and financial reporting systems. Conversely, developing markets are less efficient and suffer from a lack of compliance, regulations, enforcement and transparency (Richardson and Welker, 2001). However, this research aims to contribute to the existing literature and fill the gap by examining the extent of risk disclosure in a sample of Saudi listed banks in the context of an emerging economy, Saudi Arabia. Furthermore, what makes this research even more interesting is that Saudi Arabia has a secretive culture, where corporations release little information regarding their business affairs and risk disclosures (Roberts and Kamla, 2010).

Saudi Arabia is the focus of this study because of its unique socio-economic context. Firstly, Saudi Arabia is the largest emerging capital market that adopts an open economic philosophy based on the market economy and liberalization of trade (AMF,

2013). Secondly, the Saudi government has initiated several far-reaching reforms at the Saudi Stock Exchange (Tadawal) to mobilize domestic savings and attract foreign capital investment. These measures include the privatization of state corporations. Thirdly, Saudi Arabia has become one of the largest emerging economies in the world, having the largest stock market in the Middle East (Piesse et al., 2012). Also, the Saudi stock market is now the largest in the Arab world as far as capitalization is concerned and is becoming an important capital market in the region. Fourthly, compared to other countries with advanced capital markets, the Saudi accountancy profession is lagging behind in terms of offering professional certificates. Finally, the Saudi regulatory framework incorporates different legislation that requires the disclosure of risk related information in the corporations' annual reports. All the above reasons make investigating the extent of risk disclosure in Saudi Arabia an important issue.

Furthermore, this study makes some important contributions to the field. Firstly, it contributes to the understanding of the nature of risk disclosure in Saudi Arabia. Secondly, it contributes to existing risk reporting literature by being the first study to investigate the levels of risk disclosure in Saudi listed banks. Thirdly, it contributes to the literature on risk disclosure by investigating the differences between the risk disclosure practices of Islamic and non-Islamic banks in a rapidly developing emerging market. This thesis is organized as follows: section 2 describes risk disclosure in Saudi Arabia; section 3 discusses the theoretical framework; section 4 reviews previous literature on the quantity of risk disclosure; section 5 discusses the methodology, criteria for the selection of the sample banks, the employment of annual reports and the data collection procedure; section 6 presents and analyses the empirical findings; and section 7 outlines the conclusion, limitations and further



research.

## **4.2 Risk Disclosure in Saudi Arabia**

Financial reporting regulations in Saudi Arabia are created and managed by the government. They focus on protecting investors and other users of financial reports. The main bodies issuing rules are the Ministry of Commerce and Industry, the Capital Market Authority (CMA), the Saudi Stock Exchange (Tadawul), the Saudi Arabian Monetary Agency (SAMA) and Companies Law (1965). The latter are considered to be the main bodies monitoring publicly traded Saudi companies. Regulating, supervising and registering are some of the most important responsibilities of the above-mentioned bodies, which ensure that Saudi companies comply with national regulations. Moreover, the Ministry of Commerce and Industry indirectly performs a supervisory role over many monitoring devices, such as the Saudi Capital Market Authority (CMA), the Saudi Stock Exchange and the Saudi Arabian Monetary Agency (SAMA).

Furthermore, the role of the CMA is to regulate and develop Saudi companies by providing appropriate rules and regulations that contribute to increasing investment and enhancing transparency and disclosure standards as well as protecting investors and dealers from illegal activities in the market (CMA, 2007). Regulations on transparency and disclosure are the most important to have been issued by the Capital Market Authority. Saudi Arabia has become one of the largest emerging economies in the world, and it has the largest stock market in the Middle East (Piesse et al., 2012). Also, the Saudi stock market is now the largest in the Arab world as far as capitalization is concerned, and Saudi Capital Market growth between 1996 and 2015 was high, with a huge increase in the number of transactions, volume and value trading. For example, listed firms increased in

number from 77 in 2005 to 171 in 2015 with a market capitalization of about \$564 billion, representing nearly 44% of the total Arab stock market capitalization (SFG, 2009; Hearn et al., 2011; Tadawul, 2012; 15). Accordingly, the Saudi market may not be active in terms of corporate risk disclosure and may suffer from greater information deficits in comparison with established markets, such as the US, the UK and Europe. Although the Saudi stock market is very large compared to the markets of other developing countries, recent studies have found that, like those of most developing countries, it is not efficient (Dahel, 1999; Onour, 2004).

This study looks at Saudi Arabia because very little is known about the financial risk reporting in this country. Some cultural characteristics of Saudi Arabia, such as the strong hierarchical social structure, the importance of kinship and personal relationships, religion, the importance of professionalism, accountability and trust, and the nature of some of its socio-economic institutions, are similar to other developing countries and can provide insights into those countries that share similar characteristics. The findings of this research should be of interest not only to academic researchers interested in examining the uniqueness of risk disclosure issues in a country but also to practitioners and policy makers in Saudi Arabia and other Middle-Eastern and developing countries that share a similar socio-economic environment as it has important policy implications.

The study is justified on the following grounds. Firstly, it provides a starting point for research involving corporate risk disclosure in the Saudi context. It is one of the first empirical studies to use the unweighted disclosure index approach to investigate the levels of voluntary corporate risk disclosures in the annual reports of listed Saudi banks. Secondly, relatively little is known about risk disclosure in Saudi Arabia, and thus it may make a general contribution to this area. Thirdly, this empirical

investigation could benefit investors and regulators. Fourthly, it may help in studying other capital markets in the area, especially the Gulf Co-Operation Council (GCC) member states and other Middle-Eastern countries, and thus may contribute to the accounting literature in emerging markets.

### **4.3 Theoretical framework**

As discussed in the theoretical chapter the signalling theory emphasises that annual reports information are important in the investment decision making process for investors. Such users of such reports believe that the information reported by banks insiders will communicate essential signals since this information will supply opinions and explanations in regards to the organisation's past, present and future positioning. Hence, shareholders demand precise, relevant and comprehensive information in order for them to make correct investment decisions. Therefore, banks annual reports should incorporate such measurements and enhance the transparency of such reports.

The signalling theory will act as a supporting theory in this investigation. This theory will also be the foundation in interpreting the results of the first empirical study's question to further explain why banks are reporting such information. In essence, signalling theory implies that a company is attempting to signal good news to investors and other interested groups by disclosing more voluntarily (Oliveira et al., 2006). Signalling theory is vital in explaining the levels of risk disclosure in the annual reports and provides signals which will be of valuable importance for all user groups. This is confirmed by researchers such as Gordon et al., (2010) who used signalling theory for explaining the reason why corporations provide voluntary information. It also make sense for this study to employ this theory since it helps in explaining the variations of voluntary risk disclosure in the sample banks (i.e. Linsley

and Shrives, 2006; Al-Shammari, 2014).

Also, legitimacy theory is established upon the idea that all corporations have a social contact; with their community; where they come into an agreement to conduct their activities in a manner acceptable and desired by the larger community. Legitimacy has come to stress how firms will react to community expectations. Corporations could offer to report more information to legitimise their conditions and behaviour (e. g. Tilt, 1994; Patten, 1992). Hence, this theory is used in the current study to explain the levels of voluntary risk disclosure. As discussed in chapter three banks will attempt to disclose more risk related information when they need to legitimise their actions and obtain the approval of their stakeholders and the wider society, and even perhaps to avoid additional regulations. Also, directors have personal interests in divulging risk disclosure for example signalling their competencies to investors and how they administer such risks efficiently in order to win their trust and maximise their gains.

Descriptive risk disclosure is recognised as an important element in making firm reporting more valuable to shareholders (Miihkinen, 2012; Mokhtar and Mellet, 2013; Maffei et al, 2014). In order to improve firm descriptive risk disclosure, regulators and standard setters have attempted to advance a compound set of standards, demanding more information on different forms of risks (Dobler et al., 2011). However, firms still offer inadequate risk information (ICAEW, 2011). Similarly, the far-reaching research on this subject agrees that risk reporting practices are not beneficial for investors as such practices are not really comprehensive, in depth, forward-looking or adequate for the valuation of the total risk profile (Paaple and Spekle, 2012; Magna and Markarian, 2011) nor are they relevant for decision-making procedures (Beretta and Bozzolan, 2004). Also, there is general agreement

in the literature regarding the inadequacies of current risk reporting. The literature on this issue is far from complete (e.g. Woods et al., 2007; Maffei et al, 2014) since very little of the current research on risk reporting has empirically examined risk disclosure (Linsley and Shrives, 2006; Miihkinen, 2012). Thus, this current study will contribute to the far from complete literature on risk disclosure in developing countries, particularly in Islamic and non-Islamic banks.

#### **4.4 Literature**

The literature on the measurement of risk disclosure is profuse (Dobler, Lajili and Zeghal, 2011; Oliveira, Rodrigues and Craig, 2011b; Miihkinen, 2012; Barakat and Hussainey, 2013; Elshandidy, et al., 2013; Nitm, Lindop and Thomas, 2013; Al-Shammari, 2014; Lipunga, 2014; Campbell et al., 2014; Elshandidy, et al., 2015). However, none of the previous studies have measured the levels of voluntary risk disclosure in Saudi Arabia, apart from Abdallah, et al., (2015) who have measured the level of risk disclosure in the GCC council. In their study they have only used two non-Islamic banks, one Islamic bank and eight non-financial corporations from Saudi Arabia over a one-year period. Although, financial and non-financial corporations cannot be examined together, since financial institutions are subject to specific regulations, can be expected to provide significantly different risk disclosure and are by nature risk-oriented institutions unlike non-financial corporations, and therefore their disclosure ought to be considered independently (i.e. Linsley and Shrives 2006; Bischof 2009; Barakat and Hussainey, 2013). Which is not the case of Abdallah et al., (2015)'s study.

Thus, this is the first study that measures voluntary risk disclosure levels in all listed Saudi Arabian banks over a five-year period. Many studies have measured risk disclosure in developed economies as this is what they generally rely upon (i.e.

Elzahar and Hussainey, 2012; Elshandidy, et al., 2015). Similarly, there were some studies in emerging markets, which mostly rely upon voluntary risk disclosure (i.e. Amran et al., 2009 for Malaysia; Mokhtar and Mellett, 2013 for Egypt; Al-Shammari, 2014 for Kuwait). However, none of the previous studies have examined voluntary risk disclosure in all listed Saudi Arabian banks. Hence, this investigation will contribute to the existing literature on developing economies by examining voluntary risk disclosure in a new environment. Where empirical context is unique in spite of having developed comparatively new market strategies typically associated with Western economies such as market diversification, economic deregulation, and the reformation of economic life (Roberts and Kamla, 2010) corporations in Saudi Arabia are usually considered to be operating in an Arab-Islamic context that is often considered to be opaque in terms of disclosure practices (Roberts and Kamla, 2010). Despite this view, investors have become increasingly more interested in stabilising the capital markets in an Arab-Islamic context that is home to many international financial institutions, a centre of regional trade, and is being integrated into the global economic system with increasing speed (Roberts and Kamla, 2010).

While nonfinancial and mixed institutions in developed countries have been widely researched and reported upon in the literature (e.g. Oliveira, Rodrigues and Craig, 2011b; Dobler, Lajili and Zeghal, 2011; Elzahar and Hussainey, 2012; Elshandidy, Fraser and Hussainey, 2015), only a few studies have focused on banks and financial institutions in developed countries (Solomon et al., 2000; Linsley et al., 2006; Oliveira, Rodrigues and Craig, 2011a; Barakat and Hussainey, 2013; Maffei et al., 2014) and no prior investigations have been conducted purely on banks in developing markets (i.e. Amran et al., 2009; Hassan, 2009; Abdallah and Hassan, 2013; Mousa and Elamir 2013; Al-Shammari, 2014; Abdallah et al., 2015). Therefore,

this is the only study that investigates the levels of voluntary risk disclosure in banks in developing economies, particularly in Saudi Arabia.

Furthermore, whilst a small number of studies have examined risk disclosure over more than a one year period in developed economies (Cabedo and Tirado, 2004; Deumes, 2008; Deumes and Knechel, 2008; Rajab and Schachler, 2009; Elshandidy, Fraser and Hussainey, 2015), none have examined risk disclosure over more than a one year period in developing economies (e.g. Amran, Bin and Hassan, 2009; Hassan, 2009; Abdallah and Hassan, 2013; Mousa and Elamir, 2013; Al-Shammari, 2014; Abdallah, et al., 2015). Therefore, the current study is the only study that examines voluntary risk disclosure over a period of five years in developing economies.

Preceding literature examining the level of risk disclosure is very limited and focuses on research carried out in the West. This could be attributed to the early implementation of regulatory measures by firms and increased complexity of making investment decisions by investors in these countries. A comprehensive review of the literature shows that two methods are generally used to measure the level of risk reporting. The first method employs words as a recording unit to measure risk reporting levels (see Abraham and Cox, 2007), and the second approach employs self-constructed indices (see Al-Shammari, 2014). Therefore, this investigation aims to quantify voluntary risk disclosure in Saudi listed banks by using a self-constructed risk disclosure index. This approach is based on an un-weighted content analysis method, which counts risk words (which have been previously identified in the self-constructed risk disclosure index - see appendix) within banks' annual reports to measure the levels of voluntary risk disclosure. This is consistent with a number of prior studies (e.g. Al-Shammari, 2014; Elzahar and Hussainey, 2012; Dobler et al.,

2011).

Linsley and Shrives (2003) confirmed that German and UK firms report equal levels of risk information. Yet, the authors revealed that only a few quantitative disclosures are reported in the annual reports of the firms from both countries. They also documented that the most reported category is “non-monetary/future”. Beretta and Bozzolan (2004) examined risk disclosure practices in 85 annual reports of non-financial firms listed on the Italian Stock Market. They concentrated on the Management Discussion and Analyst section (MDA). The authors identified 75 risk items that are reported in the MDA section and documented that firms avoid conveying any anticipated effect of risks and the economic direction of the firms in quantitative terms. They also illustrated that firms are not willing to show whether reported future risks will affect them positively or negatively and affirmed that such firms were prone to report past and present risks rather than future risks.

Linsley and Shrives (2005) investigated 79 annual reports of non-financial UK listed firms employing a content analysis method. They reported that the most reported risk categories are strategic, financial and integrity risks. They also stated that there is minimal exposure of quantified risk information and a considerable quantity of risk exposure is incorporated in the general statements on their risk policy. Mohobbot's (2005) study included 90 non-financial corporations, which were randomly selected from the Tokyo stock market. The author documented that most corporations would rather report descriptive risk information and are not willing to quantify risks in their annual reports. The author also reported large variations in the levels of risk disclosure practices among the sample corporations.

Lajili and Zeghal (2005) examined risk disclosure in the annual reports of 300 TSE Canadian corporations against 12 risk factors. They reported significant variations in



disclosure quantity on risk sources and management and a lack of uniformity, quantification and forward-looking risk disclosure. They also showed that financial risk was the most regularly reported by the sample firms, which consisted of information on operations in foreign currencies. This study also documented that firms' disclosures were almost always qualitative in nature and lacked specificity and depth.

Linsley and Shrives (2006) explored risk disclosure in the annual reports of 79 non-financial FTSE 100 firms. The authors disaggregated risk disclosure into two categories. Firstly, according to six risk factors: financial, operational, empowerment, information processing and technology, integrity and strategy. Secondly, according to three narrative groups: upside/downside risk, monetary/non-monetary risk and past/future risk. By employing a content analysis method to measure the level of risk disclosure, they quantified 6,168 risk sentences that were consistent with the prior study undertaken by Lajili and Zeghal (2005). Most of the sample firms' disclosures were qualitative, with only a few being quantitative, the majority of reported statements were on general risk management policy and there was a dearth of coherence in the risk narratives, indicating that risk information gaps are existent. With such reporting, shareholders are unable to effectively evaluate the risk profile of a firm.

Linsley et al. (2006) studied risk disclosure in the banking industry through an examination of the annual reports of 18 UK and Canadian banks. The authors constructed a coding grid based upon the risk disclosure groups set forth by the Basel committee in pillar 3 "Market Discipline". They reported that the characteristics known to be more beneficial relative to risk information disclosures are quantitative and future-oriented information, which are reported less frequently than qualitative

and past information in the annual reports of the sample banks of both countries.

Konishi and Mohobbot (2007) investigated factors influencing the level of risk disclosure in 100 non-financial Japanese firms listed on the Tokyo stock exchange market. They employed a manual content analysis method to measure the extent of risk disclosure. They discovered that firms almost always reported descriptive risk information and were unwilling to quantify risk. They also documented that the sample firms disclosed more good news than bad/neutral news. Amran et al. (2009) investigated risk disclosure in 100 non-financial Malaysian corporation annual reports, repeating the methodology employed by Linsley and Shrives (2006) in the UK. They also relied on counting the number of sentences dedicated to the discussion of risk information as a representation of the level of risk exposure. They employed the stakeholder theory to connect corporations' attributes to the amount of risk exposure and explain their empirical findings. The total number of sentences dedicated to discussion of risk information by the sampled Malaysian firms was very low when compared with a 2006 study done by Linsley and Shrives in the UK.

Oliveira, Rodrigues and Craig (2011a) claimed that the implementation of IAS/IFRS had led to a better flow of risk related information but still had not guaranteed better transparency in the Portuguese banking sector. Although most banks revealed information about how they quantified and evaluated performance in managing market risks, only about one third reported quantitative information on market risk exposure and performance. Oliveira, Rodrigues and Craig (2011b) affirmed that the implementation of IAS/IFRS and the European Union's Modernisation Directive in 2005 did not have a positive impact on the quantity and quality of risk disclosure in listed Portuguese corporations. Their disclosures were generic, qualitative and backward looking. Although the authors claimed that quantitative and forward looking

information would be more appropriate to shareholders' decision needs, they found that such disclosures were less common due to potential inaccuracy and exposure to litigation costs. Dobler et al. (2011) examined the extent of risk exposure in 160 non-financial corporations from the US, Canada, the UK and Germany. Using a content analysis method for designated annual reports, they reported a consistent pattern where risk exposure was most dominant in management. The report focused on financial risk categories and contained little quantitative and forward looking exposure across the sample countries. In terms of risk exposure quantity, US corporations generally led, followed by German then UK ones.

Elzahar and Hussainey (2012) examined the extent of risk disclosure in 72 non-financial companies in the UK. Content analysis was used to quantify risk disclosure. They found that large companies were more likely to report more risk related-information in their narratives. Mousa and Elamir (2013) explored the nature of risk disclosure within the annual reports of 46 listed firms on the Bahrain Bourse. Their study concentrated on all narrative sections in the annual reports, including the notes and accounts, and only examined the quantity of risk disclosure rather than the quality. One of the main findings of their study was that risk disclosures are very limited in the annual reports of the examined Bahraini firms. Al-Shammari (2014) investigated firm specific traits and corporate risk disclosure in the annual reports of a sample of 109 Kuwaiti listed non-financial companies. The author employed a manual content analysis approach to measure risk disclosure by counting the number of risk-related sentences in annual reports. The findings of this study indicated that the quantity of risk disclosures for all categories of risks was very limited in the annual reports of the sampled companies.

***Table 1: Summary of the literature***

<b>Study</b>	<b>Country/ Period</b>	<b>Type of Risk Disclosure</b>	<b>Measure of Risk Disclosure</b>	<b>Level of Risk Disclosure (Mean/ sentence count)</b>
Beretta and Bozzolan (2004)	Italy (2001)	Voluntary	Counting the number of disclosed items	75.08
Linsley and Shrivs (2005)	UK(2001)	Voluntary	Counting risk and risk management sentences	6,168
Mohobbot(2005)	Japan(2003)	Voluntary	Counting risk and risk management sentences	90
Lajili and Zeghal (2005)	Canada (1999)	Mandatory and Voluntary	Number of words and number of sentences	76.00
Linsley and Shrivs (2006)	UK(2000)	Voluntary	Counting risk and risk management sentences	6,168
Linsley et al. (2006)	UK and Canada (1999-2001)	Voluntary	Counting risk and risk management sentences	1,325
Amran et al. (2009)	Malaysia (2005)	Voluntary	Counting the number of sentences in the discussion of risk information	2,023
Oliveira, Rodrigues and Craig (2011a)	Portugal (2006)	Mandatory and Voluntary	A binary coding system 1 if the item was reported and 0 otherwise.	-----
Dobler et al. (2011)	US, Canada, the UK and Germany (2005)	Mandatory and Voluntary	Counting risk and risk management sentences	32,521
Elzahar and Hussainey (2012)	UK (2010)	Voluntary	Counting number of risk-related sentences	28
Mousa and Elamir (2013)	Bahrain (2011)	Voluntary	Counting number of risk-related sentences	266
Al-Shammari, (2014)	Kuwait (2012)	Voluntary	Counting the number of risk-related sentences	1,461
Abdallah et al., (2015)	GCC Countries (2009)	Voluntary	Counting the number of disclosed items	40%

#### 4.5 Islamic versus non-Islamic Banks

Within Saudi Arabia some banks operate under a set of constraints guided by the Islamic legal code, or Sharia. Islamic finance grew from an isolated business activity to an important component of the global financial system (El Gamal, 2006b). Economic demand for Islamic finance signals the importance of Islamic principles with many Muslims believing that their business activities should be guided by the rules of Islamic law whereby the main objective is to ensure general well-being and

justice, values that often conflict with the free market focus on profit maximization (Rahman, 2000).

This legal system is fundamentally conservative in that it imposes a number of controls on Islamic banks, which are non-applicable to non-Islamic banks. Firstly, Islamic banks are forbidden from either paying or receiving *riba* (usury), or interest (Merchant, 2012). Secondly, Islamic banks provide finances to debtors in the context of a profit and loss sharing system (Khan, 2012). Particularly, Islamic banks must share risks under either of *Mudarabah* or *Musharakah*. Under *Mudarabah*, Islamic banks receive funds from the investing public and use those funds in any activity that the management deems appropriate so long as such activities are halal, not prohibited by Islamic law. Under *Musharakah*, banks provide loans to borrowers who will use the funds to make investments that are approved by the bank (Olson and Zoubi, 2008). Then, Islamic banks pool the profits and losses from its various investments and share them with its depositors according to a predetermined formula (Olson and Zoubi, 2008). Finally, Islamic financial institutions are forbidden from engaging in *gharar* (speculations), or taking unnecessary risks and engaging in excessive speculation (Merchant, 2012).

In contrast to the legal system under which Islamic banks function, conventional banks operate under more relaxed legal constraints in their efforts to pursue profit maximization. For example, non-Islamic banks habitually generate income from the spread between the interest charged to debtors and the interest paid to depositors whereby the varying rates of interest charged to debtors is associated with the risk of the underlying investment (e.g. Mohammad et al., 2008). Since the principles that guide Islamic banks are more conservative than are those that govern non-Islamic banks, Islamic banks are less likely to be gaged in, and therefore report, risk than

are their conventional counterparts. Thus, this study will endeavour to answer the following question:

***Q. Will Islamic banks report lower levels of risk disclosure than their non-Islamic counterparts?***

## **4.6 Methodology and Data**

This section describes the research methodology of the study, including the selection of representative banks, criteria, data collection and techniques employed.

### **4.6.1 Research paradigm**

Understanding the philosophical stance or research paradigm is essential since it provides the researcher with guidance to identify which research design is fit for purpose to accomplish the research objectives (Easterby-Smith et al., 1994). Therefore, the preferred choice of paradigm for this research is the positivism paradigm, which claims that knowledge is best expressed objectively using determined theories that are based upon laws and facts. Such a paradigm prefers to measure knowledge using quantitative methods to approve or disprove theories (Saunders et al., 2009). Therefore, this investigation takes a quantitative approach to examining the levels of voluntary risk disclosure in Saudi listed banks over a 5-year period.

### **4.6.2 Sample**

There are 24 banks in Saudi Arabia which are divided into two sets of banks. The first set of banks represents the 12 local banks. The second set of banks represents the 12 subsidiaries' of foreign banks licensed to operate in the kingdom. The second set of banks is excluded from this study since their annual reports are a part of the mother bank, thus there is not a separate annual report dedicated to the subsidiaries (SAMA, 2014).

Moreover, the sample of the current investigation consists of 12 local listed banks on Tadawul in Saudi Arabia. Where, listed Islamic banks from Saudi Arabia will form the foundation of the Islamic bank's data sources, while non-Islamic banks will form the foundation of the conventional bank's data sources. According to the Saudi Arabian Monetary Agency, there are only 12 listed local banks on the Saudi exchange market today. Four of these are entirely Islamic, and the other eight are conventional with Islamic banking windows. Accordingly, the researcher can state that a total of 12 listed banks meet the selection criteria for this investigation. This study covers a five-year period to examine voluntary risk disclosure levels in Saudi listed banks. This allows the researcher to identify any changes in the levels of risk disclosure that may have occurred over the period.

This study covers a five-year period, during which the determinants of risk disclosure in the annual reports of listed banks in Saudi Arabia are examined. The selected annual reports cover the period from 2009 to 2013. Initially, the current study attempted to carry out this empirical investigation over a ten-year period. However, two banks of the entire sample were not even listed before the year 2009, and a third bank has had a complete conversion from being conventional into a fully functioning Islamic banks. Thus, the study period was reduced to five years to include the entire population of all listed Saudi banks.

#### **4.6.3 Data collection**

The nature of this investigation dictates the use of secondary data. As argued by Bryman and Bell (2011), secondary data sources deliver good quality data and involve minimal resources when executing the data collection phase. Therefore, it is the researcher's belief that the examination of secondary data will provide the required answers for this investigation. Annual reports for the 12 listed Saudi banks

are downloaded from the banks' websites and the Saudi Arabian Stock market<sup>2</sup> (Tadawul).

#### **4.6.4 The use of annual reports as the main source of research data**

Prior investigations in the field of risk disclosure have concentrated on the employment of annual report narratives as the main source of data (e.g. Kothari et al., 2009; Li, 2010; Dobler, Lajili and Zeghal, 2011; Miihkinen, 2012; Barakat and Hussainey, 2013; Elshandidy, et al., 2013; Al-Shammari, 2014; Elshandidy, et al., 2015). Moreover, they are the fundamental form of communications that organizations employ to convey messages to their investors (Lang and Lundholm, 1993; Holland, 1998).

Furthermore, there is a substantial amount of support in the accounting disclosure literature for the examination of disclosure exercises through employing annual report narratives. Accordingly, Gray et al., (1995a; 1995b) stated that constitutional regulations oblige organizations to publish their annual reports periodically due to their significance and the provision of their consistent historical image of a company. Moreover, Hines (1988) claimed that annual reports are the most pivotal document for providing a company's social picture. A complementary argument was put forward by Tilt (1994), who stated that organizations can symbolically communicate views and values to appropriate investors through their reports. Campbell (2000) presented two more reasons to support the use of annual reports. Firstly, annual reports are the most extensively distributed of all other documents of an organization made public. Secondly, the organisation's management has comprehensive editorial power over the voluntary disclosure of information in the published annual reports. Also, Tay and Parker (1990) confirmed that genuine disclosure practices can be

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<sup>2</sup> <http://www.tadawul.com.sa>



measured more accurately from annual report narratives.

#### **4.6.5 Content Analysis**

Content analysis has been broadly used in social accounting research (Guthrie and Parker, 1989; Milne and Adler, 1999; Parker, 2005; Kamla, 2007). These studies analyse the information content disclosed in annual reports and acknowledge definite words and themes within the textual material (Beattie et al., 2004; Brennan, 2001). When analysing the content of a written document, words, phrases and sentences are coded against a specific schema of interest (Bowman, 1984). Krippendorff (1980: p. 21) described content analysis as “a research technique for making replicable and valid inferences from data”. Furthermore, Bowman (1984) claimed that content analysis is able to collect rich data since it can reveal relationships that other techniques cannot. However, a weakness of content analysis is that it is subjective (Linsley and Shrives, 2006). Therefore, validation practices are often used to override this problem (Bowman, 1984).

Additionally, content analysis can be carried out using either manual or automatic methods or a combination of the two. Many studies have used the manual method to conduct content analysis (e.g. Beretta and Bozzolan, 2004; Linsley and Shrives, 2006) despite the labour-intensive data collection process, which limits the sample size (Beattie and Thomson, 2007). Automated content analysis was first used in the 1980s, and with the creation of different content analysis software, it is constantly developing (Frazier et al., 1984). It is often the method chosen when the sample size is larger (i.e. Kothari, Li and Short, 2009). Other researchers have used both manual and automated content analysis methods (e.g. Elshandidy 2015). Hence, following previous literature (i.e. Abdallah et al., 2015) this thesis employs a manual content analysis method to examine the level of voluntary risk disclosure in Saudi listed bank.

#### 4.7 Development of Risk Disclosure indices

For this investigation to examine the level of voluntary risk disclosure in Saudi all listed banks (Islamic and Non-Islamic) two risk disclosure indexes, (which are checklists of different disclosure items included in banks' annual reports), were required (Arvidsson, 2003). For the purpose of constructing the risk disclosure indexes, an extensive review of prior studies was undertaken (e.g. Hassan, 2009; Al-Shammari, 2014; Abdullah et al., 2015). Therefore, for an item to be included, it should have been used in previous disclosure studies and should be related to the Saudi banking environment. Hence, the following steps were taken as the basis for the development of the risk disclosure indices for this study:

Step 1: A comprehensive review of the prior risk disclosure literature was undertaken to identify disclosure items which were used in prior disclosure studies (e.g. ICAEW, 1997, 2000; Linsely et al., 2006; Lipunga, 2014; Abdullah et al., 2015). Based on this, the researcher identified some items which were of relevance to the current study and based on this the first non-Islamic risk disclosure index was developed.

Step 2: A review of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI, 2014) and Islamic Financial Services Board (IFSB, 2007) risk disclosure sections to identify the risk disclosure items that should be included in listed Islamic banks' annual reports was undertaken. Due to the nature of the sample of this study, an Islamic risk related index was developed.

Step 3: The two indices were reviewed with 2 independent researchers who deal with both Islamic and conventional bank reports and specialize in the area of disclosure and financial reporting to enhance the validity of the study, indexes and results (further discussion in following section).

Therefore, two risk disclosure indices were developed solely for the purpose of measuring the level of voluntary risk disclosure in Saudi listed banks. This is similar

to the approach used by prior voluntary risk disclosure investigations (e.g. Hassan, 2009; Abdullah et al., 2015). The two indices included between them a total of 67 items that were expected to be published in the annual reports of the sample banks. The non-Islamic risk disclosure index included 54 items, which were divided across 8 categories: accounting policies, financial and other risks, derivative hedging and general risks, financial instruments, reserves, segment information, business risk and compliance with regulations. While, the Islamic risk disclosure index included 67 items, which were distributed across 10 categories: accounting policies, financial and other risks, derivative hedging and general risks, financial instruments, reserves, segment information, business risk, compliance with regulations, Islamic bank risk characteristics and Islamic standards (see appendix).

This categorization of the two crafted risk disclosure indexes is due to the nature of the listed Saudi banks, where listed banks represent two sets of banks, namely Islamic banks and conventional banks, which are vigorously offering banking services in Saudi Arabia. Moreover, one of the important issues during crafting the disclosure index was deciding whether some items should be weighted more heavily (i.e. important) than others. In accounting research, both weighted and un-weighted disclosure indices are utilized (Cooke, 1989; Marston and Shrivess, 1991; Owusu-Ansah, 1998; Raffournier, 1995).

For the purpose of this study, the un-weighted disclosure index was chosen because the study does not focus on a particular user group (Alsaheed, 2006; Naser et al., 2006). Instead the study addresses all users of annual reports, and therefore there is no need to confer different importance levels to the disclosed risk items (Oliveira et al., 2006). The contents of each bank's annual reports were compared to the items listed in the Appendix, and on the basis of a dichotomous model they were coded as

1 if disclosed or 0 if otherwise. This index coincides with other studies that quantify the extent of disclosure and risk disclosure (see Beretta and Bozzolan 2004; Barako et al., 2006; Alsaeed, 2006; Oliveira et al., 2006; 2011a).

The total score for a bank is:

$$TD = \sum_{i=1}^n d_i \quad (1)$$

Where  $d = 1$  if the item is disclosed;  $0 =$  if the item is not disclosed;  $n =$  number of items.

#### 4.7.1 Reliability and Validity of Disclosure Indices

Weber (1988) argued that the classification procedure should be reliable and valid.

The reliability and validity of content analysis approaches need to be reviewed carefully. In human-scored schemes, reliability, that is the reproducibility of the measurement, is a major concern (Marston and Shrives, 1991; Healy and Palepu, 2001). The preceding studies argued that content analysis is not reliable if it is conducted only once or only by one specific person (Neuendorf, 2002). Consequently, to ensure the content validity of the initial research instrument, it was reviewed independently by two other researchers. Subsequently, after the researcher received the independent researcher's comments and suggestions. A fourth experienced academic was required to discuss any ambiguities raised. The final disclosure checklist included 67 items. In terms of validity the research instruments (disclosure indices) are valid if they can measure what they claim to measure (Field, 2009). In this study the indices have measure what they claimed to measure, therefore the researcher can safely claim that the research instruments are valid. To ensure the reliability of the research instrument, the author and the two independent researchers scored three randomly selected banks. Then, the results from the three researchers were compared. Given that the final research disclosure

indices were agreed by all researchers, differences in the compliance scores from the researchers were insignificant. This method was adopted by Marston and Shrives (1991), who argued that the index scores awarded to firm could be considered reliable if other researchers could replicate the same results. The final disclosure checklists are presented in the following table:

**Table 2: Ensuring validity of research instrument**

Categories	Items suggested by author	Items suggested by first independent researcher	Items suggested by second independent researcher	Final index after consultation	Weight
Accounting Policies	12	13	9	10	15%
Financial risks	15	18	10	15	22.5%
Derivatives hedging and General Risk Info	8	10	9	11	16.5%
Financial instruments	2	2	3	2	3%
Reserves	2	3	2	3	4%
Segment information	2	2	2	2	3%
Business risk	3	6	4	5	7.5%
Compliance with regulations	5	11	3	6	9%
Islamic Bank Risk characteristics	9	9	9	9	13.5%
AAIOFI Standards	5	4	6	4	6%
Total	63	78	57	67	100%

*The weight is calculated based on final items for each standard dividend into total items (67). For example: weight of Accounting Policies =  $10/67 \times 100 = 15\%$*

For example; in terms of categories the author in the initial draft of the indices suggested a category under the name “*General Information*” which incorporated 9 items. However, both of the independent researchers suggested the removal of this category. After a lengthy discussion with the principal researcher, the category was removed. Also, under the business risk category the principal researcher only suggested 3 items which were “*Political Risk, Diversification Risk and Performance Risk*”. However, both of the independent researchers suggested more items, which after another lengthy discussion with the author two more items were included “*General Financial Problems and Regional Financial Problems*”.

#### 4.8 Descriptive analysis and Discussion

This section presents the results of the analysis and the resultant discussion. The

results are generally based on the outcome of the descriptive statistics of disclosure levels and rankings related to the risk categories. Recently, there has been an increase in users' demands for corporate information. The literature reveals that companies have been put under immense pressure to make even greater disclosures of corporate information, especially in relation to risks and uncertainties. This is the background against which the results of this study should be interpreted. This study sets out to examine the levels voluntary of risk disclosure amongst listed Saudi banks. Tables 3 and 4 display the results of the content analysis. The tables show that all banks in the sample disclosed risk-relevant information. Furthermore, the results displayed in tables 5, 6 and 7 below show that on average the level voluntary of risk disclosure steadily increased across the period under study, rising from 52% in 2009 to 77% in 2013; however, the highest score recorded was 78% in 2011 by Banque Saudi Fransi. This provides evidence that there was an upward trend in the average amount of risk disclosure being published by the sampled banks over the period from 2009 to 2013. The average disclosure, regardless of the universal items or Islamic items, increased overall.

**Table 3: Average risk disclosure level for Non-Islamic Banks from 2009 to 2013**

Categories	Saudi Investment Bank	Arab National Bank	National Commercial Bank	Banque Saudi Fransi	SAMBA	Saudi Hollandi Bank	SAAB	Riyad Bank	Average
Accounting Policies	66%	73%	77%	69%	64%	82%	66%	73%	<b>71%</b>
Financial and other Risks	100%	81%	87%	91%	60%	90%	92%	93%	<b>87%</b>
Derivative Hedging and General Risks	45%	58%	36%	73%	18%	47%	49%	49%	<b>47%</b>
Financial Instruments	50%	50%	100%	50%	50%	50%	50%	50%	<b>56%</b>
Reserves	67%	100%	67%	100%	100%	100%	66%	100%	<b>88%</b>
Segment Information	100%	100%	100%	50%	50%	50%	100%	50%	<b>75%</b>
Business Risk	60%	52%	60%	52%	60%	60%	40%	44%	<b>54%</b>

Compliance with Regulations	67%	66%	67%	76%	67%	67%	83%	67%	<b>70%</b>
Average	<b>69%</b>	<b>73%</b>	<b>74%</b>	<b>70%</b>	<b>59%</b>	<b>68%</b>	<b>68%</b>	<b>66%</b>	<b>68%</b>

*Notes: The disclosure score for each risk disclosure level is calculated as a ratio of the actual total items disclosed in the annual reports for each bank divided by the 54 items included in the risk disclosure index for non-Islamic and divided by the 67 items included in the risk disclosure index for the Islamic banks.*

Table 3 shows the descriptive analysis for the level of corporate risk disclosure and its categories in the annual reports of all listed non-Islamic banks in Saudi Arabia. In general, what should be noted when observing the table above is that, from a merely quantitative point of view, the total risk disclosure per index reveals that Saudi non-Islamic banks on average reported more risk disclosure than their Islamic counterparties. This is consistent with Abdallah et al. (2015). Furthermore, the results indicate that the total risk disclosure in non-Islamic banks was 68%, with the most common risk disclosure categories in the annual reports of the sampled banks being reserves (88%), financial and other risks (87%), segment information (75%), accounting policies (71%), compliance with regulations (70%), financial instruments (56%), business risk (54%) and derivative hedging (47%).

However, in terms of reporting risk disclosure levels per category for all non-Islamic banks in Saudi Arabia, the Saudi Hollandi bank scored the highest in the first category namely accounting policies (82%). In second place, came the National Commercial bank by scoring (77%). Where, in third place, came jointly the Arab National bank and Riayd bank by obtaining a score of (73%). The Banque Saudi Fransi came fourth in the accounting policies category by scoring (69%). In fifth place, jointly came the Saudi Investment bank and SAAB bank by achieving a score of (66%). SAMBA bank came last in the accounting policies category by achieving an overall score of (64%).

While, in the second category financial and other risks, the Saudi Investment banks achieved the highest score (100%), secondly, came Riyadh bank (93%), thirdly SAAB

bank acquiring a score of (92%), fourthly came the Banque Saudi Fransi at (91%), next came the Saudi Hollandi bank at (90%), then the National Commercial bank came by obtaining a score of (87%), in seventh place, the National Arab bank came by scoring (81%) in the financial risk category, where SAMBA also came last in this category by a large difference (60%). Moreover, the third category is the derivative hedging, which is the lowest category where most non-Islamic banks scored below the (49%). It also has the lowest average of all non-Islamic banks at (47%). The fourth category is the financial instruments category, which is the only category where all non-Islamic banks from this study's sample achieved a score of (50%) except the National Commercial bank which have achieved a score of (100%). Next comes the reserves category where the Arab National bank, Banque Saudi Fransi, SAMBA, Saudi Hollandi bank and Riyadh bank acquired in this category (100%), while secondly came together the Saudi investment bank and the National Commercial bank at a score of (67%) which is low compared to the first 5 banks in this category, lastly in the reserves category came SAAB bank at (66%). In the sixth category, namely segment information the banks split into two groups where Saudi investment bank, Arab National bank, National Commercial bank and SAAB obtained a score of (100%), while Banque Saudi Fransi, SAMBA, Saudi Hollandi bank and Riyadh bank achieved a score of (50%).

In the business risk category, the Saudi Investment banks, the National Commercial bank, SAMBA and the Saudi Hollandi bank all achieved a score of (60%), while the Arab National bank and the Banque Saudi Fransi together scored (52%). In this category Riyadh bank achieved (44%), also in the same category SAAB bank obtained (40%). Finally in the compliance with regulations category, the highest score was acquired by SAAB bank at (83%), the second highest score was achieved



by Banque Saudi Fransi at (76%). While in this category Saudi investment bank, National Commercial bank, SAMBA, Saudi Hollandi bank and Riyadh bank all scored the same at (67%), the Arab National bank scored (66%) in the compliance with regulations category.

However, looking at it in terms of the average risk disclosure reporting per bank of the 8 non-Islamic banks listed on the Saudi stock market the National Commercial Bank was the highest, scoring 74%, followed by the National Arab Bank came second, scoring 73%, then the Banque Saudi Fransi at 70%, fourthly the Saudi Investment bank at a score of 69%. Also, in terms of average risk reporting the Saudi Hollandi bank and SAAB bank scored the same at 68%, followed by Riyadh bank with little difference between them (66%). Finally, SAMBA Bank came last, scoring only 59% in the overall average of all categories per bank.

**Table 4: Average risk disclosure level for Islamic Banks (2009 – 2013)**

<b>Categories</b>	<b>ALJAZIRA</b>	<b>ALRAJHI</b>	<b>ALINMA</b>	<b>ALBILAD</b>	<b>Average</b>	
Accounting Policies	64%	75%	71%	83%	<b>73%</b>	<b>67%</b>
Financial and other Risks	68%	72%	70%	72%	<b>71%</b>	
Derivative Hedging and general risks	55%	69%	56%	29%	<b>52%</b>	
Financial Instruments	100%	80%	50%	40%	<b>68%</b>	
Reserves	100%	100%	67%	67%	<b>84%</b>	
Segment Information	60%	70%	50%	80%	<b>65%</b>	
Business Risk	44%	48%	48%	60%	<b>50%</b>	
Compliance with regulations	70%	83%	77%	66%	<b>74%</b>	
Islamic Bank Risk Characteristics	73%	54%	44%	49%	<b>55%</b>	<b>38%</b>
Islamic Standards	30%	25%	0%	25%	<b>20%</b>	
Average	<b>66%</b>	<b>68%</b>	<b>53%</b>	<b>57%</b>	<b>61%</b>	

Table 4 shows that the average risk disclosure among Islamic banks was 61%, while on average the most frequently reported risk categories amongst listed Islamic banks

in Saudi Arabia were reserves (84%), compliance with regulation (74%), accounting policies (73%), financial and other risks (71%), financial instruments (68%), segment information (65%), Islamic bank risk characteristics (55%), derivative hedging and general risks (52%), business risk (50%) and Islamic standards (20%). However, the most frequently reported categories among all banks (Islamic banks as well as non-Islamic banks) were reserves (88%), financial and other risks (87%) for non-Islamic (see Tables 3) and reserves and compliance with regulations (74%) for Islamic banks (see Tables 4). The two most infrequently reported categories among the Islamic banks were Islamic standards (20%) and business risk (50%) and for non-Islamic were derivative hedging and general risks (47%) and business risk (54%), (see Table 3).

However, in terms of reporting risk disclosure levels per category for all Islamic banks in Saudi Arabia, the Albilad bank achieved the highest score in the first category namely accounting policies at a score of (83%), while, Alrajhi bank, which is the largest Islamic banks in the country came second in the accounting policies category by achieving a score of (75%). In third place came the Alinma bank, which is the newest bank in Saudi Arabia, being established in 2008 scoring (71%), (Alinma bank, 2015). While, in last place came Aljazira bank, which in 2007 shifted from being a conventional bank to a fully sharia-compliant bank by scoring (64%), (Aljazira bank, 2015). The second category is the financial and other risks. In this category Albilad bank and Alrajhi bank jointly scored the highest among the Islamic at (72%). Secondly, the Alinma bank achieved in this category a score of (70%), where Aljazira bank came last by acquiring a score of (68%). However, in the derivative hedging and general risk information, Alrajhi bank scored the highest at (69%), in second place Alinma bank scored (56%), followed by Aljazira bank by a

very close score at (55%) and coming last at a very low score at this category is Albilad bank (29%). In the financial instruments category, Aljazira bank topped all Islamic banks by obtaining a score of (100%). Alrajhi bank scored second top at (80%), while Alinma bank and Aljazira bank score considerably low at the financial instruments category at (50%), (40%) respectively. Moreover, Aljazira and Alrajhi banks jointly acquired the highest scores in the reserves category (100%). This could be attributed to large size both banks enjoy, where both banks had the largest total assets over the sample period. Also, in the same category Alinma and Albilad banks jointly acquired a score of (67%). In the segment information category, Albilad bank came first with a score of (80%), followed by Alrajhi bank with a score of (70%), then Aljazira bank with a score of (60%), and followed by Alinma bank with a score of (50%). While, in the business risk category Albilad scored (60%), where in second place came jointly Alrajhi and Alinma banks at (48%), followed by Aljazira bank with a score of (44%). Whereas, in the compliance with regulations Alrajhi bank scored the highest score at (83%), then Alinma bank came second with a score of (77%), followed by Aljazira bank with a score of (70%) and in fourth place came Albilad bank at (66%). Moreover, in the Islamic bank risk characteristics category, Aljazira bank acquired the highest score of (73%), in second place came Alrajhi bank with a score of (54%), and followed by in third place Albilad bank with a score of (49%), then by Alinma bank with a score of (44%). In the last category, named the Islamic standards Aljazira scored the highest at (30%), followed by jointly Alrajhi and Albilad banks with a score of (25%) and in last place came Alinma bank with zero percent. However, over the sampled period, amongst the Islamic banks Alrajhi Bank had on average the highest score at 68% in terms of risk disclosure per bank. In second place in terms of risk reporting per bank, Aljazira bank achieved a score of (66%).

Thirdly, Albilad bank on average per bank scored (57%), while Alinma Bank had the lowest score of (53%).

#### 4.9 Further Discussion

Table 3 shows the descriptive analysis for the level of corporate risk disclosure and its categories in the annual reports of listed non-Islamic banks in Saudi Arabia. In general, what should be noted when observing the table above is that, from a merely quantitative point of view, the total risk disclosure per index reveals that Saudi non-Islamic banks on average reported more risk disclosure than their Islamic counterparties. This could be a reflection of the inherently conservative nature of the principles that guide Islamic financial institutions, which aim to provide financial products that serve the interests of society more broadly than do non-Islamic banks, which are more likely to be oriented towards the pursuit of profit maximization. Furthermore, the results indicate that the total risk disclosure in non-Islamic banks was 68%.

On the other hand, table 4 illustrates the descriptive analysis for the level of corporate risk disclosure and its categories in the annual reports of listed Islamic banks. It reveals that the average level of risk disclosure among Islamic banks was 61%. However, table 3 and 4 indicate that Islamic banks were more likely to report risk disclosure than non-Islamic banks in the areas of accounting policies, derivatives hedging and general risk information, financial instruments and compliance with regulations categories. This is concurrent with Abdallah et al. (2015). It is worth noting, however, that the difference in the risk disclosure between Islamic banks and non-Islamic banks is not momentous for the overall and all-risk categories. Generally, this suggests that on average the two groups reported a similar amount of risks. However, when comparing the overall risk disclosure levels of all 12 listed Saudi

banks in this study with risk disclosure levels in previous studies, such as Amran et al. (2008) (74.5%), Deumes and Knechel (2008) (87.3%) and Maffei et al. (2014) (84.8%), the sample banks' score was relatively low at 64%. This signifies that listed Saudi banks still have to improve upon their corporate risk disclosure levels so as to improve the overall risk disclosure practices among the banking industry, which will result in well-informed investors and more effective decision making practices. This was confirmed by the ICAEW (1999), who advised quantifying risk whenever possible to improve the quality of risk reporting. Basically, the quantification of risk by managers in the annual reports results in the overall enhancement of risk disclosure quality. This leads to investors being able to make more informed investment decisions. Moreover, Islamic banks (67%) and non-Islamic banks (68%) disclosed almost the same amount of risk in terms of the universal items, which are the first 8 categories of the risk disclosure index (see appendix). Islamic banks only reported (38%) regarding Islamic items, the last two categories of the Islamic banks risk disclosure index (see appendix).

It is evident that the sample banks reported more non-financial information than specific financial information. Looking at the above tables, on average the total number of banks examined for the purpose of this investigation reported most on the same nonfinancial category, namely, reserves. Empirical studies in different contexts have provided similar results (Rajab and Schachler, 2009; Woods and Reber, 2003, Mokhtar and Mellett, 2013). The total Saudi banks scored 79% on financial and other risks category, which is more than the average reported by previous studies, such as Mokhtar and Mellett (2013) (4.55%) and Maffei et al. (2014) (30%). The tables below show the average per year over the entire sample period of all banks.

***Table 5: Average risk disclosure of each Islamic bank (per year)***

ALJAZIRA					ALRAJHI					ALINMA					ALBILAD				
2009	2010	2011	2012	2013	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
68%	66%	64%	64%	71%	75%	74%	67%	55%	67%	52%	52%	51%	56%	56%	53%	53%	54%	66%	60%

*Table 6: Average risk disclosure of each Non-Islamic bank (per year)*

SAMBA					Saudi Hollandi Bank					SAAB					Riyad Bank				
2009	2010	2011	2012	2013	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
59%	59%	59%	59%	59%	67%	67%	67%	70%	70%	66%	72%	68%	68%	68%	65%	65%	67%	66%	66%

*Table 7: Average risk disclosure of each Non-Islamic bank (per year)*

Saudi Investment Bank					Arab National Bank					National Commercial Bank					Banque Saudi Fransi				
2009	2010	2011	2012	2013	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
68%	69%	69%	74%	67%	67%	72%	69%	77%	77%	74%	74%	74%	75%	75%	70%	66%	78%	74%	62%

Tables 5, 6 and 7 present the descriptive statistics for the scores of the risk disclosure levels for each year of the sample period for the individual banks. Table 5 displays the average risk disclosure of each Islamic bank per year. It can be seen from this table that Aljazira Bank witnessed a drop in terms of reporting risk disclosure from 68% in 2009 to 64% in 2012 before increasing up again to 71% in 2013. Such fluctuations in risk reporting over the period could be attributed to new board members joining or due to new corporate governance measures adopted.

However, as demonstrated in table 5 Alrajhi bank witnessed a decrease throughout the period, despite being the largest bank in terms of total assets and profitability. This decrease effect could be attributed to other corporate governance factors, such as changes in disclosure policy or changes in the top management. Albilad bank witnessed a steady increase in the levels of risk disclosure over the first 4-years of the period before decreasing to 60% in 2013. This effect could be due to steady profitability levels over the latter 4 years of the examined period. While, Alinma bank

witnessed the no changer effect in the levels of voluntary risk disclosure for the first 2-year, followed by a very little decrease in the subsequent year before soaring up again over the last 2-year of the period. This could be only attributed to trying new reporting strategy by management.

On the other hand, tables 6 and 7 demonstrate that most of the individual non-Islamic banks witnessed overall steady increases in the levels of risk disclosure over the sample period, which could be attributed to the same levels of profitability of these banks. However, Banque Saudi Fransi witnessed large changes over the period in its risk reporting levels, starting in 2009 at 70%, followed by a slight decrease to 66% in 2010, then soaring up to 78% in 2011, scoring the highest score of the entire sample through the whole period, then once again dropping to 74% in 2012 and reaching the lowest score 62% in 2013. This could be due to changes in the board of directors, since some board members tend to lean toward a specific disclosure strategy. Contrastingly, SAMBA Bank observed no changes in its reporting levels over the sample period.

Table 7 shows that according to legitimacy theory perspective, the motivations for voluntary risk disclosure by banks can be explained by the perceived level of stakeholder monitoring, and by perceptions of a bank's reputation (Oliveira et al., 2011b). Therefore, publicly visible older banks with higher levels of depositor confidence and with a greater ability to manage risk, disclose more risk information voluntarily. This could be an explanation of the high levels of risk disclosure practices maintained among the non-Islamic banks over the examined period, in particular the National Commercial Bank and Arab National Bank since they are two of the oldest banks in the kingdom.

Overall, the above tables indicate that the majority of banks witnessed an increase in

their risk reporting levels over the 5-year period. This provides evidence that there was an upward trend in the average amount of risk disclosure being published by the sampled banks over the period from 2009 to 2013. There is only one possible explanation for this trend, which is that all of the sampled banks were following the international financial reporting standards as well as the national accounting standards (IFRS, 2011), requiring them to apply the IFRS7, which makes it categorically clear that disclosure is mandatory. This could be confirmation that regulation is the most powerful driver of the increases in the levels of corporate risk disclosure (Adamu, 2013; Lipunga, 2014). Furthermore, some studies have documented that the amount of information disclosed by organizations has increased substantially over the past few years in part due to regulations (Oliveira et al., 2011a; Leuz, 2010) and that there has been a rise in voluntary information provided by companies (Oliveira et al., 2011a; Campbell and Slack, 2008). In addition, other studies have reported that firms react to new requirements (Miihkinen, 2012) by increasing the amount of disclosure relating to either specific risk items (Roulstone, 1999) or specific sections of their annual reports.

**Table 8: Banks Descriptive Information**

Banks	Disclosure Level	Year	Firm-Specific Characteristics Variables			
			LOG Size	Profitability	Leverage	Auditor Dummy (1-0)
ALJAZIRA	68%	2009	7.48	0.1%	8.98%	1
ALRAJHI	75%		8.23	4.06%	3.57%	1
ALINMA	52%		7.24	1.78%	0	1
ALBILAD	53%		7.24	-1.48%	1.14%	1
SAMBA	59%		8.27	2.52%	4.96%	1
Saudi Hollandi Bank	67%		7.77	0.22%	13.76	1
SABB	66%		8.10	1.78%	57.67%	1
Riyad Bank	65%		8.25	1.78%	57.67%	1
Saudi Investment Bank	68%		7.70	1.78%	57.67%	1
Arab National Bank	67%		8.04	2.08%	10.99%	1
National Commercial Bank	74%		8.41	1.78%	57.67%	1
Banque Saudi Fransi	70%		8.08	1.78%	57.67%	1



ALJAZIRA	66%	2010	7.52	0.09%	1.18%	1
ALRAJHI	74%		8.27	3.81%	2.93%	1
ALINMA	52%		7.43	0.07%	8.45	1
ALBILAD	53%		7.32	1.78%	57.67%	1
SAMBA	59%		8.27	2.39%	11.57%	1
Saudi Hollandi Bank	67%		7.73	1.48%	9.08%	1
SAAB	72%		8.10	1.78%	8.23%	1
Riyad Bank	65%		8.24	1.78%	57.67%	1
Saudi Investment Bank	69%		7.71	1.78%	57.67%	1
Arab National Bank	72%		8.06	1.71%	14.56%	1
National Commercial Bank	74%		8.45	1.78%	57.67%	1
Banque Saudi Fransi	66%		8.09	1.78%	57.67%	1
ALJAZIRA	64%	2011	7.59	0.9%	5.93%	1
ALRAJHI	67%		8.34	3.64%	3.18%	1
ALINMA	51%		7.57	1.36%	6.64%	1
ALBILAD	54%		7.44	1.78%	1.52%	1
SAMBA	59%		8.29	2.27%	10.7%	1
Saudi Hollandi Bank	67%		7.76	1.93%	8.99%	1
SAAB	68%		8.14	2.3%	7.24%	1
Riyad Bank	67%		8.26	1.78%	3.55%	1
Saudi Investment Bank	69%		7.72	1.78%	11.79%	1
Arab National Bank	69%		8.07	1.88%	10.95%	1
National Commercial Bank	74%		8.48	1.78%	57.67%	1
Banque Saudi Fransi	78%		8.15	1.78%	57.67%	1
ALJAZIRA	64%	2012	7.71	1.17%	8.41%	1
ALRAJHI	55%		8.43	3.23%	0.84%	1
ALINMA	56%		7.73	1.61%	8.24%	1
ALBILAD	66%		7.47	3.28%	1.92%	1
SAMBA	59%		8.30	2.21%	6%	1
Saudi Hollandi Bank	70%		7.84	2.08%	11.77%	1
SAAB	68%		8.19	2.27%	6.75%	1
Riyad Bank	66%		8.28	1.87%	3.24%	1
Saudi Investment Bank	74%		7.77	1.69%	14%	1
Arab National Bank	77%		8.14	1.89%	9.15%	1
National Commercial Bank	75%		8.54	1.78%	57.67%	1
Banque Saudi Fransi	74%		8.20	1.78%	9.24%	1
ALJAZIRA	71%	2013	7.78	1.78%	57.67%	1
ALRAJHI	67%		8.45	2.72%	1.3%	1
ALINMA	56%		7.80	1.72%	32.84%	1
ALBILAD	60%		7.56	1.78%	57.67%	1
SAMBA	59%		8.31	2.23%	3.64%	1
Saudi Hollandi Bank	70%		7.91	2.13%	13.03%	1
SAAB	68%		8.25	2.33%	5.17%	1
Riyad Bank	66%		8.31	2%	5.64%	1
Saudi Investment Bank	67%		7.91	1.9%	14.69%	1
Arab National Bank	77%		8.14	1.78%	6.76%	1
National Commercial Bank	75%		8.58	1.78%	57.67%	1
Banque Saudi Fransi	62%		8.23	1.58%	6.35%	1

As can be observed from the table above, the National Commercial Bank is the highest ranked bank in terms of its voluntary risk disclosure score over the entire

sample period. It is also the largest listed bank on the Saudi stock market in terms of size (total assets). This result shows that the level of risk disclosure is positively correlated with size. This is consistent with previous risk disclosure studies that employed annual reports, such as Beretta and Bozzolan (2004), Linsley and Shrives (2006), Konishi and Mohobbot (2007), Lopes and Rodrigues (2007), Vandemele et al. (2009) and Mousa and Elamir (2013), which confirmed that size is positively correlated with the level of risk disclosure. This outcome is also in line with signalling theory. According to signalling theory, larger companies rely more on external finance. Hence, they are incentivized to disclose more risk information in order to send a good signal to investors and creditors regarding their ability to manage risk. As has been established by prior investigation, leverage could affect the level of risk disclosure since the level of risk disclosure and the leverage ratio simultaneously increase or decrease. Moreover, firms with higher leverage are more likely to have a higher level of voluntary risk disclosure in their annual reports than those with lower leverage (Deumes and Knechel 2008; Hassan 2009; Marshall and Weetman 2007; Taylor et al., 2010). The table above shows that Alrajhi Bank's risk disclosure levels decreased in tandem with the leverage ratio year by year over the entire sample period, confirming the above argument. This is also concurrent with signalling theory, whereby managers tend to provide more risk management information to send a good signal to debt holders regarding corporate ability to meet obligations (Oliveira et al., 2011b).

The banks descriptive table above shows that SAMBA Bank had a consistent level of risk disclosure throughout the whole sample period. Yet, its profitability levels decreased year by year. This non-directional relationship illustrates that there is a negative association between the two variables. This is concurrent with Mousa and

Elamir (2013), who reported a negative relationship between profitability and risk disclosure levels. Furthermore, applying signalling theory could mean that those firms that are better at risk management will have higher levels of relative profitability and would want to signal their superior risk management abilities to the market place via voluntary disclosures in the annual report.

Auditor type has been suggested as a factor in explaining variations in voluntary risk disclosure levels (Al-Shammari, 2014). Furthermore, Jensen and Meckling (1976) argued that larger audit firms are less likely to be associated with clients that disclose lower levels of information in their annual reports. Chalmers and Godfrey (2004) claimed that these larger and better known auditing firms tend to encourage their clients to disclose more risk information to maintain their own reputation. The international Big 4 auditing firms are more likely to pressure their clients to disclose risk information in their annual reports to assure the shareholders regarding the quantity of risk that their companies face. However, the consistently changing levels of voluntary risk disclosure over the examined period, as can be seen from the table above, indicate that auditor type had no effect on the levels of voluntary risk disclosure in the sample banks of this study. Indeed, one of the Big 4 accounting firms audited all banks included in this investigation, which proves that there is no correlation between auditor type and the level of voluntary risk disclosure in Saudi listed banks. Nevertheless, the choice of an external auditor can serve as one signal of a firms' value. For example, Craswell and Taylor (1992) showed that listed firms are more likely to choose one of the Big 4 auditing firms. Such a choice signals to investors that the auditing of the contents of the annual reports is of high quality.

Regarding the impact of Islamic values (risk disclosure items in the Islamic index e.g.

*Qard hassan* risk “interest free loan risk”) on the level of voluntary risk disclosure in Islamic banks is low (38%). This low level of risk disclosure signifies the low compliance with the Islamic values. This effect has impacted the total level of risk disclosure. This could be attributed to the non-compliance of Saudi Islamic banks with the Islamic standards such as AAOIFI, which has decrease the levels of uniqueness of Islamic banks compared to non-Islamic. This is in line with prior literature which exhibited that Islamic banks’ report low levels of disclosure regarding Islamic values (e.g., Kamla, 2009). The weaknesses of disclosure about such values effect the investors’ as well as stakeholders’ perceptions towards the differences between the two sets of banks (e.g., El-Gamal, 2006a). This outcome is inconsistent with the argument of legitimacy theory that expects corporations’ to act in accordance with the values of the community (Carpenter and Feroz, 1992). For example, stakeholders who choose to deal with Islamic banks expect banks to fully comply with the Islamic value, and disclosure information concerning such actions.

#### **4.10 Summary**

This study sought to empirically investigate the level of voluntary risk disclosure in the annual reports of all listed banks on the Saudi stock market from 2009 to 2013. This study used the manual content analysis approach to measure voluntary risk disclosure by counting the number of words disclosed by the sample banks in their annual reports. The empirical analysis showed that overall Islamic banks reported less risk information than non-Islamic banks. However, the analysis also revealed that both types of banks reported relatively the same amount of risk information regarding the banks’ universal items and Islamic banks reported very little risk information on the Islamic risk disclosure items. Based on this, the following conclusion can be made: Islamic banks disclose less voluntary risk information than

their non-Islamic counterparties. This outcome could be a reflection of the inherently conservative nature of the principles that guide Islamic financial institutions, which aim to provide financial products that serve the interests of society more broadly than non-Islamic firms, which are more likely to be oriented towards the pursuit of profit maximization.

This investigation results have important implications for regulators in Saudi Arabia as they attempt to ensure information adequacy and the increased efficiency of the most rapidly developing capital market. Particularly, the reported results should be useful to accounting and risk regulatory bodies by providing information about the inadequacies of risk reporting in Saudi banking sector. Regulatory institutions should be above all concerned about the disclosure needs of users. Specifically, this study is significant in that it sheds light on the voluntary risk-disclosing practices of banks that operate in an environment that is often considered to be opaque. Saudi Arabia scored zero on the secrecy vs. transparency measure in Hofstede's cultural dimensions. Also, directors could use the results of this study to compare the amount of information reported in their annual reports with other banks to ensure funding. The study also provides information for managers to keep investors satisfied about the risk that their banks encounter. Investors may use the findings for understanding risk disclosure behaviour of listed banks on Tadawul. It informs investors about the characteristics of risk information in their annual reports.

The following chapter measures the determinants of voluntary risk disclosure. It investigates whether or not corporate governance attributes and board demographic traits have any influence on the levels of voluntary risk disclosure in listed Saudi Banks.

## **5 Chapter Five: Corporate Governance and Risk Disclosure: Evidence from Saudi Arabia**

### **5.1 Overview**

Regulatory institutions have had to reconsider the basis of banking regulations due to the global financial crisis. Beltratti and Stulz (2012) and Erkens et al. (2012) argued that this event resulted in serious concerns regarding risk disclosures. Due to this catastrophic corporate failure, investors' and stakeholders' attention has been drawn to the importance of risk reporting (Linsley et al., 2008). These concerns are coherent with the argument put forward by Meier et al. (1995), Schrand and Elliot (1998), Beretta and Bozzolan (2004), Cabedo and Tirado (2004), Ahmed et al. (2004), Linsley et al., (2006), Linsley and Shrivies (2006), Abraham and Cox (2007), Linsley and Lawrence (2007) and Hassan (2009), which is that risk disclosure is a pivotal aspect of business risks, where reporting offers greater transparency and enhances investors' confidence. As is evident, the global crisis also resulted in a deceleration of the global economy and thus the demand for risk reporting increased. This had led to a number of regulatory reforms, for example, the birth of the International Financial Reporting Standard 7 Financial Instruments and BASEL II, which includes greater measures on risk transparency and disclosure. It also emphasises the significance of informative risk disclosure in the banking industry for the overall enhancement of market discipline. The disclosure of informative risk information in banks has been cited as instrumental in eluding banking catastrophes (Financial Stability Board, 2012).

Disclosure of financial risk information is important since it increases transparency, thus giving shareholders' more confidence and lowering their uncertainty about future cash flow as well as making it more viable for corporations to obtain external funding at a cost of capital, hence increasing capital market activities in general

(Deumes, 1999; Easley and O'Hara, 2004; Kothari et al., 2009). Institutions are encouraged not only to report their activities but also the risks associated with them as well as their strategy for and capacity to manage these risks (ICAEW, 1999).

However, prior research shows that financial statements suffer from serious deficiencies and inadequacies in terms of the provision of risk and uncertainty disclosures (Cabedo and Tirado, 2004). One of the main causes of the global financial disaster in 2007 was the absence of adequate risk disclosure available to investors. This dearth of risk disclosure prohibited investors from having adequately appropriate information to evaluate corporations' risk reportage (Rahman, 1998). Solomon et al. (2000) found that institutional investors consider risk reporting inadequate in the UK. Therefore, this leaves investors unable to adequately assess a firm's risk profile, and hence they are unable to deliberate on the scale and categories of risk in their venture decisions (Linsley et al., 2008). This dearth of risk information in annual reports indicates the necessity to examine the determinants of risk disclosure in different settings, particularly developing markets, such as in our case study, Saudi Arabia.

Whilst previous literature discusses extensively the relationship between the determinants of risk disclosure in developed economies (Lajili and Zeghal, 2005; Linsley and Shrives, 2006; Abraham and Cox, 2007; Konishi and Ali, 2007; Deumes and Knechel, 2008; Hill and Short, 2009; Taylor, Tower and Neilson, 2010), there is very little mention of developing markets (Amran, Bin and Hassan, 2009; Hassan, 2009; Abdallah and Hassan, 2013). Furthermore, none of the preceding risk disclosure studies have investigated the impact of the combination of corporate governance and demographic variables on risk disclosure practices. This study aims to investigate risk disclosure practices in an emerging market, Saudi Arabia,

empirically examining corporate governance and demographic traits as the determinants of risk reporting practices in Saudi listed banks. To the best of the researcher's knowledge, this is the only study that has attempted to examine the combination of corporate governance and demographic traits on risk disclosure in emerging markets, and thus this research makes a novel contribution to the existing accounting literature. Furthermore, this study contributes to the risk disclosure literature by employing the upper echelons theory in order to examine the determinants and their effects on risk disclosure practises. In addition, this is the only study that examines the demographic traits of the board of directors in a developing country. In particular, this study contributes to the board demography, governance and risk disclosure literature by theoretically justifying and empirically investigating the implications of such determinants and theories in regards to risk disclosure in the banking industry. This study is motivated, firstly, by the call made by Dobler et al. (2011) for more investigation into the influence of corporate governance determinants on risk disclosure, especially in developing markets and, secondly, by the call made by Abdallah, Hassan and McClelland, (2015) for more research into the relationship between demographic characteristics and risk disclosure.

This study differs from Mousa and Elamir (2013), Mokhtar and Mellett (2013) and Abdallah, Hassan and McClelland (2015), who examined a single attribute of corporate governance characteristic and from Amran, Bin and Hassan (2009), Hassan, (2009), Abdallah and Hassan (2013) and Al-Shammari (2014), who did not investigate corporate governance and demographic attributes by comprehensively examining corporate risk disclosure and exploring demographic characteristics. Moreover, not a single study has examined corporate governance as a determinant of risk disclosure in the Saudi context. Also, not one of the above-mentioned studies



explored the demographic traits of a top management team in emerging markets. This investigation differs from all of the above-mentioned studies in that it examines the demographic characteristics of the top board of directors, employing the upper echelons theory to examine risk reporting practices in the banking industry. Furthermore, this study differs from Amran, Bin and Hassan, (2009), Hassan, (2009), Abdallah and Hassan, (2013), Mousa and Elamir, (2013), Mokhtar and Mellett, (2013), Al-Shammari, (2014) and Abdallah et al., (2015) by being the first to examine risk disclosure over a period of five years in a developing economy.

The empirical findings show that large banks with high outsider ownership, high profitability, high regularity of audit committee meetings and gender diversity are more likely to demonstrate higher levels of risk disclosure practices. Also, risk disclosure is negatively affected by board education levels. Moreover, as can be seen from our empirical findings, external ownership, audit committee meetings, gender diversity, profitability and board education levels are primary determinants of risk disclosure practices in Saudi listed banks, while the rest of the independent variables of both corporate governance mechanisms and demographic traits are insignificantly correlated with risk disclosure practices in Saudi listed bank. Our findings have several important implications for banks stockholder, regulatory bodies and any other interested group on the importance of corporate governance and demographic determinants, which can be used to augment risk reporting in the banking industry. This study also supports the upper echelons theory and further encompasses demographic research into the risk disclosure field.

The remainder of the paper proceeds as follows: section 2 discusses the theoretical framework; section 3 develops the hypotheses; section 4 outlines the research

design and methodology; section 5 discusses empirical analysis; section 6 is the discussion; and section 7 offers conclusions.

## **5.2 Corporate governance and banking**

It has been argued that compared with other industries, the banking industry is the industry which has the highest requirements for corporate governance and disclosure regulations. As such industry is a financial intermediary body which is an important part in every country's economy and has a major role in the financial system of that country (Hussainey and Al-Nodel, 2008). Furthermore, the banking industry is based on trust, however banks as financial entities deal with all kinds of risks on a daily bases since it is a part of their business (Barakat and Hussainey, 2013). Therefore, to keep public confidence and decrease risks, Saudi banks need to have good financial performance and demonstrate corporate governance best practice. Such behaviour is greatly important for shareholders when considering investment decision makings.

## **5.3 Theoretical framework**

Corporate governance has been defined by Solomon and Solomon (2004: 14) as "the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all stakeholders and act in a socially responsible way in all areas of their business activities". Also, Sharman and Copnell, (2002) defined corporate governance as "the system and process by which entities are directed and controlled to enhance performance and sustainable shareholder value, and it is concerned with the effectiveness of management structure, the sufficiency and reliability of corporate reporting and the effectiveness of risk management systems".

The literature has established a robust relationship between disclosure and corporate governance. The FRC (2008) affirmed that management effectiveness, firm performance and shareholder value is supported by the combined code on corporate governance, which also promotes certainty in corporate disclosure and governance. Mallin (2002: 253) stated that “corporate governance codes and their recommendations undoubtedly contribute towards increased transparency and disclosure”. Previous studies by Solomon et al. (2000) and Solomon and Solomon (2004) have also contributed to the relationship between corporate governance and risk disclosure.

In concordance with various theoretical debates (i.e. agency theory regards corporate governance as a control mechanism), the literature has generally reported a link between reporting and corporate governance (Ho and Wang, 2001; Elshandidy and Neri, 2015). For instance, the impact of corporate governance attributes on disclosure exercises has proven to diminish information asymmetries and enhance the functionality of organisational stewardship. Furthermore, the precision of risk information is used as an external control mechanism, which lessens agency costs and is of great importance to all interested groups (investors and analysts). This provides all interested groups with the functionality to formulate precise investment decisions and evaluate institutions’ risk profiles effectively (Elshandidy and Neri, 2015; Campbell et al., 2014; Kravet and Muslu, 2013; Miihkinen, 2013).

The theoretical association between corporate governance and disclosure has mainly been examined through information asymmetry (signalling theory) and agency theory. In the case of future disclosure examinations, the literature has proposed the employment of agency and signalling theories to examine the links between disclosure and managerial incentives (Core, 2001; Beyer et al., 2010).

Moreover, corporate governance mechanisms have been recognised as controlling agency problems and guaranteeing that directors' actions are in the best interest of shareholders (Ho and Wong, 2001).

Agency theory explains the disagreements between directors and shareholders when directors' interests differ from those of shareholders. However, it has been established by a number of prior investigations that various monitoring mechanisms, such as audit committees, independent external auditing and well-timed financial reviews (Deumes and Knechel, 2008; Spira and Page, 2003) are able to mitigate agency problems since they provide top management with more reliable information for financial reporting purposes. Jensen and Meckling (1976) argue that monitoring plays a central part in controlling the conduct of directors. Healy and Palepu (2001) proposed four resolutions for agency problems, the second of which includes corporate governance, with an emphasis on the board of directors' responsibility to monitor and discipline management in the best interest of outside owners.

Information asymmetry conflicts (also underpinned by signalling theory) between internal directors and external investors could extend to internal control systems in the case of corporate governance (Akerlof, 1970; Spence, 1973). Accordingly, outsiders cannot observe internal control activity and conduct in some circumstances due to the lack of regulations and guidance on internal control activity and conduct. Therefore, shareholders tend not to have a full understanding of the nature and scope of internal control systems. This leads to shareholders having difficulty appreciating managers' efforts to counter risks. Yet, managers could reduce information asymmetries by using their discretion to provide more information on internal control and risk management, potentially benefitting analysts, investors and other market users (Lajili and Zeghal, 2005; Deumes and Knechel, 2008).

It has been noticed from prior literature that agency theory and information asymmetry, both of which underpin signalling theory, are deployed to explicate risk disclosure to investors (Abraham and Cox, 2007; Lopes and Rodrigues, 2007; Vandemaele et al., 2009; Elshandidy et al., 2013). When internal management decides to disclose risk information to decrease agency conflicts, this culminates in mitigating information asymmetries between both parties. However, internal management might sometimes choose to release some risk information to signal their competence and capability to handle risks to distinguish themselves from the rest, which might translate into an improved reputation and some monetary gain. In addition to formulating this thesis's hypotheses, the following section discusses a number of corporate governance attributes and their potential impact on risk disclosure practices.

Corporate governance studies investigate the relationship between corporate governance attributes and corporate performance. This investigation concentrates on the impact of corporate governance attributes on risk disclosure. Whilst a number of studies have looked into the effect of corporate governance on disclosure in developed countries, the impact of corporate governance on risk disclosure in developing markets has received scant attention. Thereafter, this research will try to address this gap and contribute to the literature by examining the effect of corporate governance attributes on risk disclosure practices in Saudi Arabia.

The upper echelons theory implies that certain organisational effects are linked to top management teams having specific demographic profiles. This theory proposes that the characteristics of top management, in particular demographic characteristics, might affect strategic decision-makings and hence performance. At the centre of this theory is the notion that the background knowledge and values of corporate directors

impact upon the essential strategic decisions made by these central corporate managers. Thus, in the current study the concept is extended to the determinants of risk disclosure, investigating whether such features of the top board could impact upon the determinants of risk reportage in the banking sector. Such demographic traits play an important role in determining key institutional effects, such as the provision of risk disclosure in the annual reports. This theory will also assist this investigation in interpreting the findings of the current study's question to identify what determines risk information in the annual reports. It also grants this study the opportunity to investigate the core determinants of board demography in relation to risk disclosure.

#### **5.4 Literature**

While many studies have examined the individual characteristics of corporate governance, such as ownership structure and independent outside directors (Mohobbot, 2005; Konishi and Ali, 2007; Deumes and Knechel, 2008; Hill and Short, 2009; Taylor, Tower and Neilson, 2010), only a few have explored corporate governance characteristics in developed countries (Abraham and Cox, 2007; Oliveira, Rodrigues and Craig, 2011b; Elzahar and Hussainey, 2012), Apart from Mousa and Elamir (2013), Mokhtar and Mellett (2013) and Abdallah, Hassan and McClelland (2015), who examined a single attribute of corporate governance characteristics, percentage of foreign ownership, duality and board size, the literature on developing economies has not explored comprehensively corporate governance characteristics (Amran, Bin and Hassan, 2009; Hassan, 2009; Abdallah and Hassan, 2013; Al-Shammari, 2014). Furthermore, not a single study has examined corporate governance as a determinant of risk disclosure in the Saudi context in particular. Therefore, this is the first study that focuses on the Saudi market in that domain. In

addition, the current study is the only one that explores corporate governance characteristics and risk disclosure in the GCC market since the previous literature focused on firm-specific characteristics.

Furthermore, whilst a small number of studies have examined risk disclosure over more than a one year period in developed economies (Cabedo and Tirado, 2004; Deumes, 2008; Deumes and Knechel, 2008; Rajab and Schachler, 2009; Hill and Short, 2009; Taylor, Tower and Neilson, 2010; Elshandidy, Fraser and Hussainey, 2015), none have examined risk disclosure over more than a one year period in developing economies (Amran, Bin and Hassan, 2009; Hassan, 2009; Abdallah and Hassan, 2013; Mousa and Elamir, 2013; Al-Shammari, 2014; Abdallah et al., 2015). Therefore, the current study is the only study that examines risk disclosure over a period of five years in developing economies.

While nonfinancial and mixed institutions in developed countries have been widely researched and reported upon in the literature (Carlon, Loftus and Miller, 2003; Beretta and Bozzolan, 2004; Linsley and Shrives, 2005; Lajili and Zeghal, 2005; Combes-Thuelin, Henneron and Touron, 2006; Abraham and Cox, 2007; Deumes and Knechel, 2008; Hill and Short, 2009; Taylor, Tower and Neilson, 2010; Oliveira, Rodrigues and Craig, 2011b; Dobler, Lajili and Zeghal, 2011; Elzahar and Hussainey, 2012; Elshandidy, Fraser and Hussainey, 2015), only a few studies have focused on financial institutions in developed countries (Solomon et al., 2000; Linsley, Shrives and Crumpton, 2006; Oliveira, Rodrigues and Craig, 2011a; Maffei et al., 2014) and no investigations have been conducted on financial institutions in developing markets (Amran, Bin and Hassan, 2009; Hassan, 2009; Abdallah and Hassan, 2013; Mousa and Elamir 2013; Al-Shammari, 2014; Abdallah, et al., 2015). Therefore, this is the only study that investigates financial institutions in developing economies,

particularly Saudi Arabia. Also none of the above studies have examined the demographic attributes of top management teams or have they employed the upper echelons theory in examining the nature and determinates of risk disclosure. Therefore, this is the only study that examines the demographic traits of the top boards in developing countries. This is a response to the call for more research into the relationship between the demographic characteristics and risk disclosure made by Abdallah, Hassan and McClelland (2015). Based on the developing and appropriate preceding literature on disclosure and risk disclosure in relation to corporate governance, a number of corporate governance attributes will be presented along with their potential impact on risk disclosure practices. This study's hypotheses will thus be formulated.

## **5.5 Hypotheses development**

### **5.5.1 Ownership Structure**

Corporate governance and financial reporting have been markedly affected by ownership structure and corporate culture (Beattie et al., 2001). It has been argued that ownership and governance (which constitute the board of directors) could affect companies' risk reporting since the directors compose the yearly reports for shareholders (Abraham and Cox, 2007). Moreover, when reviewing the literature for the purpose of conducting this investigation, it was noticed that a variety of proxies have been applied to the ownership structure variable. These are: ownership concentration; institutional ownership; the number of shareholders; government ownership; the proportion of shares owned by outsiders; family ownership; managerial ownership; the percentage of closely held shares (CHS); foreign ownership and the NOSH-Factor, which combines the free-float shares; the percentage of total share available to the ordinary investor; total strategic holdings;



and investment-company held shares. However, empirical research has discovered a mixture of outcomes in this regard, which might be explained by the dissimilarity between the employed measurement and the ownership factor.

As a consequence, Fama and Jensen (1983) stated that modern establishments are distinguished by the detachment of ownership from control i.e. detaching management decisions from monitoring decisions. Additionally, Cooke (1989, p.177) stated, "Where there is a divorce of ownership from control, the potential for agency costs exists because of conflict between, firstly, shareholders and managers and, secondly, bondholders and shareholder-managers". Owusu-Ansah (1998) confirmed that ownership structure and disclosure connection is explained by agency theory since modern corporations are distinguished by the detachment of ownership from control.

On the one hand, corporations with dispersed public ownership of securities will be inclined to have high agency costs, whereby stockholders can pressurize management for more information as part of the monitoring activity. On the other hand, in the event of concentrated ownership, there is little or no physical segregation between owners and managers of the capital and most of the risk related information can be exchanged at boardroom meetings or in a casual manner. Hence, less risk related information will be accessible to the public (Mohobbot, 2005). Furthermore, information asymmetry can also be related to the discussion on the effect of ownership structure on financial reporting. Concentrated ownership companies may not encounter a high level of information asymmetry via augmented exposure, and these companies are not as easily able to comply with public reportage since most of the information is communicated at meetings and other informal manners (Mohobbot, 2005). What's more, Owusu-Ansah (1998) claimed

that when there is extensively distributed ownership, individual shareholders are not in a strong position to influence company disclosure policies and practices owing to not having the power to access the firm's internal information. Conversely, Hossain, Tan and Adams (1994) posit that discretionary reporting tends to be more common in extensively held companies in order for directors to efficiently oversee managers so as to optimize the firm's financial interests and ensure that they are operating in the best interests of the owners. Nevertheless, Kothari (2000) stated that the ownership distribution pattern and dispersed managerial ownership foster the demand for reporting to be high. However, Mohobbot (2005) argued that in the case of concentrated ownership concentration, most of the risk related information could be exchanged at the boardroom meeting or by any other casual manner, which will result in less risk related information being available to the market. Thus, there may be a negative relationship between risk disclosure and the number of shareholders. What's more, Wallace and Naser (1995) argued that the more people who demand to know about the activities of a company, the more comprehensive the reporting of the company. The authors also proposed that the boost in risk reporting could solve supervising difficulties related to growth in the proportion of the company owned by outsiders.

Konishi and Ali (2007) established that there was an insignificant correlation between the ownership diffusion pattern and the number of risk disclosures. However, the researchers still felt that there was an association between the two variables. They explained that managers could hold a high proportion of stocks and choose not to report all risk related information. Konishi and Ali (2007) confirmed that risk reporting policy is controlled by the board of directors or the top management team, implying that there can be no risk disclosure without their involvement. In addition, Deumes

and Knechel (2008) discovered a negative relationship between internal control disclosures and both ownership concentration and managerial ownership. The authors suggested that this could indicate that there are monetary reasons why corporate managers voluntarily disclose more/less information on internal control and that corporate managers evaluate the disclosure's costs and advantages then only disclose if the advantages outweigh the costs.

In spite of this, The Office of Fair Trading (2009) argued that government ownership can influence markets through immediate participation, for example, as market makers or as suppliers and buyers of goods and services or by indirect participation in private markets via taxation, regulations and subsidies. Moreover, Owusu-Ansah (1998) claimed that government ownership could lead to unusual access to corporations' information so as to monitor their investment actions, making them less motivated to increase public disclosure.

Konishi and Ali (2007) acknowledged that the aim of those corporations' disclosure strategies is to respond to the disparities in the demand for public exposure encountered. They also argued that where the government owns the majority of shares, risk reportage would be lower than when ownership is dispersed. This is due to the increased pressure on corporate managers to report more risk related information. However, Cooke (1998) documented an insignificant relationship between government ownership and disclosure. Nonetheless, Mohobbot (2005) contended that if the number of foreign investors is high, there is more pressure on corporate managers to report higher numbers of risk related disclosures. Furthermore, Mangena and Taurigana (2007) reported a positive relationship between disclosure and foreign holdings, whereas Konishi and Ali (2007) documented an insignificant relationship between the two variables.

In the case of institutional holdings, Hassan (2008c) affirmed that company directors respond to demands from institutional environments by adjusting some practices, such as the reportage of risk related information, so as to acquire social legitimacy. Additionally, Taylor (2011) stated that institutional stockholders are expected to reduce asymmetrical information by performing an overseeing role due to close contacts with the management of organizations as well as preventing management from withdrawing risk information. However, Solomon, Solomon, Norton and Joseph (2000) reported that institutional stockholders in the UK acknowledged that expanded corporate risk disclosure would aid their portfolio investment decision-making, yet they did not support a regulated setting for risk disclosure or any general statement on business risk. Furthermore, Abraham and Cox (2007) discovered that there was a negative relationship between risk disclosure and long-term institutional investors in the UK, whereas they found a positive correlation with short-term investors. However, Taylor (2011) reported that there was no significant association between long-term institutional shareholders and disclosure in Australia. The author also discovered a positive correlation between short-term institutional shareholders and risk reportage.

Therefore, directors might provide more information to investors as a signal in order to decrease information costs rising from dispersed ownership structure. Marshall and Weetman (2007) claim that higher levels of insider control as proxied by the percentage of closely held shares (CHS) are correlated with lower levels of risk disclosure. This finding backs the argument that information asymmetries exists between managers and shareholders when there is a divorce of ownership from control (Cooke, 1989; Mohobbot, 2005). Moreover, the agency theory advocates that companies with greater (lower) inside (outside) ownership structure are

expected to be more (less) secretive and less transparent (Brown et al, 2011; Deumes and Knechel, 2008). Hence, where there is a greater parting of ownership from control, investors monitoring costs are more likely to be higher in contrast to companies with a lesser parting of ownership from control. In order to decrease this phenomenon companies ought to offer more risk disclosure (Eng and Mac, 2003; Deumes and Knechel, 2008; Elshandidy et al, 2013).

Elshandidy et al. (2013) documented a positive significant correlation between ownership structure (proxied by CHS and NOSH-Factor) and risk disclosure. In addition, some empirical research results have revealed that institutions with lower insider ownership (proxied by CHS) are prone to higher risk disclosure (Elshandidy et al., 2013; Marshall and Weetman, 2007; Gelb, 2000). Also, institutions with higher outsider ownership (proxied by NOSH-Factor) are prone to considerably higher levels of risk disclosure (Elshandidy et al., 2013; Deumes and Knechel, 2008; Abraham and Cox, 2007). Akhigbe and Martin (2006); Sharma (2014) found a positive association between disclosure and ownership structure banking sector. Therefore, the following hypotheses were formulated:

***H1: There is a negative relationship between risk disclosure and insider ownership.***

***H2: There is a positive relationship between risk disclosure and outsider ownership.***

### **5.5.2 Board Size**

To date, there have been few specific investigations into the relationship between board size and risk disclosure (Muzahem, 2011). However, a number of researchers have examined board size in the context of voluntary disclosure. Furthermore, Cheng and Courtenay (2006) claimed that there is no consensus regarding a

connection between the level of voluntary exposure and board size and that it remains an empirical issue. The same could be said for the relationship between board size and risk disclosure. Moreover, Chen and Jaggi (2000) argued that a large number of directors on the board could lessen the information asymmetry issue and instigate more disclosure. Also, Healy and Palepu (2001) confirmed that the number of directors on the board could affect its control and monitoring operations, though disclosure is regarded as a monitoring item that could be increased.

Conversely, Cheng and Courtenay (2006) agreed that the more directors on the board the less efficient it would be at monitoring management. According to agency theory, bigger boards are bad and corrupt, while smaller boards are good and effective in terms of enhancing performance and disclosure (Jensen and Meckling, 1976). Free rider problems between executives, expanded decision-making time, raised costs, poor communication and monitoring could all have an adverse effect on disclosure levels and good practice (Jensen, 1993). However, several recent studies have associated large boards with greater risk disclosure (Allegrini and Greco, 2013; Elshandidy et al., 2013; Nitm et al., 2013; Elshandidy and Neri, 2015)

All in all, the empirical findings on this issue have been mixed. Nitm et al. (2013), Elshandidy et al. (2013), Allegrini and Greco (2013) and Elshandidy and Neri (2015) all found a positive relationship between the number of directors on the board and risk disclosure. In addition, Abeysekera (2010) discovered that there was a positive connection between disclosure and board size in Kenya. However, Cheng and Courtenay (2006) established that there was no significant association between the two variables, while Jia et al. (2009) Guest (2009) and Coles et al. (2008) documented a negative relationship between board size and disclosure and performance. Farag et al (2014) find a positive and highly significant association

between board size and disclosure level in the banking industry. Therefore, the following hypothesis was formulated:

***H3: There is a positive relationship between risk disclosure and board size.***

### **5.5.3 Independent Directors**

It has been claimed by agency theorists that the board of directors acts as a shield and plays a substantial part in corporate governance in terms of decision control and the monitoring of operations (Cheng et al., 2006). However, Ho and Wong (2001) contented that agency theory does not assume that all groups on the board of directors enhance accountability and extend disclosure. There is a mixture of corporate insiders and outsiders on the board, all of whom may have distinctive views on disclosure. The outsiders (independent directors) act as a measure of corporate governance quality and are more likely to minimize agency problems and lower the demand for regulatory intervention in corporate disclosure (Abraham and Cox, 2007). Accordingly, Lopes and Rodrigues (2007) claimed that more independent directors are required on boards of directors to control and monitor the operations of managers and that this leads to more disclosure from corporations.

However, the empirical findings on independent directors and risk disclosure are diverse. Abraham and Cox (2007) and Elshandidy et al. (2013) confirmed that there was a positive correlation between independent directors and risk disclosure, whereas Lopes and Rodrigues (2007) found no significant relationship between risk disclosure and independent directors. Jizi et al (2014) supported a positive association between disclosure and board independence based on large US commercial banks. Therefore, the following hypothesis was formulated:

***H4: There is a positive relationship between risk disclosure and independent directors.***

#### 5.5.4 Non-executive Directors

The empirical findings on the influence of non-executive directors on disclosure practices have been mixed. Fama and Jensen (1983) claimed that the existence of non-executive directors on the board could result in the reduction of agency conflicts among owners and managers. Moreover, Barako et al. (2006) argued that non-executive directors are regarded by investors and stockholders as a fundamental control and monitoring element of corporate governance, delivering the indispensable checks and balances required to improve board effectiveness. Also, Haniffa and Cooke (2002) affirmed that non-executive directors are considered to be the control, check and balance mechanism that increases board effectiveness. However, Ho and Wong (2001) contented that agency theory does not assume that all groups on the board of directors enhance accountability and extend disclosure.

In opposition, Abraham and Cox (2007) claimed that an increased number of non-executive directors on the board makes it more likely that stockholders' preferences on accountability and transparency are met. Furthermore, the authors argued that the findings illustrated that the combination of boards play a substantial part in the transmission of risk related disclosures to shareholders and different groups of directors. As a result, more reportage is predicted if the non-executive directors are in fact performing their monitoring job rather than their perceived-monitoring job, putting pressure on management to release more information (Haniffa and Cooke, 2002; Eng and Mac, 2003).

Berry (2008) confirmed that in his roles as a non-executive director of a number of UK corporations he had endeavoured to contribute to the expansion of efficient risk management as well as attempting to clarify the key risks to the board. He also argued that not all non-executive directors are independent and that dependent non-executive directors could have contacts with management which would call to



question their role in monitoring, controlling and increasing disclosure levels.

Empirical investigations by Abraham and Cox (2007) and Deumes and Knechel (2008) found that there was no significant relationship between non-executive directors and risk disclosure, whereas, Eng and Mac (2003) and Elshandidy et al. (2013) reported a positive relationship between non-executive directors and risk disclosure. Based on this discussion the following hypothesis was formulated:

***H5: There is a positive relationship between risk disclosure and non-executive directors.***

#### **5.5.5 Audit Committee Independence**

It has been argued that limited research has attempted to examine the link between disclosure and the features of audit committees (Albitar, 2015). As a part of the internal control system and corporate governance, corporations assign audit committees. Audit committee members have to work on behalf of the board of directors and for the benefit of investors. Moreover, Barako et al. (2006) explained that the audit committee can play a supervisory role, which would lead to an enhanced quality of information flowing between stockholders and directors, particularly in the event of financial reporting wherein the two parties hold unequal levels of information. Similarly, Forker (1992) stated that an audit committee can act as an efficient monitoring mechanism that minimizes agency costs and augments disclosure. In addition, Ho and Wong (2001) claimed that because audit committees contain predominantly non-executive managers, they have the power to moderate the amount of information withheld. Audit committees play potentially an important part in ensuring sound corporate governance (Avison et al., 2012)

Furthermore, Taylor (2011) argued that the agency theory argument suggests that the more independent the audit committee is from upper administration, the more

probable it is to act in the best interests of the firm's investors in terms of decreasing information asymmetry. The researcher also acknowledged that audit committees have two main responsibilities, firstly, to make sure that risks are coped with and internal controls exist to protect against risks and secondly, to ensure that corporate statements are examined to guarantee the integrity of financial and other investor related disclosures for shareholders.

Nevertheless, the empirical findings on disclosure and audit committee independence have been mixed. Taylor (2011) and Oliveira et al. (2011b) reported a positive association between audit committee independence and risk disclosure. However, they also reported an insignificant association between risk disclosure and the financial expertise of audit committee members. Furthermore, Neri (2010) found an insignificant relationship between these two variables. Therefore, the following hypothesis was formulated:

***H6: There is a positive relationship between risk disclosure and the independence of audit committee.***

#### **5.5.6 Audit committee size**

As previously stated, a part of the internal control system and corporate governance corporations assign audit committees. This concept was first proposed and examined by Forker (1992). The stated that an audit committee can act as an efficient monitoring mechanism that can minimize agency costs and augment disclosure. Moreover, Ho and Wong (2001) claimed that the presence of an audit committee significantly affects the extent of disclosure. Also, the authors claimed that because audit committees contain predominantly non-executive managers, they have the power to moderate the amount of information withheld. Moreover, Chen and Jaggi (2000) argued that a large number of directors on the committee could

lessen the information asymmetry issue and lead to more disclosure. Prior empirical research has indicated a positive relationship between disclosure and audit committee size (Barako et al., 2006). Therefore, the following hypothesis was formulated:

***H7: There is a positive relationship between audit committee size and risk disclosure***

#### **5.5.7 Audit committee meetings**

Previous literature has offered pragmatic evidence on the advantages of directors meticulously controlling disclosure, with the number of meetings being a key aspect of this control (Allegrini and Greco, 2013). Karamanou and Valeas (2005) claimed that regular meetings have a fundamental impact on audit committee effectiveness. It has also been argued that regular audit committee meetings are more likely to lead to compliance with responsibilities and the monitoring of financial reporting (to improve the quality of information that flows between stockholders and directors, where the two parties hold unequal levels of information (Barako et al., 2006)). In addition, Chen et al. (2006) affirmed that meeting more regularly decreases the risk of fraud. Karamanou and Vafeas (2005) documented a positive relationship between the regularity of audit committee meetings and the probability of making earnings forecasts, thus leading to greater disclosure. Also, Allegrini and Greco (2013) reported a positive link between the regularity of audit committee meetings and disclosure. Therefore, the following hypothesis was formulated:

***H8: There is a positive correlation between the number of meetings of the audit committee and risk disclosure.***

#### **5.5.8 Demographic Variables**

There have been a number of examinations of the relationship between the

attributes of top organizational managers and various organizational effects (Michel and Hambrick, 1992; Bantel, 1993; Walt and Ingley, 2003; Kang et al., 2007; Adams and Ferreira, 2009; Mutuku et al., 2013). Two essential theoretical advances in the area of organizational research are key. Firstly, Cyert and March (1963) developed the concept of the dominant coalition, which shifts the focus from the individual CEO to the whole team of the board of directors in terms of organizational leadership. The second concept is the increased emphasis on utilizing observable demographic characteristics, such as age, gender, tenure and experience in organizational studies and investigating the link between these attributes and organizational consequences (Pfeffer, 1983; Tihanyi et al., 2000; Mutuku et al., 2013)

In groundbreaking work by Hambrick and Mason (1984), these two concepts, namely the dominant coalition and demographic research, were combined. The authors suggested that certain organizational effects are linked to top management teams having specific demographic profiles. Moreover, the upper echelon theory proposes that top management characteristics, in particular their demographic characteristics, could impair strategic decision making. At the centre of this theory is the idea that background knowledge and the values of corporate directors impact upon essential strategic decisions made and acted upon by these central corporate managers. Hambrick and Mason also claimed that observable attributes, for example, age, practical experience and tenure, could function as practical proxies for the cognitive base that guides top directors' decisions.

However, a number of academic researchers have criticized the demographic approach (Pettigrew, 1992; Lawrence, 1997; Aldrich, 1979). Therefore, the main concern is the necessity to access the "black box" that might contain the operative mechanism connecting demographic characteristics to organizational aftermath

consequences (Finkelstein and Hambrick, 1996). Pettigrew (1992: 178) claimed that little is known about “the processes by which top teams go about their tasks”. Lawrence (1997) illustrated that demographic variables are sometimes employed as representatives for subjective concepts. The author noticed that investigators depending on the demographic approach make a congruence assumption via which demographic variables are employed to represent subjective concepts without offering a logical justification for why this is a valid approach.

Yet, studies investigating team demography and processes have offered important insights into the reported “black box”. For instance, Smith et al. (1994), Tihanyi et al. (2000) and Mutuku et al. (2013) reported that top management team demography was indirectly associated with performance via intervening process variables incorporating social integration and communication. Meanwhile, Pelled, Eisenhardt and Xin (1999), Walt and Ingley (2003), Kang et al. (2007) and Adams and Ferreira (2009) reported that team demography diversity can lead to disagreement, which can affect group performance, which in turn affects all aspects of organizational decision-making and outcomes. In addition, some of these investigators found that these associations were further controlled by task routines and group longevity.

Limitations are inherent in any approach. However, a strand of literature that depends predominantly on top management team demographic variables has produced important findings. These investigations mostly concentrated on two dimensions of team composition. Firstly, they focused on the impact of demographic attributes on the consequences of organizational decisions based upon the notion that particular demographic attributes are connected with top management perceptions, which eventually lead to certain actions and consequences. Some of these investigations recognized a significant link between top management team

demographic traits and corporate strategies (Wiersema and Bantel, 1992; Bantel, 1993; Mutuku et al., 2013; Adams and Ferreira, 2009; Nielsen and Huse, 2010; Ellwood and Gracia-Lacalle, 2015; Allini et al., 2016).

All in all, the dependence on the demographic approach still appears to be justified (Finkelstein and Hambrick, 1996). Lawrence (1997) also demonstrated that demographic variables have important qualities, offering high content validity and replicability in a domain where replication is all too rare. In addition, Pfeffer (1983) recommended the employment of observable managerial traits as a means of addressing the shortcomings of subjective studies, which sometimes incorporate measurement error, differences in conceptualizations and low levels of explained variance. This is also reflected in Finkelstein and Hambrick's (1996: 47) work, which demonstrated that, "an executive's tenure in the firm is open to essentially no measurement error". Furthermore, the authors responded to the limitations of the dependence on psychological as matched to demographic variables. Finkelstein and Hambrick (1996: 46) also noted that demographic traits are more easily obtainable by investigators since top directors are normally reluctant to "submit to batteries of psychological tests".

The decision that institutions make to disclose risk related information necessitates careful assessment and consideration of a huge collection of complicate organizational issues. However, extending the demographic approach into the field of banks' risk disclosure practices could lead to better understanding of the role of top management teams and their decisions in relation to voluntary risk disclosure at their banks. In the following section, the demographic characteristics are explored and hypotheses are developed.

#### **5.5.8.1 Gender Diversity**

The presence of woman on the board of publicly listed institutions is becoming of interest to researchers (Ellwood and Gracia-Lacalle, 2015). However, one could argue from an agency theory viewpoint that gender does not influence the effectiveness of the board of a firm. However, the upper echelons theory argues that top management demographic characteristics, such as gender, could influence strategic decision-making. Hence, gender differences might indicate variations in behaviour and skills between board members (Allini et al., 2016). Moreover, prior studies have generally revealed a mixture of results regarding women directors. Adams and Ferreira (2009) and Nielsen and Huse (2010) reported that women on top management teams influence decisions positively, while Bianco et al. (2011) strongly question their capacity to impact upon or add extra value to the team. In contrast, evidence from previous risk disclosure studies falls into two strands of literature. The first strand found that there is a positive correlation between gender and risk disclosure (Nitm et al., 2013; Allini et al., 2016), whereas the second strand reported a negative relationship between the two variables (Allini et al., 2014). Therefore, the following hypothesis was formulated:

***H9: There is a positive relationship between gender and risk disclosure***

#### **5.5.8.2 Tenure**

Tenure is a significant factor in group procedure within a top management group. On the one hand, augmented tenure is related to decreased disagreement, permanence and better communication (Katz, 1982). It has also been argued that more tenure time on the board could be linked with shared cognitive structures and social cohesion (Michel and Hambrick, 1992). On the other hand, it has been argued that top board tenure could have negative outcomes (Keck, 1997) since directors working together for extensive periods of time could be inclined to develop similar views

owing to the long-term acculturation of top team associates, which then results in a shared common perspective and corporate paradigm (Pfeffer, 1983). Such effects might result in dysfunctional decision-making, generating combined defensive avoidance (Keck, 1997; Janis and Mann, 1977). However, due to the ambiguous and difficult nature of risk disclosure decisions, a common understanding of the nature of risk disclosure could be fundamental. Therefore, members of the top management team with extended tenure could cultivate a more precise shared cognitive structure regarding the nature of risk disclosure decisions. Furthermore, extended tenure enables board members to better evaluate the surrounding environment of banks' risk disclosure. Therefore, the following hypothesis was formulated:

***H10: There is a positive relationship between tenure of the board and risk disclosure.***

#### **5.5.8.3 Education Levels**

Prior literature has indicated that educational background affects strategic decision making procedures and outcomes (Hitt and Tyler, 1991). Moreover, it ensures better monitoring and the effectiveness of top management boards in light of agency theory (Allini et al., 2016). Also, it is an important determinant in the disclosure exercise (Farook et al., 2011; Haniffa and Cooke, 2002). Therefore, Hambrick and Mason (1984) claimed that executives with superior educational qualifications are better able to embrace new and innovative actions as well as uncertainty. Moreover, educational qualifications could be perceived as an important institutional asset, which may influence accounting values and exercises (Gray, 1988). Top executives with a strong educational background tend to have superior technical knowledge and a more open-minded attitude to risk disclosure decisions, which could lead to the reduction of information asymmetry (Domhoff, 1983). However, Guner et al. (2008)



stated that there is a dearth of empirical studies on the association between board effectiveness and educational background. Only a few studies have examined this relationship empirically and revealed the same results. Gul and Leung (2002) and Allini et al. (2015) reported a negative association between educational background and risk disclosure. Therefore, the following hypothesis has been formulated:

***H11: There is a negative association between educational background of the board and the risk disclosure.***

#### **5.5.8.4 Diversity**

Top management team diversity is referred to as the heterogeneity of top executive teams regarding age, gender, tenure, educational background, nationality, ethnicity and functional background (Williams and O'Reilly, 1998; Simons et al., 1999; Walt and Ingle, 2003; Carter et al., 2003; Kang et al., 2007; Allini et al., 2016). Moreover, Shaw and Barrett-Power (1998) affirmed that diversity is a progressively significant element in institutions, which are becoming more diverse in respect of age, nationality, background, gender, ethnicity and other demographic traits. It has also been determined that when disentangling complex, non-routine issues, diverse groups are more efficient as they include a collection of personalities with different proficiencies, experience, capabilities and viewpoints. It has also been illustrated that boards with diverse membership with different abilities make more novel and higher quality decisions than boards with less diverse membership (Bantel and Jackson, 1989). The literature shows that numerous variables influence the association between diversity (based on nationality) and board decision-making (in the case of this study, this could be the decision to disclose or withhold any risk information disclosures). Furthermore, risk disclosure studies have found that diversity significantly influences risk disclosure (Allini et al., 2016). Based on the above

discussion, the following hypothesis was formulated:

***H12: There is a positive association between diversity of the top management team and the degree of risk disclosure***

### **5.5.9 Control variables**

Control variables are incorporated in this study to reduce the influence of the above-stated determinants. This study incorporates as control variables size and profitability, which are discussed in the subsequent section. These are also in accordance with some prior literature (Elshandidy et al., 2013; Nitm et al., 2013; Khlif and Hussainey, 2014; Allini et al., 2016; Elshandidy and Neri, 2015).

#### **5.5.9.1 Size**

Company size variable is one of the most extensively used and associated variables with risk disclosure as well as being a forceful driver for disclosure. However, company size proxies a number of disclosure theories, which make it confusing and difficult to interpret the size real effect and its meaning becomes uncertain (Raffournier, 1997). However, there is a wider range of theoretical explanations for the correlation between company size and risk disclosure.

There are a number of prior investigations, which have employed company size as a representative for political costs. For instance, Watts and Zimmerman (1986) claimed that political expenditures are greater in large corporations than in small companies, owing to their large shareholders/investors base. Moreover, Linsley and Shrives (2000) argued that large firms entice greater media, public and politicians attention. According, Cooke (1989a) cutting political expenditures could offer motivations for directors to report more information. Also, a number of studies proclaimed that large corporations have effective information systems in place, which

makes reporting supplementary information less expensive than the case in their smaller counterparties.

On the other hand, Lopes and Rodrigues (2007) claimed that proprietary costs connected with the competitive disadvantages of reportage are reduced as firm size expands. Disclosure is an expensive practice and requires the employment of professional staff to execute the process of disclosing, therefore large companies tend to have the financial means for the execution of this process. Moreover, shareholders theory is employed to interpret risk reportage behaviour. In a study completed by Amran et al., (2009) the authors accomplished that as the organisation develop in size, the number of investors' enlarges. Thereafter, it is predicted that the weight of disclosure becomes greater to fulfil their requirements. Further, Linsley and Shrides (2006) affirmed that investors might have a belief that bigger organisations should offer more publicities or the investors might have different desires for firm information and bigger organisations might answer to their expectations or desires.

Furthermore, Beretta and Bozzolan (2004) stated that in large corporations the amount of external capital tends to be excessive for example, majority of their assets are borrowed from financial institutions. Therefore, the difficulty is great in the notion that larger corporations encounter more risky uncertain situations. Moreover, bigger corporations possess a wide range of divergent operations and encounter more difficulty compared to smaller companies, therefore it is anticipated that they possess more risks and information to report to their clients (Abraham et al., 2007). Although, Deumes and Knechel (2008) claimed that high inherent risk makes it more probable that faults befall in disclosing risks on to clients.

Nonetheless, the empirical evidence of disclosure investigations indicated that the impact of company size on risk reportage is diverse. Some researches established no relationship among company size and risk disclosure such as Beretta and Bozzolan, 2004; Ashbaugh-Skaife, Collins and Kinney, 2007; Doyle, Ge and McVay, 2007. Whereas, majority of the other empirical results demonstrated that there was a positive and significant relationship between size and risk disclosure for example, McNally et al., 1982; Chow and Wong-Boren, 1987; Linsley and Shrives, 2006, Abraham and Cox, 2007, Deumes and Knechel, 2008, Barakat and Hussainey, 2013, Elshandidy et al, 2013, Nitm et al, 2013. Although, there are some studies, which reported negative correlation between both variables such as Lajili and Zeghal 2005, and Hill and Short 2009. The current study expects a positive relationship between the level of voluntary risk disclosure and size of the bank.

#### **5.5.9.2 Profitability**

Profitability is employed as a company performance proxy, which is of a major interest to end users of annual statements. Therefore, signalling theory will lead to corporate managers wanting to signal their excellent risk management abilities to investors through reporting risks in their companies' annual reports (Konishi and Ali, 2007). Moreover, Elshandidy et al. (2013) stated that high-profitability companies have superior incentives to signal the quality of their performance and their capability to administer risks effectively. Also, it has been established that managers of highly preformed companies would be willing to report more information so as to signal good news, enhance company's image and managerial abilities in overseeing risks to the market to entice more investment (Iatridis, 2008).

Furthermore, it is assumed that profitable corporations are better and have effective risk management systems since they have more resources obtainable to them to

invest in internal control and risk management systems (Deumes and Knechel, 2008). These systems could imply the identification and management of risks at their early phases, which sequentially the corporation benefits from in preventing such losses and augmenting their profitability and performance. Therefore, investors of such corporations demand fewer disclosures concerning risks and company management that leads to the demotivation of management to intensify internal risk reportage. On the other hand, Skinner (1994) argued that bad performance elevates managers' incentives to report all types of risk related information and ensure stockholders about the corporation's future prospects in order to circumvent the adverse effect of future litigation risks.

However, empirical investigations have evident a mixture of findings between risk reportage and profitability. Where, on the one hand Mohobbot, (2005), Deumes and Knechel (2008) and Miihkinen, (2012) outcomes indicated a positive association between risk disclosure and profitability. On the other hand, Lajili and Zeghal, (2005), Neri (2010) and Oliveira et al., (2011) discovered a negative relationship among profitability and risk reporting. This study predicts a positive relationship between the level of voluntary risk disclosure and profitability.

## **5.6 Methodology and Data**

This section describes the research design of this investigation, including sample, data collection and techniques used to accomplish the aims of this research.

### **5.6.1 Sample and Data Collection**

Following prior literature on the subject (Lipunga, 2014; Barakat and Hussainey, 2013), this study excluded all non-financial corporations. Financial institutions are by nature risk-oriented institutions unlike non-financial corporations, and therefore their disclosure ought to be considered independently (Linsley and Shrives, 2005, 2006;

Barakat and Hussainey, 2013). This research encompasses all listed banks on the Tadawul Stock Market.

Annual reports are used in this investigation because of their wide coverage and availability. This study's focus on annual reports is due to their being the main source of information for shareholders as well as their growing use in statements, showing their value to user groups (Elshandidy et al., 2013; Barakat and Hussainey, 2013; Elshandidy and Neri, 2015). This is concurrent with Marston and Shives (1991), who described them as the "main disclosure vehicle" and argued that annual reports are the most complete financial statements accessible to investors. Moreover, Beattie et al. (2002) affirmed that annual reports provide comprehensive narratives, information as well as explaining accounting figures, sketches and presents perspectives. Also they corroborate quantitative measures incorporated in the financial reports (Chugh and Meador, 1984). (For further argument please see section 4.6.4)

### **5.6.2 Content Analysis Approach**

Such studies analyse the information content revealed in annual reports and acknowledge words and themes within the textual material (Beattie et al., 2004; Brennan, 2001). Therefore, when analysing the content of a written document, words, phrases and sentences are coded against a specific schema of interest (Bowman, 1984). In terms of this study, the annual reports of all banks are coded against a set of words in order to quantify the level of risk disclosure reported in their annual reports over the five-year period. Krippendorff (1980: 21) described content analysis as "a research technique for making replicable and valid inferences from data". Also, Bowman (1984) argued that content analysis facilitates the collection of rich data since it can reveal relationships that other techniques cannot. However, a weakness of content analysis is that it is subjective (Linsley and Shives, 2006). Therefore,

validation practices are often used to override this problem (Bowman, 1984). (For further argument see section 4.6.5)

### **5.6.3 Risk Disclosure Index Development**

See Section 4.7

### **5.6.4 Reliability and Validity Measures**

See Section 4.7.1

### **5.6.5 Multicollinearity issues**

This is an important assumption which has to be met under the multiple regressions to ensure that no perfect multicollinearity occurs between the independent variables (Field, 2009). This is important since the occurrence of serious multicollinearity in the regression models could inflate standards errors for the coefficients of the explanatory variables (Wallace et al., 1994; Gujarati, 2003). In this study the Variance Inflation Factor (VIF) is used to inspect the existence of multicollinearity. This is in line with prior research such as Owusu-Ansah and Yeoh, (2005), which employed the VIF to check for any multicollinearity in their study. However, the degree to which the correlation among the variables is perfect or harmful differs. Tabachnick and Fidell (1996) advocated that the correlation coefficient should not exceed 0.7 in order to avoid any noises in the model. Where, Gujarati, (2003) proposed that as a rule of thumb serious multicollinearity happens when the correlation coefficient exceeds 0.8. However, some literature suggested that for serious multicollinearity to occur, the VIF must exceeds the 10 marks (Neter et al., 1983; Naser et al., 2006).

### **5.6.6 Regression Model**

This study uses the following ordinary least squares (OLS) regression model to examine the relationship between risk disclosure in the annual reports and both corporate governance mechanisms and demographic traits in all Saudi listed banks:

$$\text{RISKD}_{it} = \beta_0 + \beta_1 \text{CHS}_{it} + \beta_2 \text{NOSH-FACTOR}_{it} + \beta_3 \text{BSIZE}_{it} + \beta_4 \text{INDEP}_{it} + \beta_5 \text{NON}_{it} + \beta_6 \text{ACINDEP}_{it} + \beta_7 \text{ACSIZE}_{it} + \beta_8 \text{ACMEET}_{it} + \beta_9 \text{EDUC}_{it} + \beta_{10} \text{TENU}_{it} + \beta_{11} \text{GENDER}_{it} + \beta_{12} \text{DIVERSITY}_{it} + \beta_{13} \text{SIZE}_{it} + \beta_{14} \text{PROF}_{it} + \beta_{15} \text{ISLAMIC.DUM}_{it} + \beta_{16} \text{YEA.DUM}_{it} + \varepsilon_{it} \quad (2)$$

Where: RISKD = risk disclosure score

$\beta_0$  = the intercept

$\beta_1 \dots \beta_{16}$  = regression coefficients (See Table 9 for explanation)

$\varepsilon$  = error term

I = Bank

T = Year

**Dependent variable:** risk disclosure score. Following prior studies (Linsley and Shrives, 2006; Elzahar and Hussainey, 2012; Abdallah et al., 2015), content analysis is used to measure the level of risk disclosure in the annual reports. The number of risk-related words is used as a measure of risk disclosure levels.

**Independent variables:** To examine the determinants of risk disclosure, corporate governance and demographic traits, information was collected from different sources.

Table 9 summarizes the measurement and definition of those variables.

**Table 9: Summary of variable names, description and sources**

Abbreviated name	Full name	Variable description	Predicted Sign	Data source	Prior studies
<b>Dependent variables</b>					
RISKD	Risk disclosure	Risk disclosure level based on risk index		Annual reports	Linsley and Shrives, (2006); Elzahar and Hussainey, (2012); Abdallah et al., (2015)
<b>Independent variables</b>					
<b>1. Corporate Governance characteristics</b>					
BSIZE	Board size	Number of board members	+	Annual report	Elshandidy and Neri (2015); Elzahar and Hussainey (2012);
CHS	Internal Ownership	Percentage of shares held by internal shareholders	-	DataStream	Elshandidy et al. (2013); Marshall and Weetman, (2007); Elshandidy, (2014)
NOCH-Factor	External Ownership	Percentage of shares held by external shareholders	+	DataStream	Elshandidy et al. (2013); Elshandidy and Neri (2015); Elshandidy, (2014)
INDEP	Independent directors	Number of non-executive directors on the board of directors	+	Bloomberg Annual Report	Alergini and Greco (2013); Allini et al. (2016); Allini et al., (2014)



NON	Non-executive directors	Dummy variable 1 if board contains non-executive directors and 0 otherwise.	+	Bloomberg Annual Report	Elshandidy et al. (2013); Nitm et al. (2013); Elshandidy and Neri (2015);
ACINDEP	Audit committee independence	Proportion of non-executive director on board.	+	Bloomberg Annual Report	Oliveira et al., (2011b); Neri, (2010)
ACSIZE	Audit committee size	Number of audit committee members	+	Annual report	Elzahar and Hussainey (2012);
ACMEET	Audit committee meetings	Number of audit committee meetings	+	Annual report	Karamanou and Vafeas (2005); Alergini and Greco (2013); Allini et al. (2016)
<b>2. Demographic characteristics</b>					
EDUC	Education Levels	Dummy variable 1 if one of the board members holds a PhD and 0 otherwise.	+	Annual report	Allini et al. (2016)
TENU	Tenure	Dummy variable 1 if the number of years the board member permanence on the board is above the sample median of 5 years, 0 otherwise.	+	Annual report	Chung et al., (2015)
GENDER	Gender Diversity	Dummy variable 1 if board contains female directors and 0 otherwise.	+	Annual report	Allini et al. (2016); Nitm et al. (2013); Allini et al. (2014)
DIVE	Diversity (Based on Nationality)	Dummy variable 1 if board contains more than one nationality and 0 otherwise.	+	Annual report	Nitm et al. (2013); Allini et al. (2016);
<b>3. Firm-specific characteristics (Control Variables)</b>					
SIZE	Bank size	Natural logarithm of total assets	+	DataStream	Elzahar and Hussainey (2012); (2007); Mokhtar and Mellet, (2013);
PROF	Profitability	ROA (Return On Assets)	+	DataStream	Elzahar and Hussainey (2012); Elshandidy and Neri (2015)
ISLAMIC.DUM	Islamic dummy variable	Dummy variable 1 if the bank is Islamic and 0 otherwise	+	SAMA	Abdullah et al., (2015)
This table provides the description and measures of risk disclosure reporting, as dependent variables, and firm characteristics, corporate governance mechanism and demographic traits as independent variables. It also provides the source of each variable.					

## 5.7 Empirical analysis

### 5.7.1 Descriptive analysis

Table 10 shows the main descriptive statistics for the corporate governance variables and the demographic traits used in the analysis of the sample banks in this investigation. It shows the minimum, maximum, statistical mean, standard deviation, skewness and kurtosis. Firstly, it shows that the mean total voluntary risk disclosure reported by all sample banks is 66.03%. It also shows that there is a large variation in reporting voluntary risk disclosure between the sampled banks, with a minimum of 51% and a maximum of 78%. It also shows that the mean of CHS holdings is 19% and the mean of NOCH-Factor ownership is 29.5%, while the mean board size is 10 directors, with a mean of 7 members of the board in the sample banks consisting of non-executive directors. Furthermore, the table shows that the independent directors mean is 5, with a minimum of 3 and a maximum of 8 independent directors. Secondly, the audit committee (AC) independence mean is .75, whereas the audit committee size ranges from 2 to 5 directors, with a mean of 3. There is also a large variation in the number of AC meetings between the sample banks, with a minimum of 3 meetings, a maximum of 11 and a mean of 5. 33.3% from the selected banks are Islamic and 66.6% are non-Islamic banks. Finally, this table also shows the demographic traits of the top management teams included in the descriptive analysis, which are gender diversity, tenure, education levels and diversity (based on nationality). It is also important to note that all of these variables have been treated as a dummy variable (1-0). Where gender scored an overall mean of .08, tenure of the top board of directors scored a total mean of .6, while education scored a total mean of .7 and diversity scored a total mean of .3 in the entire sample of this investigation.

**Table 10: Descriptive statistics**

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Devi</b>	<b>Skewness</b>	<b>Kurtosis</b>
<i>RISKD</i>	60	.51	.78	.6603	.07059	-.503	-.488
<i>CHS</i>	60	.00	69.00	19.1000	17.46056	.858	.102
<i>NOCH</i>	60	25.00	45.00	29.5000	5.08091	1.016	.127
<i>BOARDSIZE</i>	60	7.00	11.00	9.5500	.94645	-.211	-.259
<i>INDEP</i>	60	3.00	8.00	5.1333	1.62049	.370	-1.081
<i>NON</i>	60	1	11	7.37	2.718	-.538	-.878
<i>ACINDEP</i>	60	.00	1.00	.7500	.43667	-1.185	-.619
<i>ACSIZE</i>	60	2.00	5.00	3.7667	.96316	.021	-1.219
<i>ACMEET</i>	60	3.00	11.00	5.3667	1.95688	1.092	.883
<i>GENDER</i>	60	.00	1.00	.0833	.27872	3.093	7.826
<i>TENURE</i>	60	.00	1.00	.6000	.49403	-.419	-1.889
<i>EDUCATION</i>	60	.00	1.00	.7000	.46212	-.895	-1.241
<i>DIVERSITY</i>	60	.00	1.00	.3333	.47538	.725	-1.526
<i>SIZE</i>	60	7.24	8.58	7.9940	.35203	-.447	-.831
<i>ROA</i>	60	-.01	.04	.0192	.00869	-.636	3.124
<i>ISLAMIC.DUM</i>	60	.00	1.00	.3333	.47538	.725	-1.526

*RISKD*: Risk disclosure score (based on an unweighted disclosure index); *CHS*: Internal ownership (Percentage of shares held by internal shareholders); *NOCH*-Factor: External ownership (Percentage of shares held by all external shareholders); *BSIZE*: Board size (Number of board members); *INDEP*: Independent directors (Number of non-executive directors on the board of directors); *NON*: Non-executive directors (Dummy variable 1 if board contains non-executive directors and otherwise 0); *ACINDEP*: Audit committee independence (Dummy variable; 1 if audit committee independence exists, and 0 otherwise); *ACSIZE*: Audit committee size (Number of audit committee members); *ACMEET*: Audit committee meetings (Number of audit committee meetings); *GENDER*: Gender (Number of females on the board); *TENU*: Tenure (Dummy variable 1 if the number of years the board member permanence on the board is above the sample median of 5 years, otherwise 0); *EDUC*: Education (Number of board members holding a PhD); *DIVE*: Diversity (Number of other nationalities of the board ); *SIZE*: Bank size (Natural logarithm of total assets); *PROF*: Profitability (Return On Assets)

### 5.7.2 Regression analysis

The analysis of the level of voluntary risk disclosure of all Saudi listed banks and their determinants led to some concrete results. Where five of the independent variables, namely Noch-Factor, audit committee meetings, gender diversity, education levels and ROA, are the main variables directing risk disclosure decisions in Saudi listed banks. The model summary (at the bottom of the regression table below) demonstrates that the R square and adjusted R square are high for the study under consideration, where both R square and adjusted R square are high at .706 and .576, respectively, supporting the explanatory power of the model. The Durbin-Watson test confirmed that there is no autocorrelation problem with the data.

Moreover, the summary below indicates that the model is significant, with an F value of 5.458, confirming the fitness of the model used for the purpose of this study.

**Table 11: Pearson correlation Matrix**

	RISKD	CHS	NOCH	BOARDSIZE	INDEP	NON	ACINDEP	ACSIZE	ACMEET	GENDER	TENURE	EDUCATION	DIVERSITY	SIZE	ROA	ISLAMIC
RISKD	1	-0.129	.411**	-0.107	-0.171	-0.095	0.074	0.136	0.054	0.093	-.356**	-0.241	.375**	.479**	.271*	-.488**
CHS		1	-.492**	.364**	0.195	.290*	-0.190	0.243	0.196	0.061	0.195	-0.059	-.261*	0.006	.329*	0.204
NOCH			1	0.073	-0.248	-.308*	.325*	-0.062	0.153	-0.215	-0.218	-0.173	.547**	0.071	-0.227	-0.214
BOARDSIZE				1	-0.038	.467**	-0.072	0.013	.566**	0.016	0.007	-0.081	0.226	0.101	.283*	.264*
NON						1	0.050	.454**	.459**	0.138	-0.103	0.251	0.114	-0.052	0.200	0.074
ACINDEP							1	0.141	-0.089	0.174	-0.079	.294*	.408**	-0.225	-.279*	-.408**
ACSIZE								1	0.190	-0.242	0.121	-0.046	-0.086	0.019	0.219	0.025
ACMEET									1	-0.212	0.014	0.030	-0.024	-0.055	0.158	.304*
GENDER										1	-0.246	0.197	.426**	-0.166	-0.181	-0.213
TENURE											1	0.134	-.433**	-0.126	0.039	0.217
EDUCATION												1	0.077	-0.211	-0.148	-.309*
DIVERSITY													1	0.112	-0.055	-.500**
SIZE														1	.529**	-.535**
ROA															1	-0.055
ISLAMIC																1

For variables explanations see table 10. Note that \*\* and \* indicate that there is a correlation significant at the 0.01 and at the 0.05 between the respective factors respectively.

Table 11, the Pearson correlation matrix is deployed to measure the strength and the direction of the linear relationship between any two variables. The results above in the correlation coefficient demonstrate a positively significant correlation between the level of risk disclosure and NOCH-Factor at a value of .411\*\*. They also show the same relationship between board diversity at a value of .375\*\*, size at 479\*\*, profitability at .271\* and the level of voluntary risk disclosure. Moreover, the correlation matrix indicates a negatively significant association between tenure at a value of -.356\*\*, Islamic at -0.488\*\* and the level of voluntary risk disclosure practices. However, the table shows that the highest correlation was between bank size and the level of risk disclosure at .479\*\*. Moreover, table 11 shows that there are insignificant associations between CHS, board size, independent directors, non-executive directors, audit committee independence, audit committee size, audit committee meetings, gender diversity, tenure and education levels with the level of voluntary risk disclosure reported by all Saudi listed banks.

**Table 12: Regression results for the corporate governance and the demographic variables**

Model	Unstandardized Coefficients		t	Sig.	VIF
	B	Std. Error			
Constant	0.310	0.363	0.854	0.398	
CHS	-6.178	0.001	-0.096	0.924	3.675
NOCH	0.008	0.003	2.823	0.007	6.114
BOARDSIZE	-0.018	0.014	-1.310	0.198	5.098
INDEP	0.009	0.006	1.336	0.189	3.181
NON	-0.003	0.005	-0.571	0.571	5.354
ACINDEP	-0.028	0.024	-1.163	0.252	3.182
ACSIZE	0.012	0.009	1.272	0.211	2.378
ACMEET	0.010	0.005	2.059	0.046	2.826
GENDER	0.114	0.034	3.371	0.002	2.579
TENURE	-0.024	0.016	-1.492	0.143	1.766
EDUCATION	-0.039	0.019	-2.008	0.051	2.308
DIVERSITY	-0.031	0.032	-0.940	0.353	6.891
SIZE	0.026	0.049	0.535	0.595	8.639

ROA	2.832	1.036	2.734	0.009	2.347
ISLAMIC vs. Non-Islamic	-0.063	0.040	-1.568	0.125	7.559
<b>Model Summary</b> Adjusted R square 0 .591 F value 4.484 P Value 0.000					
For variables explanations see table 10. Note that “+” indicates that there is a positive correlation or a proof of influence exists between the respective factors and “-“indicates that there is a negative correlation or proof.					

This study uses Ordinary Least Square (OLS) regression analysis to examine the determinants of the level of voluntary risk disclosure in all Saudi listed banks. The coefficients table above demonstrates the interrelationships between the risk disclosure score as the dependent variable and a number of corporate governance attributes and demographic traits variables as independents. Also the table above shows the interrelationships between the two firm-specific variables as control and the level of risk disclosure. Thus, before conducting the regression analysis, multicollinearity was tested by employing the Variance Inflation Factor (VIF) to detect any noises in the model. When carried out for the purpose of this investigation, this statistical test gave no indication of multicollinearity problems as shown in the table above. Since the VIF did not exceed 10 for any variable in any model, it was concluded that collinearity was not a serious problem (Neter et al., 1983; Naser et al., 2006). Moreover, it can be seen from the regression results table above that there is a positive significant relationship between NOCH-Factor, audit committee meetings, gender, size, profitability and voluntary risk disclosure in listed banks on Tadawul. The coefficients on the variables are positive and statistically significant at .05, .05, .01, .01 and .05, respectively. Also, the table shows that there is a negatively significant association between board education and risk disclosure, with a coefficient value of .05, while the rest of the independent variables of both

corporate governance mechanisms and demographic traits are insignificantly correlated with the level of voluntary risk disclosure in Saudi Arabia.

## 5.8 Discussion

This investigation found that ownership structure has a significant effect on the level of voluntary risk disclosure. These findings are in line with prior empirical findings which indicate that corporations with higher outsider ownership (as proxied by NOCH-Factor) are more likely to provide considerably higher levels of risk disclosure (Elshandidy et al., 2013; Abraham and Cox, 2007). Also, these results are in line with both agency theory and information asymmetry theory, which both propose that directors are only driven to offer higher levels of voluntary risk disclosure when there is a widely dispersed ownership structure to mitigate information asymmetries owing to external pressures (Mohobbot, 2005; Lajili and Zeghal, 2005), implying that H2 is empirically supported. In regards to ownership the results show that 29.5% which is higher than internal ownership (19.1%) in all listed banks. This pressurise the directors to disclose more risk information.

Also, the coefficient on audit committee meetings is .012 and is significant at value of .05 significance level. These findings show that banks with high frequency of audit committee meetings are more motivated to disclose more voluntary risk information. Such results are consistent with prior empirical findings by Karamanou and Vafeas (2005) and Allegrini and Greco, (2013). Also, this outcome is consistent with the agency theory, whereby internal and external monitoring practices complement each other in reducing agency conflicts and information asymmetry between different types of stockholders, implying that H8 is empirically supported.

The result shows that the average audit committee meetings during the year are 5 times. This average is matching with Eow (2003) who found that the audit committee



in Malaysia should meet at least five times in a year. The number of audit committee meetings might be a measure of carefulness and, therefore, audit committee effectiveness. Consequently, frequency of audit committee meetings is positively related to risk disclosure. Menon and Williams (1994) found that audit committee independence is unlikely to be effective unless the committee is also active (i.e. meets frequently). An audit committee that holds fewer meetings is perceived to be less likely to pursue their duties diligently. Kalbers and Fogarty (1993) perceived an effective audit committee to be a function of audit committee members' desire to carry out their duties. Menon and Williams (1994) agree with Kalbers and Fogarty but pointed to the number of committee meetings as a measure of that desire. This finding was validated by Abbot et al. (2000), who opined that the desire to fulfil audit committee responsibilities is signalled by the number of audit committee meetings. Yet, the other corporate governance variables (CHS, INDEP, NON, BSIZE, ACINDEP and ACSIZE) are found to have an insignificant correlation with the level of voluntary risk disclosure in all Saudi listed banks.

In terms of the demographic characteristics, table 12 shows that banks with women on the top management board of directors are more likely to disclose voluntary risk disclosure. The coefficient on gender diversity is 0.117 and is significant at the 0.01 significance level. This effect is consistent with the previous empirical findings of Nitm et al. (2013) and Allini et al. (2016). Also, Adams and Ferreira (2009) reported that women on top management teams influence decisions positively. Moreover, this is consistent with the upper echelons theory, which proposes that top management demographic characteristics, such as gender, could influence strategic decision-making such as the decision to report voluntary risk disclosure, implying that H9 is empirically supported.

Even though the presence of women is only 8% of the boards of Saudi banks, it positively contributes towards the level of voluntary risk disclosure as the results exhibit. Which, suggest that more women should be included in the boardrooms. Despite the fact that women participation in the boardroom is very much restricted due to segregation of women from men in the Islamic teachings and a tradition deep-rooted the country they positively affect the levels of risk disclosure. This association is in line with the argument suggested by the upper echelons theory implying that certain organizational demographic attributes such as gender affect strategic decision-makings and hence performance. Looking at it within the scope of this study gender is an attribute of top board members and a driver of risk disclosure in Saudi banks. This is suggesting that women directors improve the effectiveness of the board and enhance transparency. This finding is in line with results obtained by Adams and Ferreira (2009) and Allini et al., (2016).

This study finds a negative association between board education levels and risk disclosure, since the coefficient is -0.039 statistically significant at 5%. This outcome is consistent with Gul and Leung (2002) and Allini et al., (2016). Therefore, the H11 is accepted. This relationship is concurrent with the the upper echelons theory which proposes that top management demographic attributes influence firms strategic decision-makings i.e. the revelation of risk disclosure and ensures better monitoring and the effectiveness of top management boards. Moreover, this outcome adds to the literature on such relationship, since the literature argues that there is a scarcity of empirical evidence on the relationship between board education levels and board effectiveness (Güner et al., 2008). The findings of this study do not support that the following demographic traits variables (TENU and DIVE) have a significant relationship with risk disclosure in Saudi Arabian listed banks.

Additionally, for the control variables, the findings report that the coefficient on profitability is 2.644 and is significant at a .05 percentage level. This effect is consistent with prior literature that examined profitability in relation to risk disclosure and observed the same findings (Deumes and Knechel 2008; Miihkinen, 2012; Khlif and Hussainey, 2014). This association between profitability and risk disclosure is also consistent with signalling theory. Helbok and Wagner (2006) and Linsley et al. (2006) confirmed that banks with superior risk management techniques tend to have greater levels of profitability, and hence directors have greater incentives to signal their performance and their capacity to manage risk successfully. Moreover, managers of companies with high profitability would tend to provide more risk information in order to justify their present performance to the shareholders as well as to justify their compensations to the firm' owners. This justification is matching with Agency theory which argues that corporate managers of profitable corporations are motivated to disclose more information to increase their compensation (Abd El Salam, 1999). This positive correlation may be justified based on the fact that corporate boards of highly profitable firms are more likely to disclose more information to increase stockholders' confidence and to raise capital at the lowest cost (Marston and Polei, 2004).

## 5.9 Summary

This investigation sought to empirically examine the impact of corporate governance and top team demographic traits on the levels of voluntary risk disclosure practices and to identify the determinants of voluntary risk disclosure practices in all Saudi listed banks from 2009 to 2013. The empirical findings show that banks with high outsider ownership, high profitability, high regularity of audit committee meetings and mixed gender diversity on the top management board of directors are more likely to

demonstrate higher levels of voluntary risk disclosure practices. Also, the level of voluntary risk disclosure is negatively affected by high board education level. Moreover, as can be seen from the empirical findings of this investigation, external ownership, audit committee meetings, gender diversity, board education and profitability are primary determinants of voluntary risk disclosure practices in listed banks on the Saudi Exchange Stock Market (Tadawul), while the rest of the independent variables of both corporate governance mechanisms and demographic traits are insignificantly correlated with the levels of voluntary risk disclosure practices in Saudi banks.

The findings of this study have several important implications, by informing banks' stockholders, regulatory bodies and any other interested groups about the importance of corporate governance and demographic determinants, which can be used to augment voluntary risk reporting in the banking industry in an effort to ensure information adequacy and increased market efficiency. The reported findings should be useful to accounting and risk regulators by providing information about the inadequacies of risk disclosure in Saudi and a more complete picture of risk components and determinants in listed banks. While this study does not explore the risk profiles of Islamic banks directly, the results somehow propose that Islamic banks are more likely to be risk-averse than their non-Islamic counterparts suggesting a worthy field for future research. These implications could extend to the governance, board demography and risk disclosure literature by theoretically justifying and empirically investigating the implications of such determinants and theories in regards to voluntary risk disclosure in the banking sector. This focus is significant because it provides insights into the determinants of voluntary risk disclosure in banks that operate in an environment regarded as being invariably

opaque. Further research could also consider the use of bootstrapping to increase the use of the data.

The following chapter measures the economic consequences of risk disclosure. It examines the effect of the level of voluntary risk disclosure on firm value.

## **6 Chapter Six: Value relevance of voluntary risk disclosure levels: Evidence from Saudi banks**

### **6.1 Overview**

The need for financial reporting and disclosure arises from increased information asymmetry gaps and agency conflicts between insiders (managers) and outsiders (investors) (Kothari et al., 2009). However, corporate disclosures can assist in reducing such information gaps, ease such conflicts, augment the credibility of such financial reportage, and complement the role of accounting information in relation to firm value (FV). Previous researches have studied the consequences of disclosure on market valuation of firm (Klein et al., 2005). Enhanced accessibility of corporate information can enhance the capital market efficiency and entice more investors (Wang et al., 2008). Hassan et al., (2009) reported that disclosure is employed as an instrument to moderate agency costs ascending from the likelihood that insiders might not act in the best interest of investors. It has also been argued by Pagano et al., (2002) that disclosure is an instrument which permits stakeholders to enlarge their ability in monitoring and improving the valuation of the firm.

The literature on the economic consequences of disclosure has mostly explored well-developed economies and focused on non-risk voluntary disclosure (Healy and Palepu, 1993; Clarkson et al., 1996; Baek et al., 2004; Nekhili et al., 2012; 2015). In addition, Hassan et al. (2009) claimed that all the empirical findings on disclosure are in line with finance-theory extrapolations, implying that greater public disclosure of information to investors and interested groups increases the valuation of the firm. Prior investigations have explored the relationship between voluntary disclosure and the cost of capital and stock liquidity (Botosan and Plumlee, 2002; Easley and O'Hara, 2004; Healy et al., 1999; Leuz and Verrecchia, 2000), and a small stream of literature has examined the relationship between voluntary disclosure and firm value

(Hassan et al., 2009; Nekhili et al., 2012, 2015; Uyar and Kilic, 2012). However, to the best of the researcher's knowledge, all prior research on the latter relationship has been conducted on developed economies, whilst there is no empirical research focusing on this association in developing economies. Thus, the objective of this study is to examine the relationship between the levels of voluntary risk disclosure and firm value in a developing economy, Saudi Arabia. Preceding literature has examined disclosure levels of firms and determinants of disclosure; whereas, there is not a large body of research which examine the effect of disclosure on FV (Uyar and Kilic, 2012) yet the dearth is even greater when it comes to the effect of voluntary risk disclosure on firm value. Thus, there is a need for more elaboration on the value that corporate information have on risk disclosure in banks.

This study is motivated by the fact that the effect of disclosure on firm value is still an empirical issue (Hassan et al., 2009). Further to this Al-Akra et al., (2010), has demounted that there is little empirical research to back the link between the two variables. Moreover, Hassan et al., (2009 p.80) has briefly touched upon this association by asserting that, "There is little direct empirical evidence with regard to the relationship between disclosure and firm value". Hence, this research is motivated to conduct an empirical study in Saudi listed banks to demonstrate what the level of voluntary risk disclosure can add value for the sample banks. It is also motivated by the rarity of studies exploring the impact of the level of risk disclosure in relation to firm value. In addition, Vogel (2005) argued that the findings associated with the relationship between disclosure and firm value still remain inconclusive. Such inconclusiveness creates ground for further investigation not just for risk disclosure, but also for other kinds of disclosure. Furthermore, prior researches have claimed that the association between firm value and disclosure is sensitive to the

proxy used for valuation of the firm (Uyar and Kilic, 2012; Elzahar, 2013). The above argument also highlights the need for more research into this association. There is a dearth of academic examination that studies the potential economic consequences and valuation implications for banks. Finally, this study is motivated by the dearth of research on financial institutions reporting disclosures, risk disclosure and by the calls for more research on the valuation implications of such disclosures made by preceding studies (Hassan et al., 2009; Leuz and Wysocki, 2008).

This study makes some contributions to the literature of risk disclosure and economic consequences. Even though, there have been a dearth of empirical studies studying the link between risk disclosure and market valuation in the banking sector, as far as the researcher knows, this is the first study to empirically investigate this relationship in Saudi banks. The study offers a unique contribution to the existing literature by looking at the economic consequences of risk disclosure in Saudi listed banks. This study also contributes to the literature on general accounting disclosure and in particular advances the literature on risk disclosure in developing economies by empirically examining the link between voluntary risk disclosure levels and the market valuation of banks in Saudi Arabia. It also contributes to the literature by extending the traditional research on corporate disclosure beyond the narrow focus of financial disclosure to include risk disclosure in relation to firm value. This study also contributes to the existing literature by indicating that there is a positive firm value arising from the levels of voluntary risk disclosure. It also contributes to the understanding of the role of accounting information in relation to the market valuation of a firm. Studies about such markets are required and are fundamental to ameliorating the weak transparency and disclosure situation through attracting the attention of regulatory institutions and corporation directors (Uyar and Kilic, 2012).



There is a lack of research investigating the impacts of risk disclosure on the firm value for banks in a developing country. Thus this study fills this gap.

It has been suggested by previous literature that there is a positive link between the levels of disclosure in relation to firm value. However, this association continues to be vague whether rises in information can assure an enhanced market valuation of the firm for MTBV and ROA or not. Hence, the possible impact of risk disclosure on firm value is still an open empirical question particularly for banks in emerging markets. This study fills this gap in the literature by providing a direct analysis of the association between risk disclosure and firm value based on two different measures namely market to book value at the end of the year and profitability (MTBV and ROA). The first measure is a market based measure and the second is an accounting based measure. This study focus is on banks in an emerging market context which offers a unique empirical setting which permits for a clearer and richer picture between their levels of voluntary risk disclosure and banks market valuation from well-developed countries. This investigation contributes to the literature by demonstrating that corporate risk disclosure is essential for efficient firm value. This proposes that policymakers, accounting and regulatory institutions such as SAMA, SOCOPA and the CMA might earnestly contemplate the quantity, quality and comprehensiveness of risk materials when endeavouring to facilitate capital market efficiency for Saudi listed banks by introducing a new form of risk disclosure' measures. Prior economic consequences studies tend to concentrate on the cost of equity and remain silent in regards to the valuation of firms (Dhaliwal et al., 2011). The findings of this investigation produce some awareness to help directors who attempt to increase the market value of their banks. The evidences of this investigation on the influence of risk disclosure in relation to firm value contribute to

previous disclosure and risk disclosure literature by advancing the association between the two variables, which states that different proxies for firm value may have different effects on the level of risk disclosure.

Preceding research has concentrated on other forms of economic consequences ignoring the market valuation of banks. The effects of augmented disclosure on cost of capital (Easley and O'Hara, 2004; Kothari et al., 2009) analysts' forecasts (Wang et al., 2013) financial performance (Wang et al., 2008) and share price anticipation of earnings (Schleicher et al., 2007). This stream of literature is focused mostly on developed countries. There is a dearth of research investigating the link between disclosure and firm value stated Uyar and Kilic (2012), especially in developing economies. This stream of research is still in its early stage. However, to the best of the researcher knowledge research concerning the association between risk disclosure and firm value is absent in general and in particular in banks in developing markets. However, the economic consequences have not yet been empirically examined in banks in developing markets and in the case of this study in Saudi Arabia measuring the influence of risk disclosure on firm valuation.

The empirical findings of this study indicate that the impact of the levels of voluntary risk disclosure on firm value vary depending on the proxy used for firm value. The results reported based on the market based measure show that there is a non-significant relationship between firm value and the levels of voluntary risk disclosure (MTBV). The results generated from the accounting based measure (ROA) show that there is a positively significant association between the levels of risk disclosure and firm value. The remainder of the paper proceeds as follows: section 2 discusses the theoretical framework, section 3 provides the literature review and hypothesis

development; section 4 discusses control variables, section 5 outlines the research design; section 6 discusses the results; and section 7 concludes.

## **6.2 Theoretical framework**

An assertion has been made by Linsley and Shrives (2006) that there is a difficulty in considering any risk disclosure investigation, which is to clearly identify risk information. Therefore, it is crucial to impeccably define risk. Yet, defining risk can be problematic as the level of management control over risk varies in accordance to the type of risk, for example, financial risk could be controlled by financial instruments and other risks are operational (Schrand and Elliott, 1998). (For further discussion see section 4.3). Therefore, for the purpose of this study, the researchers adopted a well-defined and fit for purpose risk disclosure definition by Linsley and Shrives (2006, p.3), who defined risk reporting as “If the reader is informed of any opportunity or prospect or of any hazard, danger, harm, threat, or exposure, which has already impacted upon the company or may impact upon the company in the future or of the management of any such opportunity prospect, hazard, harm, threat or exposure”. (For further discussion see section 4.3)

### **6.2.1 Risk Disclosure Theories**

A number of different theories have been proposed to explain why companies report risk information. However, there is no single theory which can explain the phenomena of disclosure as a whole, thus researchers tend to choose the most articulated theory with their study's hypotheses (Linsley and Shrives, 2000). This section will consider the theoretical perspectives employed for the purpose of this study.

Modern firms are renowned by the detachment of ownership from control (Fama and Jensen, 1983) and this contributes to the widening information gap between

managers (insiders) and investors (outsiders). Thus, there is a great need for corporate risk disclosure as it represents a vital line of communications between the two parties. Cooke (1989) argued that where there is a detachment of ownership from control, the likelihood of agency costs arises due to disagreement between shareholders and managers and between bondholders and shareholder-managers. Also, Healy and Palepu (2001), Verrecchia (2001) and Hassan et al., (2009) contended that the need for more corporate disclosure arises from the information asymmetry problem. Henceforth, enhancing voluntary disclosure can reduce such conflicts and lessen future corporate performance uncertainty as well as facilitate trading in shares hence increases firm valuation (Hassan et al., 2009).

The influence of disclosure on firm value can be explained based on signalling and stakeholder theories. A number of prior researches have attempted to highlight the relationship between firm value and voluntary disclosure based on signalling theory (Gordon et al., 2010; Anam et al., 2011). All-inclusive disclosure indicates better corporate governance management and fewer agency conflicts, leading to a higher market valuation of the firm (Sheu et al., 2010). In addition, Gordon et al. (2010) asserted that voluntary disclosure in annual reports sends a clear signal to the capital market that is likely to increase a firm's present net value and in turn its stock market value. Gallego-Alvarez et al., (2010) argued that disclosure has a positive consequence on shareholder value creation. While, Cormier et al., (2011) claimed that, disclosure supplies value-relevant information to stock markets. In essence, signalling theory implies that a company will try to signal good news to investors and other interested groups by disclosing more voluntarily (Oliveira et al., 2006). Moreover, Linsley and Shrivs (2005) posited that signalling theory is the most relevant theory in terms of illuminating the phenomena of voluntary risk disclosure.

Furthermore, some previous investigations have reported that increasing the levels of voluntary disclosure culminates in less misvaluation of share prices, thus increasing firms' market value (Anam et al., 2011).

Moreover, according to the signalling theory, when a firm's performance is good, directors will prefer to signal their firm's performance to their investors and the rest of the market by reporting more supplementary information, whilst directors of firms that are performing badly do not. In fact, such disclosure by managers has many advantages, such as improved reputation of a firm, higher liquidity of stocks and increased market valuation of a firm, whereas when firms keep silent, investors and the rest of the market can misinterpret this as them withholding the worst possible information (Spence 1973; Verrecchia, 1983; Strong and Walker, 1987; Mohobbot, 2005; Linsley and Shrives, 2000; 2006; Hassan, 2009). Increased information disclosure allows shareholders to make accurate assessments of the fundamental parameters in relation the future stock returns, decreasing non-diversifiable estimation risk and uncertainty in relation to future cash flows as well as future profitability (Clarkson et al., 1996). Also through augmented disclosure, the willingness for shareholders to trade is improved and enhances the liquidation of shares cultivating in an increased firm value (Easley and O'Hara, 2004).

It has been noted that some organisations restrict their disclosures to only mandatory disclosure, whereas others might aim for more transparency and the disclosure of other supplementary information. Also, it has been established by prior investigations that traditional mandatory disclosure is unsuccessful in capturing value relevant information (Healy and Palepu, 1993; Hussainey and Walker, 2009), whilst previous literature has claimed that there are a number of advantages to voluntary disclosure (Nikhil et al., 2015). Moreover, directors could opt for more voluntarily

disclosure of information regarding their risk management and the methods used to deal with risks in their organisation as a means of conveying the firm's genuine value to external investors (Merkley, 2014). Furthermore, increased voluntary disclosure is predicted to increase stock liquidity by diminishing transaction costs and raising the demand for shares hence increase future profitability. It is also predicted that improved disclosure will decrease uncertainty surrounding the estimation of stock returns. Furthermore, the rate of return required by company shareholders will be reduced, the company's capital costs will plummet and the company's market value will rise. Moreover, prior studies have found that increased information disclosure can impact upon a company's market value by increasing the actual cash flow to investors as a consequence decreases agency conflicts (Lambert et al., 2007).

The signalling theory will also act as a supporting theory in this investigation. This theory will also be the foundation in interpreting the results of the current study's questions to further explain why banks are reporting such information. The signalling theory is employed since it helps in explaining the relationship between firm value and the level of voluntary risk disclosure in this study. For the sake of knowing whether the disclosure in annual reports can offer beneficial information to stakeholders, and whether risk disclosure is value relevant for stakeholders or not, it is necessary to make clear the definition of stakeholders. In term of the current study, banks should consider who their stakeholders are. Because without understanding who their stakeholders are, companies might not know how to offer the information which meets stakeholders' interests.

Stakeholder theory asserts that a company always deals with many users as their stakeholders. Stakeholders incorporate employees, shareholders, banks, insurance companies, government, local authorities and public administration, communities,

environment, even competitors, depositors, creditors, and borrowers. In addition, a community can also be a stakeholder which has the power to force a company to disclose its position. Therefore, corporations must uphold good communication channel with their stakeholders by revealing their performance timely and transparently. The information might not properly be accepted by all users (stakeholders), and noises may disturb the communications between sender (Bank) and users (stakeholders); resulting in stakeholders receiving inadequate/incomplete information that does not meet their needs. This theory will be used to support the analysis in order to answer the third research question, is risk disclosure value relevant or not? If the information is rewarding for stakeholders, it means information is value relevant for stakeholders and meets with their interests.

### **6.3 Literature Review and Hypothesis Development**

Out of the many studies reported in the literature, only a few have explored firm value and disclosure in developed countries (Healy et al., 1999; Leuz and Verrecchia, 2000; Baek, Kang and Park, 2004; Da Silva and Alves, 2004; Uyar and Kilic, 2012; Elzahar et al., 2015) and only one study has examined firm value and disclosure in emerging economies (Hassan et al., 2009). To the best of the researcher's knowledge, not a single study has explored the effect of voluntary risk disclosure on firm value and thus this is the first to do so. This dearth of literature makes this exploration of the relationship between firm value and voluntary risk disclosure in the context of Saudi Arabia all the more valuable.

This study focuses particularly on the market valuation in relation to voluntary risk disclosure reported by all Saudi listed banks. It is worth noting that most of the preceding investigations into firm value have concentrated on disclosure in non-financial corporation (Baek et al., 2004; Hassan et al., 2009; Nekhili et al., 2012;

2015; Elzahar et al., 2015), leaving the association between the two variables in the banking industry completely un-researched. This study is intended to shed light on the effect of banks' voluntary risk disclosure on firm value in an emerging market. Risk disclosure in the banking industry is still relatively under-researched and suffers from major limitations (Oliveira et al., 2011a; Barakat and Hussainey, 2013). This is of particular importance for a number of reasons. Banks are risk management entities since their primary business is to take risks and provide liquidity. Accordingly, banks are predicted to release considerable amounts of risk disclosure in order to enlighten external investors (Bessis, 2002), thus indirectly increasing the market valuation of the firm. Generally, disclosure has ascended to a different level of significance within banks compared to non-financial corporations since by their nature banks are inherently opaque (Huang, 2006).

Prior literature on disclosure has indicated that corporate disclosure can moderate the information asymmetry amid internal and external personnel (Kothari et al., 2009). Therefore, improved disclosure may culminate in increased demand for a firm's shares and, thus, a rise in the price of shares (Clarkson et al., 1996; Hassan et al., 2009; Healy and Palepu, 1993) since the disclosure ought to reveal the firm's value (Healy et al., 1999). An environment rich in information might result in positive economic consequences, such as increases in the value of the firm (Beyer et al., 2010; Leuz and Wysocki, 2008). The consequences of augmenting the levels of disclosure are usually debated in terms of diminishing mispricing, increasing profitability and firm value (Botosan and Plumlee, 2002). Moreover, prior empirical researches provide some supporting proof in relation to the association between voluntary disclosure levels and firm value. Healy et al., (1999) documented that companies with increased levels of disclosure could at the same time enjoy



considerable improvements in market valuation. This direct effect of the levels of disclosure on firm value influences administrators' decisions and effects the distribution of future cash flows (Lambert et al., 2007). Also, according to Elzahar et al., (2015) augmented disclosure will possibly enhance the market valuation of firms.

Substantial amounts of literature studied the effects of disclosure in generally, but the number of studies that investigated the impact of disclosure on firm value is limited. This lack is even greater when exploring risk disclosure in relation to firm value. Several empirical investigations established that voluntary disclosure augments stockholders' ability to forecast future earnings, which has an effect of the valuation of the firm (e.g., Hussainey et al., 2003). It has been contended by Rhodes and Soobaroyen (2010) that disclosure can limit the raise of agency conflicts by diminishing information asymmetry, consequentially augments market valuation of firms. Sheu et al., (2010) stipulated that the capital market only supplies higher firm valuations to firms, which opt for a more inclusive disclosure policy. Gordon et al., (2010) provided strong evidence that greater levels of voluntary disclosure are positively related with the valuation of the firm.

Nonetheless, the findings of researches investigating the relationship between corporate disclosure and firm value are mixed. For instance, several investigations have documented a positive link between the two variables (see Baek et al., 2004; Cheung et al., 2010; Gordon et al., 2010; Jiao, 2011; Anam et al., 2011; Dhaliwal et al., 2011). However, Hassan et al., (2009) claimed that the effect of disclosure on firm value is still worthy of empirical investigation. They intimated that there is no significant association between firm value and discretionary disclosure although there is a negative and significant relationship between the market value of the firm and mandatory exposure. Concurring with their findings, Uyar and Kilic (2012)

claimed that the link between discretionary disclosure and company value differs according to the proxy employed for the market value of the firm.

In theory, the market value of a firm raises due to augmented disclosure levels via either a reduction in the cost of capital or an upturn in the cash flow to the company's shareholders or both (Amihud and Mendelson, 1986; Diamond and Verrecchia, 1991). Debatably, high exposure levels decrease the cost of capital since they encourage investors to lower their estimation of the risk level and, thus, decrease the mandated rate of return when purchasing a company's shares (Coles et al., 1995; Clarkson et al., 1996). Moreover, the value of the company rises following the predicted enhancement in stock liquidity since the transaction costs are decreased whilst the demand for the company's shares soars (Amihud and Mendelson, 1986; Diamond and Verrecchia, 1991). There could be problems with information asymmetry and agency conflicts between company directors and external stakeholders (Healy and Palepu, 2001) since external investors do not generally have access to the in-house information of the firm that is freely available to company directors. This could affect the expectations of outside stakeholders concerning risk, mandated returns and company cost of capital and, thus, the company's share value. However, augmented voluntary corporate disclosure can be employed to mitigate these problems (Hassan, 2009).

Healy and Palepu (1993) argued that the higher the disclosure level, the more possibility there is that shareholders are able to understand the way managers operate. Also, Diamond and Verrecchia (1991) claimed that by lowering the information asymmetry amongst management and un-informed shareholders leads to less uncertainty regarding the future performance of the company and an enhancement in the liquidity of its shares. Hence, Coles et al. (1995) and Clarkson et

al. (1996) contended that lower transaction costs in addition to a higher demand for shares could lead to an upturn in share price and, thus, the value of the firm. Nonetheless, the impact of augmented disclosure may not be positive since it might have a negative impact on the company's competitiveness (Healy and Palepu, 1993) and, thus, have an adverse impact on the company's valuation. High quality exposure has a positive impact on the value of a company due to institutional investors being attracted to the company (Dhaliwal et al., 2011).

Hassan et al., (2009) argued that the association between the two variables is complicated and depends upon whether the exposure is voluntary or mandatory. However, the authors found no significant link between firm value and the voluntary exposure made by Egyptian companies, whereas they identified a negative and significant relationship between company value and mandatory exposure. Moreover, Uyar and Kilic (2012) established that the link between discretionary disclosure and firm value is influenced by the measurement of firm value. For example, when they used market-to-book value as opposed to market capitalisation as the dependent variable in the regression model, their findings went from positive to insignificant.

Furthermore, earlier investigations that examined the effect of disclosure on company value reported mixed findings as previously emphasised. The limited empirical literature examining the relationship between market value firms and voluntary disclosure suggests a positive relationship between the two variables (Baek et al., 2004, Lim et al., 2007; Anam et al., 2011; Sheu et al., 2010; Nekhili et al., 2012), for instance, Anam et al. (2011) and Sheu et al. (2010) reported that discretionary disclosure levels in Malaysia and Taiwan are associated with company value. Correspondingly, Silva and Alves (2004) established that financial information discretionarily reported by Latin American companies has a significant and positive

relationship with company value. However, Uyar and Kilic (2012) and Elzahar et al., (2015) claimed that the link between discretionary exposure and company value differs according to the proxy employed for the market value of the firm, and Hassan et al., (2009) reported that the association between the two variables depends on the type of disclosure used. Vafaei et al.'s (2011) study included both developed and developing countries and documented that there is a significant association between disclosure and firm value for Hong Kong and the UK and reported a negative relationship between the two variables for Singapore and Australia. Therefore, based on the above discussion the following hypothesis is formulated:

***H13: There is a positive association between the levels of voluntary risk disclosure and firm value.***

## **6.4 Research control variables**

For literature related to the control variables; check section 5.5.9 However, in addition to these variables; in this study the model contains additional three control variables which are leverage; liquidity and dividend pay-out.

### **6.4.1 Leverage**

Leverage is employed as a representative for agency costs, where higher leverage level results in higher agency costs (Lopes and Rodrigues, 2007). Therefore, Oliveira et al., (2011) and Elshandidy et al., (2013) stated that companies bearing high levels of leverage ratio are inclined to be more risky and unpredictable. However, the agency theory posits that agency costs upsurge with high leverage ratio (Elzahar and Hussainey, 2012). Correspondingly, Abraham, Solomon and Stevenson, (2007) confirmed that firms which are viewed to possess higher levels of market risk are motivated to release larger amounts of information in an attempt to minimise monitoring costs which stakeholders will experience when investing in the

organisation. Consequently, stockholders of such companies might introduce more restrictive agreements into their debt contracts, which will lead to the escalation of agency and monitoring costs. On the other hand, it is likely that corporations with higher levels of risk will report larger sums of risk related disclosures since the managers have an incentive to comprehensively explicate the sources of these risks so as to decrease agency costs (Linsley and Shrivess, 2006). However, risk news relevant market, credit and internal risk control could play a fundamental part in mitigating creditors' anxieties about the solvency of the company's and its competences to generate sufficient cash flows in the future (Rajab and Handley-Schachler, 2009).

Also, the leverage variable is employed as a proxy for signalling arguments to clarify disclosure exercises in public firms. However, Elzahar and Hussainey, (2012) claimed that corporate directors report risk news when they have a high leverage level to signal to stockholders and depositors the company's competences to meet short and long term financial obligations. Also, Linsley and Shrivess, (2006) claimed that firms with high risk levels will report additional information on how they handle risks in an attempt to signal to stakeholders and other participants that there is a well-organised risk management system in place and management capabilities and skills in administering such risks. On the other hand, some researchers disputed that such organisations might be unwilling to voluntarily reveal risk information since their management might not desire to consider their risk level where investors thereafter might regard them as a risky company and decide not to invest in such risky business (Mohobbot, 2005). On the contrary, low risk level firms will dispatch good signals by releasing a greater amount of risk disclosure in order to entice more capital (Iatridis, 2008).

Empirical studies on the relationship between risk disclosure and leverage levels indicated either a positive or a no significance relationship. None of the prior investigations reviewed illustrated a negative association. Abraham and Cox, (2007); Deumes and Knechel, (2008); Iatridis, (2008); Elshandidy et al., (2013); Hassan, (2009) demonstrated a positive association between the two variables. Whereas, Elzahar and Hussainey, (2012); Nitm et al., (2013); Miihkinen, (2012) did not find any significant relationship among risk disclosure and leverage levels. The current study expects a positive relationship between the level of voluntary risk disclosure and leverage.

#### **6.4.2 Liquidity**

Liquidity is an important variable, which represents information of many elements on firm's ability to meet short and long term financial obligations. This information could be of a major assistance for regulatory institutions, investors and debtholders. Therefore, the incapability of a firm to meet its financial requirements for both short and long term could lead to postponements in repaying debts, loss of confidence in the market between lenders and creditors and in extreme cases bankruptcy (Naser, Al-Khatib and Karbhari, 2002). According to Cabedo and Tirado, (2004) accounting standards necessitate a reflective cash flow statement to be generated to enlighten clients of the liquidity flows of the company and help them in the evaluation of the firm's ability to produce liquidity to meet its commitments. However, Wallace et al., (1994) argued that high liquidity companies are more motivated to report risk news than low liquidity companies. Yet, their results indicated that liquidity has a significant and a negative effect on disclosure level.

Capital need theory posited that corporations report more risk related information in an attempt to entice capital at the lowest cost. Therefore, Chio, (1973) argued that

corporations that are prone to reveal more valuable information than obligated by law are regularly those going to the financial market to raise capital. This amplification in disclosure would signify two things for them; a lower cost of capital and a reduction in the level of risk associated with a certain security.

Foster, (1986) implied that in capital markets when firms try to raise capital at the lowest achievable cost, in the existence of competition on the same security proposed and future returns, there are risks and uncertainties incorporated in the firm and its securities, which lead stockholders, investors and other market participants demand more news to aid appraise the risks of the current future cash flows, securities value and investment decisions. Consequently, firms are motivated to report information that will minimise the risk related info, which sequentially allows them to raise capital at the lowest achievable costs.

Jensen and Meckling, (1976) theorised that agency cost theory describes the relationship between the stockholder and manager, where the stockholder gives some decision-making authority to the manager who acts on his behalf. Although, disagreement occurs since both parties attempt to maximise their own interest for instance, increasing dividends considerably will result in making the firm become riskier by not having enough cash flow, which will hurt lenders. Another example would be when managers choose to borrow more capital on the same assets, which results in making current lenders worse off. This kind of conflict would potentially lead to more demands for risk related information.

However, empirical researches evident a mixed findings on the relationship between liquidity and risk disclosure. Some researches documented a negative relationship between the two variables (Wallace et al., 1994; Naser, Al-Khatib and Karbhari,

2002) while others documented an insignificant correlation between liquidity and risk disclosure (Owusu-Ansah, 1998; Wallace and Nasser, 1995; Owusu-Ansah and Yeoh, 2005; Al Shammari et al., 2008). The current study expects a positive relationship between the level of voluntary risk disclosure and liquidity of the bank.

#### **6.4.3 Dividend Pay-out**

Prior academic literature have argued from an agency perspective that dividends could prove to have a diminishing impact on agency costs via the distribution of free cash flow that a company's administration may on the other hand employ on unprofitable ventures (Jensen, 1986). It also has been acknowledged that dividend policies are employed as a mean of handling agency matters between outside investor and corporate insiders (Fluck, 1998). Dividend payments could be regarded as a form of risk premium that is distributed to the investors. Also, stockholders who are in receipt of dividends might be less inclined towards information regarding the risks an institution is trying to address. Therefore, disbursing dividends among shareholders could compensate for the reduction in risk disclosure (Elshandidy and Neri, 2014). Another argument led by Farinha (2003) states that directors might be paying out dividends to circumvent any disciplinary actions taken by investors. Previous empirical studies on corporate disclosure reported that organisations with lower dividend yields are more prone to offer significantly greater levels of disclosure than firms with higher yields (Hussainey and Walker, 2009). Additionally, the fact that companies have an option of dividend policy proposes that higher dividend disbursements are related to less riskiness and less information asymmetry (Elshandidy and Neri, 2014). This study predicts a positive relationship between the level of voluntary risk disclosure and bank's dividends pay-out.



## 6.5 Research design

### 6.5.1 Sample and Data Collection

This section describes the sample, the sources of relevant information and the data collection procedure and defines all variables used for the purpose of this investigation (for further details see section 4.6).

### 6.5.2 Development of Risk Disclosure index

See Section 4.7

### 6.5.3 Reliability and Validity of Risk Disclosure Index

See section 4.7.1

**Dependent variable:** This study uses two different proxies for measuring firm value. Firstly it uses the market based measure which is the natural logarithm of market to book value at end of year (MTBV). This is in line with previous studies (Hassan et al., 2009; Uyar and Kilic, 2012). Secondly, it uses the accounting based measure, which is the return of assets (ROA). This is consistent with (Garay et al., 2013; Aras et al., 2010). Two measures examinations have different theoretical implications (Hillman and Keim, 2001). The current study employs two dependent variables related to firm value to test the hypothesis of the study. This is concurrent with preceding literature (Barontini and Caprio, 2006; Sheu et al., 2010). These two models measure how the level of voluntary risk disclosure affects the market value of the bank. This study's main emphasis is on exploring the relationship between the levels of voluntary risk disclosure and firm market value. An extensive line of preceding literature has argued that discretionary disclosure is better used as an instrument intended to reduce information asymmetries and satisfy shareholders' information demands. The aim of this research is to investigate whether increased discretionary risk disclosure affects the firm's market value.

**Endogenous variable:** Risk Disclosure; which proxies for the level of voluntary risk disclosure of all banks included in the sample of the study. The level of voluntary risk disclosure is the totality of the scores attained from 54 items that fall into 8 different categories of information (See appendix). The level of voluntary risk disclosure was calculated based on an un-weighted (Dichotomous) risk disclosure index, whereby an item is assigned a score of 1 if it is disclosed and a score of 0 if otherwise (Uyar and Kilic, 2012; Hassan et al., 2009). This measure was preferred since the research does not concentrate on a specific user group (Naser et al., 2006) but rather addresses all users of annual reports. Thus, there is no need to put different weights on the reported risk items (Oliveira et al., 2006).

**Table 13: Summary of variable names, description and sources**

Abbreviated name	Full name	Variable description	Predicted Sign	Data source	Prior studies
Dependent variables					
FV	Firm value	Natural logarithm of the ratio of market value of equity to book value of equity at the financial year-end (MTBV)	+	DataStream	Hassan et al., (2009); Uyar and Kilic (2012); Nekhili et al., (2015)
		ROA (Return On Assets)			Garay et al., (2013); Aras et al., (2010); Klapper and Love,( 2002)
Independent variable					
RISKD	Risk disclosure	Risk disclosure level based on risk index		Annual reports	Hassan et al., (2009); Uyar and Kilic (2012); Nekhili et al., (2014)
Control variables					
1. Firm-specific characteristics					
SIZE	Bank size	Natural logarithm of total assets	+	DataStream	Al-Akra and Ali (2012); Moumen et al., (2015) Jankensgard et al., (2014)
PROF	Profitability	ROA (Return On Assets)	+	DataStream	Moumen et al., (2015); Jankensgard et al., (2014)
LEV	Leverage	Long-term debt/ total assets	+	DataStream	Uyar and Kilic (2012); Jankensgard et al., (2014)
LIQ	Liquidity	Current Ratio: Current Assets/Current Liabilities	+	Annual report	Diamond, and Verrecchia, (1991).
DIVID	Dividend payout	Dividends per share	+	DataStream	Jankensgard et al., (2014); Elzahar et al., (2015)

<b>2. Corporate Governance characteristics</b>					
BSIZE	Board size	Number of board members	+	Annual report	Nekhili et al., (2015); Ntim et al., (2012)
CHS	Internal Ownership	Percentage of shares held by internal shareholders	-	DataStream	Jankensgard et al., (2014); Nekhili et al., (2015)
NOCH-Factors	External Ownership	Percentage of shares held by external shareholders	+	DataStream	Nekhili et al., (2015); Defond et al., (2005)
INDEP	Independent directors	Number of non-executive directors on the board of directors	+	Bloomberg Annual Report	Nekhili et al., (2015); Ntim et al., (2012)
NON	Non-executive directors	Dummy variable 1 if board contains non-executive directors and otherwise 0.	+	Bloomberg Annual Report	Ntim et al., (2012)
ACINDEP	Audit committee independence	Dummy variable; 1 if an audit committee independence exists, and 0 otherwise	+	Bloomberg Annual Report	Nekhili et al., (2015); Defond et al., (2005)
ACSIZE	Audit committee size	Number of audit committee members	+	Annual report	Defond et al., (2005); Black et al., (2006)
ACMEET	Audit committee meetings	Number of audit committee meetings	+	Annual report	Black et al., (2006)
<b>3. Demographic characteristics</b>					
EDUC	Education Levels	Number of board members holding a PhD	-	Annual report	*
TENU	Tenure	Dummy variable 1 if the number of years the board member permanence on the board is above the sample median of 5 years, 0 otherwise.	+	Annual report	*
GENDER	Gender Diversity	Number of females on the board	+	Annual report	*
DIVE	Diversity	Number of other nationalities on the board	+	Annual report	*
ISLAMIC.DUM	Islamic dummy	Dummy variable 1 if the bank is Islamic and 0 otherwise	+	Annual report	Abdallah et al (2015)
<p>This table provides the description and measures of risk disclosure reporting, as dependent variables, and firm characteristics, corporate governance mechanism and demographic traits as independent variables. It also provides the source of each variable.</p> <p>* No prior studies have examined the association between risk disclosure and firm value using these variables.</p>					

#### 6.5.4 Model development

The aim of this research is to examine the association between firm value and voluntary risk disclosure level. Moreover, since all of the selected variables can affect firm value directly or indirectly by affecting the level of voluntary risk disclosure two synchronised models, wherein the level of voluntary risk disclosure is a strategic choice that relies on a wide range of variables, was developed (see Table 13).

##### ***The market based measure:***

$$MB_{it} = \beta_0it + \beta_1 RISK_{Dit} + \beta_2 NOCH\_FACTOR_{it} + \beta_3 BSIZE_{it} + \beta_4 INDEP_{it} + \beta_5 NON_{it} + \beta_6 ACINDEP_{it} + \beta_7 ACSIZE_{it} + \beta_8 ACMEET_{it} + \beta_9 EDUC_{it} + \beta_{10} TENU_{it} + \beta_{11} GENDER_{it} + \beta_{12} DIVE_{it} + \beta_{13} SIZE_{it} + \beta_{14} PROF_{it} + \beta_{15} CHS_{it} + \beta_{16} LEV_{it} + \beta_{17} LIQ_{it} + \beta_{18} DIVID_{it} + \beta_{19} YEA.DUM_{it} + \beta_{20} ISLAMIC.DUM_{it} + \varepsilon_{it} \quad (3)$$

Where: MB = Firm Value (measure by market to book value)

$\beta_0$  = the intercept

$\beta_1$ .....  $\beta_{20}$  = regression coefficients (See Table 13 for more explanation)

$\varepsilon$  = error term

I = Bank

T = Year

##### ***The accounting based measure:***

$$ROA_{it} = \beta_0it + \beta_1 RISK_{Dit} + \beta_2 NOCH\_FACTOR_{it} + \beta_3 BSIZE_{it} + \beta_4 INDEP_{it} + \beta_5 NON_{it} + \beta_6 ACINDEP_{it} + \beta_7 ACSIZE_{it} + \beta_8 ACMEET_{it} + \beta_9 EDUC_{it} + \beta_{10} TENU_{it} + \beta_{11} GENDER_{it} + \beta_{12} DIVE_{it} + \beta_{13} SIZE_{it} + \beta_{14} CHS_{it} + \beta_{15} LEV_{it} + \beta_{16} LIQ_{it} + \beta_{17} DIVID_{it} + \beta_{18} YEA.DUM_{it} + \beta_{19} ISLAMIC.DUM_{it} + \varepsilon_{it} \quad (4)$$

Where: FV = Firm Value (measure by ROA)

$\beta_0$  = the intercept

$\beta_1$ .....  $\beta_{19}$  = regression coefficients (See Table 13 for more explanation)

$\varepsilon$  = error term

I = Bank

T = Year

## 6.6 Analysis and discussion

### 6.6.1 Descriptive statistics

Table 14 presents the summary descriptive statistics of the variables used in the analyses to determine the empirical directional or non-directional relationship between firm value and the voluntary risk disclosure levels in banks listed on the Saudi Stock Market (*Tadawul*). A number of interesting findings emerged from the

descriptive statistics. It demonstrated a great disparity in voluntary risk reporting practices among the sample population. For example, RISKD ranged from a minimum of 51 percent to a maximum of 78 percent, with an average of 66.03 percent of voluntary risk disclosure levels in the sample. Also, it showed that the average market to book value of listed banks in Saudi Arabia is 1.72 percent with a maximum value of 4.02 and a minimum value of 0 percent.

The figures for all control variables (which were generated from corporate governance, demographic attributes and firm-specific characteristics) are presented in the next paragraph as minimum, maximum and mean values in percentages. (Also see Table 14). Table 14 demonstrates that CHS holdings has in this model reported quite a large variation ranging from 0 percent for the minimum and 69 percent for the maximum with a mean of 19.1 percent. This phenomenon could be attributed to the nature of the ownership structure in the Kingdom of Saudi Arabia where some banks are wholly owned by a single family who sits on the board of directors and act as internal shareholders. Alrajhi bank is an example of such structure. While, the table below shows that NOSH holdings has reported a minimum of 25 percent, a maximum of 45 percent and a mean of 29.5 percent. Also, Table 14 illustrates that BSIZE ranges from 7 members to a maximum of 11 on the board of directors, with an average mean of 9 members. Whereas, the INDEP members of the board recorded an average mean of 5 members with a minimum of 3 and a maximum of 8. Table 14 also shows that NON members have a minimum of 1 member to a maximum of 11 members with an average mean of 7. The table below illustrates that the descriptive statistics for the ACINDEP which has recorded a minimum of 0 members and a maximum of 1 audit committee independent member. ACSIZE has a mean of 3 members with a minimum of 2 and a maximum of 5. For the audit

committee frequency of meetings (ACMEET) table 14 shows that there is a minimum of 3 meetings, a maximum of 11 and an average mean 5. Further, GENDER has a minimum of 0 members and a maximum of 1 on the board of directors. TENU has recorded a minimum of 0 and a maximum of 1, while EDUC recorded a minimum of 0 and a maximum of 1. Also DIVE recorded a maximum of 1. Table 14 also demonstrates that SIZE has an average mean of 8, a minimum of 7 and a maximum of 7.60 percent, While, PROF has a maximum of .04, a minimum of -.01 and a mean of .019. LEV on the other hand has a maximum of 13.7, a minimum of 0 percent and an average mean of 0.57. LIQ has reported in the table below a minimum of 1.10, a maximum of 10 percent and a mean of 1.4. Lastly, DIVID has reported a minimum of 0, a maximum of 69 and a mean of 25 percent.

**Table 14: Descriptive statistics for all variables included in this study of MTBV**

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Dev</b>	<b>Skewness</b>	<b>Kurtosis</b>
<b>RISKD</b>	60	.51	.78	.6603	.07059	-.503	-.488
<b>MTBV</b>	60	.00	4.02	1.6038	.83039	.563	1.323
<b>ROA</b>	60	-.01	.04	.0192	.00869	-.636	3.124
<b>CHS</b>	60	.00	69.00	19.1000	17.46056	.858	.102
<b>NOCH</b>	60	25.00	45.00	29.5000	5.08091	1.016	.127
<b>BOARDSIZE</b>	60	7.00	11.00	9.5500	.94645	-.211	-.259
<b>INDEP</b>	60	3.00	8.00	5.1333	1.62049	.370	-1.081
<b>NON</b>	60	1	11	7.37	2.718	-.538	-.878
<b>ACINDEP</b>	60	.00	1.00	.7500	.43667	-1.185	-.619
<b>ACSIZE</b>	60	2.00	5.00	3.7667	.96316	.021	-1.219
<b>ACMEET</b>	60	3.00	11.00	5.3667	1.95688	1.092	.883
<b>GENDER</b>	60	.00	1.00	.0833	.27872	3.093	7.826
<b>TENURE</b>	60	.00	1.00	.6000	.49403	-.419	-1.889
<b>EDUCATION</b>	60	.00	1.00	.7000	.46212	-.895	-1.241
<b>DIVERSITY</b>	60	.00	1.00	.3333	.47538	.725	-1.526
<b>SIZE</b>	60	7.24	8.58	7.9940	.35203	-.447	-.831
<b>ISLAMIC</b>	60	.00	1.00	.3333	.47538	.725	-1.526
<b>LEV</b>	60	.00	13.76	.5780	2.04382	5.695	33.444
<b>LIQ</b>	60	1.10	10.89	1.4118	1.26123	7.444	56.696
<b>DIVID</b>	60	.00	69.15	25.8103	21.41391	.340	-.796

FV: Firm value (Market to Book Value); RISKD: Risk disclosure score (based on an unweighted disclosure index); CHS:

Internal ownership (Percentage of shares held by internal shareholders); NOCH-Factor: External ownership (Percentage of shares held by all external shareholders); BSIZE: Board size (Number of board members); INDEP: Independent directors (Number of non-executive directors on the board of directors); NON: Non-executive directors (Dummy variable 1 if board contains non-executive directors and otherwise 0); ACINDEP: Audit committee independence (Dummy variable; 1 if audit committee independence exists, and 0 otherwise); ACSIZE: Audit committee size (Number of audit committee members); ACMEET: Audit committee meetings (Number of audit committee meetings); GENDER: Gender (Number of females on the board); TENU: Tenure (Dummy variable 1 if the number of years the board member permanence on the board is above the sample median of 5 years, otherwise 0); EDUC: Education (Number of board members holding a PhD); DIVE: Diversity (Number of other nationalities of the board ); SIZE: Bank size (Natural logarithm of total assets); PROF: Profitability (Return On Assets); LEV: Leverage (Long-term debt/ total assets); LIQ: Liquidity (Current Ratio: Current Assets/Current Liabilities); DIVID: Dividend pay-out (Dividends per share) and ISLAMIC.DUM: Dummy variable 1 if bank is Islamic and 0 otherwise

## 6.6.2 Market-based measure results

### 6.6.2.1 Univariate analysis

Table 15 illustrates the correlations between firm value and the levels of voluntary risk disclosure along with the correlations for the other explanatory variables. It also presents the Pearsons correlation matrix for all variables employed in this study's regression analysis to check for multicollinearity. Bivariate analysis was used to check for multicollinearity. When the level of association between the risk disclosure score and firm value, measured by the market to book value at end of year and other associations between the control variables, was legitimately low, this indicated that there were no multicollinearity problems. Later in the ordinary least square (OLS) regression analysis, the calculated variance inflation factor (VIF) values support the absence of multicollinearity defects as multicollinearity did not exceed the 10 percent mark (Naser et al., 2006; Field, 2009).

Similarly, Pearsons correlation matrix was used to test for the directional and non-directional relationships between firm value and the rest of the control variables. This study further examined residual statistics and Durbin-Watson statistics for linearity and autocorrelation problems (See Model Summary in Table 16). However, the tests showed no serious violation of these linear assumptions. In addition, the table illustrates that there is no statistically significant association between the dependent

variable (FV based on MTBV) and the endogenous variable (RISKD) of this investigation. However, there are a number of statistically significant associations between the dependent variable and the control variables. For example, CHS, BSIZE, PROF and DIVID are statistically significant and positively associated with FV, while EDUC is statistically significant and negatively correlated with FV. The highest correlation that can be seen from table 15 is between BSIZE and FV at a value of 0.604, followed by EDUC at a value of 0.463. Also, table 15 indicates that there are insignificant correlations between the rest of the control variable and the dependent variable (Based on the market measure).



**Table 15: Pearson correlation Analysis**

	MTBV	RISKD	CHS	NOCH	BOARDSIZE	INDEP	NON	ACINDEP	ACSIZE	ACMEET	GENDER	TENURE	EDUCATION	DIVERSITY	SIZE	LEV	LIQ	DIVID	ISLAMIC
MTBV	1	-0.115	.393**	-0.014	.600**	0.165	.272*	0.067	0.226	0.16	0.021	0.07	-.255*	0.165	-0.035	0.057	-0.062	.262*	.316*
RISKD		1	-0.129	.411**	-0.107	-0.171	-0.095	0.074	0.136	0.054	0.093	-.356**	-0.241	.375**	.479**	-0.093	-.294*	.318*	-.488**
CHS			1	-.492**	.364**	0.195	.290*	-0.19	0.243	0.196	0.061	0.195	-0.059	-.261*	0.006	0.049	0.063	0.232	0.204
NOCH				1	0.073	-0.248	-.308*	.325*	-0.062	0.153	-0.215	-0.218	-0.173	.547**	0.071	-0.052	-0.114	-0.113	-0.214
BOARDSIZE					1	-0.038	.467**	-0.072	0.013	.566**	0.016	0.007	-0.081	0.226	0.101	0.002	-0.069	0.135	.264*
INDEP						1	.439**	.335**	.335**	0.075	0.05	0.11	.326*	-0.169	-.478**	0.19	-0.016	-0.079	0.073
NON							1	0.05	.454**	.459**	0.138	-0.103	0.251	0.114	-0.052	0.083	-0.174	0.168	0.074
ACINDEP								1	0.141	-0.089	0.174	-0.079	.294*	.408**	-0.225	-0.062	-.274*	-0.086	-.408**
ACSIZE									1	0.19	-0.242	0.121	-0.046	-0.086	0.019	-0.137	-0.121	.302*	0.025
ACMEET										1	-0.212	0.014	0.03	-0.024	-0.055	-0.123	-0.093	-0.004	.304*
GENDER											1	-0.246	0.197	.426**	-0.166	.336**	-0.054	-0.111	-0.213
TENURE												1	0.134	-.433**	-0.126	-0.091	0.108	-0.045	0.217
EDUCATION													1	0.077	-0.211	0.123	0.114	-0.167	-.309*
DIVERSITY														1	0.112	0.103	-0.085	-0.04	-.500**
SIZE															1	-0.166	-.299*	.658**	-.535**
LEV																1	0.009	-0.233	-0.008
LIQ																	1	-0.167	0.215
DIVID																		1	-.268*
ISLAMIC																			1

For variables explanations see table 14. \*\* Denote correlation is significant at the 5% level (tow-tailed tests). \* Denote correlation is significant at the 10% level (tow-tailed tests).

#### **6.6.2.2 Multivariate analysis**

For a more comprehensive analysis of the relationship between firm value and voluntary risk disclosure (Based on the market measure), a multivariate analysis, which controls for other variables expected to impact upon the value of the firm, was conducted. The method used to study the relationship between firm value and voluntary risk disclosure levels in all listed Saudi banks was the ordinary least square (OLS) regression analysis. The results of the regression are presented in table 15. This study's model used a market based measure; market to book value at year-end as the dependent variable, total risk disclosure score as its endogenous variable and a mixture of corporate governance, demographic attributes and firm-specific characteristics as control variables (see Table 13). As can be observed from the model summary table the model is significant at the (0.000) level with an F value of (7.024) and with an adjusted R square of 0.692 percent. Therefore, the explanatory power of the independent and control variables on firm value are fairly high. However, based on this model the regression analysis table indicates that there is an insignificant relationship between firm value and the level of voluntary risk disclosure in Saudi listed banks. Therefore, this study's hypothesis is rejected in this model. The results are consistent with previous studies, such as Uyar and Kilic (2012) and Hassan et al., (2009). This investigation's outcome based on the market based measure (MTBV) is inconsistent with the signalling theory, which indicates that when a firm's performance is good, directors will signal their firm's performance to their investors and the rest of the market by reporting more information voluntarily, whilst directors of firms that are performing badly will not do so. The purpose of such disclosure is to obtain a good market reputation and increase firm value since investors and the rest of the market may misinterpret a firm keeping silent as it is withholding the worst possible information (Mohobbot, 2005; Linsley and Shrides,

2000; 2006; Hassan, 2009). This model outcome is also inconsistent with previous literature, which have employed a market based measure and found positive association between voluntary risk disclosure and firm value (Ahmad, 2015). This research model finding is attributed to the deep-rooted tendency of the Saudi capital market to be opaque (Roberts and Kamla, 2010) and explained by Hofstede's cultural dimensions, where Saudi Arabia scored zero on the secrecy vs. transparency measure.

Table 16 also presents the multivariate analysis for all of the control variables, where NOCH has a negatively significant relationship with firm value at 5% level. Also, there is a positively significant relationship between board independence and firm value at 10% level. In addition, audit committee independence has a positively significant association with firm value at 10% level. There are positively significant associations between DIVERSITY and SIZE and firm value at 1% and 10% levels, respectively. There is a positive association between nature of bank (Islamic vs non-Islamic) and firm value at the 1% level. However, the rest of the control variables are split between two groups, the first group being negatively insignificant and the second group being insignificantly associated with firm value.

**Table 16: Regression analysis**

Model	Unstandardized Coefficients		t	Sig.	VIF
	B	Std. Error			
(Constant)	-10.020	5.260	-1.905	0.065	
RISKD	0.403	1.507	0.267	0.791	3.144
CHS	0.007	0.007	1.050	0.301	3.634
NOCH	-0.063	0.031	-2.057	0.047	6.699
BOARDSIZE	0.178	0.148	1.204	0.236	5.436
INDEP	0.128	0.070	1.843	0.073	3.535
NON	-0.058	0.053	-1.094	0.281	5.850
ACINDEP	0.708	0.302	2.347	0.024	4.822
ACSIZE	0.050	0.100	0.505	0.616	2.570

ACMEET	-0.064	0.055	-1.164	0.252	3.201
GENDER	-0.551	0.404	-1.363	0.181	3.524
TENURE	0.162	0.164	0.988	0.330	1.828
EDUCATION	0.065	0.207	0.315	0.754	2.546
DIVERSITY	1.520	0.323	4.705	0.000	6.553
SIZE	1.240	0.675	1.837	0.074	6.690
LEV	0.028	0.036	0.781	0.440	1.527
LIQ	-0.063	0.069	-0.921	0.363	2.075
DIVID	0.008	0.005	1.497	0.143	3.394
ISLAMIC	1.923	0.451	4.266	0.000	7.759
<b>Model Summary</b> Adjusted R Square: 0.692 F value: 7.024 Sig. : 0.000					
For variables explanations see table 14. Note that “* ** ***” represent 10% 5% 1% respectively, which indicates that there is a positive correlation or a proof of influence exists between the respective factors and “-“indicates that there is a negative correlation or proof.					

### 6.6.3 Accounting-based measure results

Table 17 shows the correlation matrix for the dependent and continuous independent variables. Consistent with this study's hypothesis, the levels of voluntary risk disclosure is positively significant with firm value based on ROA at a value of (0.271\*). It signifies that the overall level of voluntary risk disclosure of all Saudi listed banks has strong impact on profitability. The correlation matrix also shows the interrelationships with this model's explanatory variables. It shows that CHS (0.329\*); BSIZE (0.283\*); SIZE (0.529\*\*); DIVID (0.557\*\*) are positively correlated with firm value. While, ACINDEP (-0.279\*) and LEV (-0.398\*\*) are negatively associated with firm value based on the second model. In terms of the other control variables, the correlation between them and firm value based on ROA is insignificant. It shows that NOCH (0.055\*); GENDER (0.098\*) and LEV (0.034\*) are negatively correlated with firm value. While, DIVERSITY (0.043\*) are positively associated with firm value based on the second model. In terms of the other control variables, the correlation between them and firm value based on ROA is insignificant.



**Table 17: Pearson correlation Analysis**

	ROA	RISKD	CHS	NOCH	B.SIZE	INDEP	NON	ACINDEP	ACSIZE	ACMEET	GENDER	TENURE	EDUCAT	DIVERS	SIZE	LEV	LIQ	DIVID	ISLAMIC
ROA	1	.271 <sup>*</sup>	.329 <sup>*</sup>	-0.227	.283 <sup>*</sup>	-0.172	0.200	-.279 <sup>*</sup>	0.219	0.158	-0.181	0.039	-0.148	-0.055	.529 <sup>**</sup>	-.398 <sup>**</sup>	-0.011	.557 <sup>**</sup>	-0.055
RISKD		1	-0.129	.411 <sup>***</sup>	-0.107	-0.171	-0.095	0.074	0.136	0.054	0.093	-.356 <sup>***</sup>	-0.241	.375 <sup>***</sup>	.479 <sup>***</sup>	-0.093	-.294 <sup>*</sup>	.318 <sup>*</sup>	-.488 <sup>***</sup>
CHS			1	-.492 <sup>**</sup>	.364 <sup>***</sup>	0.195	.290 <sup>*</sup>	-0.190	0.243	0.196	0.061	0.195	-0.059	-.261 <sup>*</sup>	0.006	0.049	0.063	0.232	0.204
NOCH				1	0.073	-0.248	-.308 <sup>*</sup>	.325 <sup>*</sup>	-0.062	0.153	-0.215	-0.218	-0.173	.547 <sup>***</sup>	0.071	-0.052	-0.114	-0.113	-0.214
B.SIZE					1	-0.038	.467 <sup>**</sup>	-0.072	0.013	.566 <sup>***</sup>	0.016	0.007	-0.081	0.226	0.101	0.002	-0.069	0.135	.264 <sup>*</sup>
INDEP						1	.439 <sup>**</sup>	.335 <sup>***</sup>	.335 <sup>***</sup>	0.075	0.050	0.110	.326 <sup>*</sup>	-0.169	-.478 <sup>***</sup>	0.190	-0.016	-0.079	0.073
NON							1	0.050	.454 <sup>***</sup>	.459 <sup>***</sup>	0.138	-0.103	0.251	0.114	-0.052	0.083	-0.174	0.168	0.074
ACINDEP								1	0.141	-0.089	0.174	-0.079	.294 <sup>*</sup>	.408 <sup>***</sup>	-0.225	-0.062	-.274 <sup>*</sup>	-0.086	-.408 <sup>***</sup>
ACSIZE									1	0.190	-0.242	0.121	-0.046	-0.086	0.019	-0.137	-0.121	.302 <sup>*</sup>	0.025
ACMEET										1	-0.212	0.014	0.030	-0.024	-0.055	-0.123	-0.093	-0.004	.304 <sup>*</sup>
GENDER											1	-0.246	0.197	.426 <sup>**</sup>	-0.166	.336 <sup>***</sup>	-0.054	-0.111	-0.213
TENURE												1	0.134	-.433 <sup>**</sup>	-0.126	-0.091	0.108	-0.045	0.217
EDUCAT													1	0.077	-0.211	0.123	0.114	-0.167	-.309 <sup>*</sup>
DIVERS														1	0.112	0.103	-0.085	-0.040	-.500 <sup>***</sup>
SIZE															1	-0.166	-.299 <sup>*</sup>	.658 <sup>***</sup>	-.535 <sup>***</sup>
LEV																1	0.009	-0.233	-0.008
LIQ																	1	-0.167	0.215
DIVID																		1	-.268 <sup>*</sup>
ISLAMIC																			1

For variables explanations see table 14

#### **6.6.3.1 Multivariate analysis**

This study also presents in table 18 below the regression results for the second model, which shows the analysis of the association between the levels of voluntary risk disclosure and firm value (Based on the accounting measure). As can be observed from the model summary table the model is significant at the (0.000) level with an F value of (3.877) and with an adjusted R square of (0.518 %). Therefore, the explanatory power of the independent and control variables on firm value based on ROA are fairly high. However, the accounting based measure indicates in the table below that there is a positively significant relationship between firm value and the level of voluntary risk disclosure in Saudi listed banks at a value of (0.017). Therefore, this study's hypothesis is accepted. The results are consistent with Botosan and Plumlee, (2002) who found that increased levels of disclosure have a positive economic consequence on profitability and value of the firm. Since, shareholders greatly value the information disclosed in annual reports because by obtaining such information they can make more valuable investment decisions. In addition, information can reduce asymmetric information and agency conflicts between managers and investors. Hussainey and Walker, (2009) clearly stated that voluntary disclosure provides value relevant information for users.

Also, this finding is in line with the limited empirical literature examining the relationship between firm value firm and voluntary disclosure, which documented a positive relationship between the two variables (Baek et al., 2004, Lim et al., 2007; Anam et al., 2011; Sheu et al., 2010; Gordon et al., 2010; Nekhili et al., 2012). This result also supports Gallego-Alvarez et al., (2010) who have reported in their study that disclosure has a positive consequence on shareholder value creation. As the directors of such entity report voluntary information in their annual reports to

communicate signals to investors, therefore such behaviour is likely to impact the stock market value and increase the valuation of a firm.

This study's findings based on the accounting measure is consistent with the signalling theory, which indicates that when a firm's performance is good, directors will signal their firm's performance to their investors and the rest of the market by reporting more information voluntarily. Signalling theory proposes that highly profitable companies will send signals of their quality to investors (Watson et al., 2002). The purpose of such disclosure is to obtain a good market reputation, increase the trade of shares and thus increase firm value (Mohobbot, 2005; Linsley and Shrivs, 2000; 2006; Hassan, 2009). Moreover, Gordon et al. (2010) asserted that voluntary disclosure in annual reports sends a clear signal to the capital market that is likely to increase a firm's present net value and in turn its stock market value. This model's finding is consistent with results of previous studies, which adopted signalling theory (Anam et al., 2011; Sheu et al., 2010; Curado et al., 2011). By reporting more complete and supplying accurate information, an annual report becomes more value relevant for investors. This positive association supports the traditional view that more information complements firms' value.

**Table 18: Regression analysis**

Model	Unstandardized Coefficients		t	Sig.	VIF
	B	Std. Error			
(Constant)	-0.097	0.069	-1.405	0.168	
RISKD	0.049	0.020	2.490	0.017	3.144
CHS	0.000	0.000	1.478	0.148	3.634
NOCH	-0.001	0.000	-1.981	0.055	6.699
BOARDSIZE	0.002	0.002	0.797	0.431	5.436
INDEP	0.001	0.001	0.756	0.455	3.535
NON	0.000	0.001	-0.624	0.536	5.850
ACINDEP	-0.001	0.004	-0.328	0.745	4.822
ACSIZE	0.000	0.001	0.105	0.917	2.570



ACMEET	0.000	0.001	-0.656	0.516	3.201
GENDER	-0.009	0.005	-1.699	0.098	3.524
TENURE	0.002	0.002	1.021	0.314	1.828
EDUCATION	0.003	0.003	1.030	0.310	2.546
DIVERSITY	0.009	0.004	2.096	0.043	6.553
SIZE	0.010	0.009	1.173	0.248	5.690
LEV	-0.001	0.000	-2.208	0.034	1.527
LIQ	0.000	0.001	0.521	0.606	2.075
DIVID	3.768	0.000	0.557	0.581	3.394
ISLAMIC	0.007	0.006	1.188	0.243	7.759
<b>Model Summary</b> Adjusted R Square: 0.518 F value: 3.877 Sig. : 0.000 For variables explanations see table 14.					

The mixed results of this study are in line with Vafaei et al., (2011) and Ahmad, (2015) whom have reported significant and insignificant association between disclosure and firm value in one study. These results confirm the findings of previous studies such as Uyar and Kilic (2012) and Elzahar et al., (2015) who claimed that the association between voluntary disclosure and firm value varies according to the proxy employed for the market value of the firm. Where, this study found in the first model based on the market based measure (MTBV) an insignificant correlation between firm value and the levels of voluntary risk disclosure. While, in the second model which was based on an accounting based measure (ROA) found a positively significant association between the two variables. This variation in the result between the two models can be justified based on the adoption of different measures of firm value (MTBV and ROA). Overall, a healthy amount of disclosure could result in desirable economic consequences such as a decrease in the cost of capital of a company (Beyer et al., 2010) and an increase in the valuation of the firm (Leuz and Wysocki, 2008).

The results approved outcomes of Botosan and Plumlee (2002) who find that the impacts of disclosure are sensitive to the category of disclosure being made. In relation to the insignificant association in the MTBV model, which means that Saudi banks were not able to convey information in terms of the signals related to risk through their annual reports and financial statements, and those risk reports were not useful for stakeholders to evaluate the exact value of the firm. Also this could be justified by the lack of regulations governing risk disclosure for listed firm in the Saudi market. It also may be justified based on the culture of investors and other stakeholders in developing countries as well as GCC such as Saudi Arabia in this case who do not have an interest about the disclosure in general and risks information in particular. Concerning the ROA model, the study's results (the association was positively significant) approves that improved risk disclosure has positive consequences on investor through increasing the shares' liquidity and improving FV as well.

The results show that disclosure of risk practices can increase the valuation of the firm as exhibited in the ROA model. Investors prefer to buy shares from firms that are perceived to have superior risk management capabilities; because better risk management abilities are associated positively with stock returns (Sensarma & Jayadev, 2009). This is consistent with the findings of the current study. Amran et al., (2009) explain this relationship using stakeholder theory: that company report risk disclosure needs to satisfy relevant stakeholders' expectations about company's performance in order to increase its market valuation not to reduce information asymmetries.

## 6.7 Summary

This study empirically examines the relationship between the levels of voluntary risk disclosure and firm value of all Saudi listed banks. The findings of the multivariate analysis demonstrated that there is no association between the levels of voluntary risk disclosure and firm value as measured by the market to book value at the end of the year (MTBV). But, the results generated from the accounting based measure (ROA) show that there is a positively significant association between the levels of risk disclosure and firm value. This view is in line with Gelb and Zarowin (2002) who have documented that companies with high disclosure levels are more likely to demonstrate stronger levels of firm value. In terms of the control variable, the findings indicated that there is a positively significant relationship between firm value and board size, profitability and leverage. This research's outcomes showed that there are negatively significant associations between firm value and education levels and liquidity in the all listed banks in the first model. For the second model control variables BSIZE reported a positively significant relationship with firm value. Where, NOCH and LEV reported a negatively significant link with firm value. However, the rest of the control variables are split between two groups, the first group being negatively insignificant and the second group being insignificantly associated with firm value for both models.

Even though a large body of prior research existed on the economic consequences of general disclosure, no prior research had been conducted on the relationship between risk disclosure and firm value. Therefore, this study contributes to the literature by being the first study to examine the extent of voluntary risk disclosure and its economic consequences as evidenced in the annual reports of banks. It also contributes to the general accounting disclosure literature and in particular

contributes to the literature on risk disclosure in developing economies. In particular in the GCC states since no prior research has examined such relationships. In addition, it furthers the understanding of the role of accounting information in relation to market valuation of firms. Such studies about these markets are necessary and are fundamental in relation to ameliorating the weak transparency and disclosure situation by attracting the attention of regulatory institutions and corporation directors (Uyar and Kilic, 2012).

This study has several important implications for banks' investors, regulatory bodies and any other interested groups on the importance of corporate voluntary risk disclosure and its economic consequences and can be used to increase the value relevance in the banking sector. It also informs regulators about the current level of risk disclosure in all Saudi listed banks as well as informing them of the influence risk disclosure has on the value of the firm. These institutions are expected to guide firms toward the best practices of disclosures since firms look for such guidance by performing motivating role in this new era of information disclosure. It also calls on to managers who prefer to withhold from offering information to shareholder to be more transparent if they prefer to increase their banks market value and entice more investment.

Chapter Seven provides the concluding remarks of this thesis. It provides a summary of this study's overview. It also presents a summary of the key findings of the research and discusses their implications. It includes a summary of possible limitations of the study and highlights several avenues of potential future research.

## 7 Chapter Seven: Conclusion

The principal aim of this chapter is to highlight the main conclusion of this investigation. This chapter is divided into five sections: an overview of the study; a summary of the key findings; a description of the contributions of the research to knowledge and to the practice of risk disclosure; an explanation of some of the implications of the study; the limitations of the study; and finally, recommendations for further research in the field of risk disclosure.

### 7.1 Overview

This study has examined current corporate voluntary risk disclosure practices in all banks listed on the Saudi Exchange Stock Market (Tadawul) and attempted to ascertain whether the level of voluntary risk disclosure in the annual reports of Saudi listed banks changed over the five year period under investigation. Also, this study examined whether the Saudi banks showed any variations in attitude towards voluntary risk reporting or established any limitations on voluntary risk disclosure practices. This study examined risk disclosure over five years to investigate present practices and initiate trends in risk disclosure practices.

The accounting regulations and rules for banks have developed rapidly over the past few years in relation to risk taking and uncertainty. Also, due to the global financial crises, a number of regulatory reforms have been introduced, for example the International Financial Reporting Standard 7 Financial Instruments and BASEL II, which includes greater measures on risk transparency and disclosure. It also underlines the significance of informative risk disclosure in the banking industry for the overall enhancement of market discipline. The disclosure of informative risk information in banks has been emphasized as being a successful instrument for

cluding banking catastrophes (Financial Stability Board, 2012). Also, constructive and lengthy discussions by the office of financial research (OFR) have taken place in order to enhance the quality of financial reporting and satisfy the information needs of investors. Further, accounting institutions have developed a number of measures and frameworks to encourage risk disclosure in the annual reports of institutions.

Thus, there is a need for more risk disclosure investigations to fill the gap in the literature (ICAEW, 2002, 2003, 2004). Furthermore, there has been an increased attention on financial reporting in the accounting literature, and accounting standard setters have called for improved financial reporting so as to satisfy the information demands of investors and other interested user groups. The latter value annual reports since they are a prime source of risk/financial information and a means of communication; however, there are still demands for more timely disclosure and, in particular, demands for more forward-looking information. Thus, there is a need to increase the level of understanding of risk disclosure and risk management among capital market participants particularly in Saudi Arabia.

The current study has offered a clearer understanding of the levels of voluntary risk disclosure in Saudi Arabian banking industry by examining the levels of risk disclosure in both set of banking systems in the kingdom; namely Islamic and non-Islamic. Secondly, this study links the levels of annual report voluntary risk disclosure with some corporate and demographic characteristics to investigate what encourages banks to go beyond disclosure requirements and release further information needed by all users of annual reports.

Thirdly, this study also explored the economic consequences of increasing voluntary risk information in the annual reports by empirically examining the effect of voluntary

risk disclosure levels on banks' firm value. Evidently, augmented disclosures improve stock market liquidity and decrease the cost of capital due to decreased transaction costs and increased demand for securities, hence enhancing firm value (Easley and O'Hara, 2004; Lambert et al., 2007). However, empirical evidence has yielded a mixture of results (Hassan et al., 2009; Sheu et al., 2010; Vafaei et al., 2011; Nekhili et al., 2012; Uyar and Kilic, 2012). Thus, the present study strived to conduct a comprehensive investigation on the impact of voluntary risk disclosure on firm value in the Saudi banking system. This investigation strived to advance the knowledge in this area as well as contributes to the above three arguments.

## **7.2 Contributions**

This study bridges a gap between the three broad strands related to existing body of literature on disclosure (measures the levels of voluntary risk disclosure; explores the determinants of risk disclosure and investigates the economic consequences of risk disclosure).

To the first strand, to the best of the researcher knowledge, there is not a single study examining the levels of voluntary risk disclosure in the context of Saudi Arabia in general or in both type of banking systems namely Islamic and non-Islamic. This investigation employs two comprehensive risk disclosure indices which were developed solely for the purpose of measuring the level of voluntary risk disclosure in Saudi listed banks. The indices included between them a total of 67 items that were expected to be published in the annual reports of the sample banks. The non-Islamic risk disclosure index included 54 items, which were divided across 8 categories: accounting policies, financial and other risks, derivative hedging and general risks information, financial instruments, reserves, segment information, business risk and compliance with regulations. The Islamic risk disclosure index

included 67 items, which were distributed across 10 categories: accounting policies, financial and other risks, derivative hedging and general risks information, financial instruments, reserves, segment information, business risk, compliance with regulations, Islamic bank risk characteristics and Islamic standards. This categorization of the two crafted risk disclosure indexes is due to the nature of the listed Saudi banks, where listed banks represent two sets of banks, namely Islamic banks and conventional banks, which are vigorously offering banking services in Saudi Arabia.

Also, the current study is of major contribution since it differs from Mousa and Elamir (2013); Mokhtar and Mellett, (2013) and Abdallah, et al., (2015), who studied a single attribute of corporate governance characteristics. And differs from Amran, Bin and Hassan, (2009); Hassan, (2009); Abdallah and Hassan, (2013); Al-Shammari, (2014) who did not explore corporate governance nor demographic attributes by comprehensively examining corporate risk disclosure and exploring demographic characteristics. Moreover, not a single study has examined corporate governance as a determinant of risk disclosure in the Saudi context. Also, not a single study of the above-mentioned has investigated the demographic traits of the top team management in emerging markets. Also, this investigation differs from all of the above-mentioned studies by examining the demographic characteristics of the top board of directors as well as incorporating the upper echelon theory into the risk reporting practice in the banking industry. Furthermore, this research differs from (Amran, Bin and Hassan, 2009; Hassan, 2009; Abdallah and Hassan, 2013; Mousa and Elamir, 2013; Mokhtar and Mellett, (2013); Al-Shammari, 2014; Abdallah, et al., 2015) by being the first study to examine risk disclosure over a period of five years in developing economies.



To the third strand, previous studies have focused on the impacts of increased disclosure on the cost of capital (Elzahar et al., 2015); analysts' forecasts (Wang et al., 2013); financial performance (Wang et al., 2008); and share price anticipation of earnings (Hussainey and Walker, 2009). This stream of literature is focused mainly on the international firms and conventional banks in developed countries. There have been very few studies that measured the association between disclosure and FV (Uyar and Kilic, 2012). Risk disclosure investigations are still missing. However, exploring this form of economic consequences on risk disclosure has not yet been empirically examined in Saudi banks. According to Hassan et al., (2009) this association is still worthy of empirical examination.

This study also differs from all previous risk disclosure studies (Cabedo and Tirado, 2004; Deumes, 2008; Deumes and Knechel, 2008; Rajab and Schachler, 2009; Hill and Short, 2009; Taylor, Tower and Neilson, 2010; Elshandidy, Fraser and Hussainey, 2015; Abdallah, Hassan and McClelland, 2015; Hassan et al., 2009; Healy et al., 1999; Leuz and Verrecchia, 2000; Baek, Kang and Park, 2004; Vafaei et al., 2011; Da Silva and Alves, 2004; Hassan et al., 2009; Uyar and Kilic, 2012; Elzahar et al., 2015; Mohobbot, 2005; Konishi and Ali, 2007;) by being the first study to examine the level of voluntary risk disclosure in relation to firm value. Also, the current research differs from all of the above-mentioned studies by being the first study to examine voluntary risk disclosure in relation to firm value in listed banks over a five-year period.

This study also contributes to the understanding of the nature of voluntary risk disclosures in both banking systems in Saudi Arabia. It contributes to the literature on the risk disclosure practices between Islamic and non-Islamic banks in the most rapidly developing emerging market. It also contributes to the existing risk reporting

literature by being the first to investigate the levels and a combination of determinants of voluntary risk disclosure practices in all Saudi listed banks. In particular it advances and contributes to the literature on voluntary risk disclosure in developing economies by empirically examining the link between voluntary risk disclosure levels and the market valuation of all listed banks in Saudi. This study contributes to risk disclosure theories by employing the upper echelon theory in examining the determinates and their effects on risk disclosure practices. Further, this is the only study that examines the demographic traits of the board of directors in developing countries. In particular, this study contributes to the board demography, corporate governance and risk disclosure literature by theoretically justifying and empirically investigating the implications of such determinants and theories in terms of risk disclosure in the banking industry. Furthermore, it contributes to understanding the role of the accounting information in relation to market valuation of the firm. Such studies about such markets are required and are fundamental in enhancing the weak transparency and disclosure situation by enticing the attention of regulatory institutions and corporate managers (Uyar and Kilic, 2012).

In brevity, this investigation makes major contributions to the literature and increases the knowledge on risk disclosure and reporting practices in the annual reports of all listed Saudi banks, namely Islamic and non-Islamic banks. It also makes a healthy contribution to the discussion on the levels, type, determinants, economic consequences and risk disclosure in banks annual reports. Augmentations in risk reporting in the annual reports could be seen as evidence of the international effort to regulate risk reporting in banks.

### 7.3 Empirical Findings

The outcomes of the research established that the amount of voluntary risk disclosure tended to increase over the period, reflecting the increasing pressure from regulators and users during this time. There were variations in the reporting practices across the sample banks in terms of the total voluntary risk disclosure scores. This could be attributed to the absence of any kind of comprehensive standards or particular regulations regarding risk reporting and management in Saudi Arabia. Some banks did not report risk information as such but rather reported it as a part of their regular financial disclosure requirement. They were thus not completely following appropriate risk reporting procedures. This research used a content analysis approach that incorporated a checklist of items as a means of capturing the level of voluntary risk disclosure.

In particular, the empirical findings of this study show that Islamic banks report less risk information than non-Islamic banks. However, the analysis reveals that both types of banks report approximately the same amount of risk information regarding the banks' non-Islamic risk related items. Further, the empirical analysis shows that Islamic banks report very little concerning Islamic risk related disclosure items. Based on this, the following conclusion can be made: Islamic banks disclose less risk information than their non-Islamic counterparties. This outcome could be a reflection of the inherently conservative nature of the principles that guide Islamic financial institutions, which provide financial products that aim to serve the interests of society more broadly than do non-Islamic banks, which are more likely to focus upon profit maximization.

The empirical findings also show that banks of high outsider ownership, high profitability, high regularity of audit committee meetings and a mixture of gender on

the board are more likely to demonstrate higher levels of voluntary risk disclosure. Contrastingly, voluntary risk disclosure is negatively affected by the levels of education of board members. As can be seen from the empirical findings, external ownership, audit committee meetings, gender diversity, education levels, profitability are primary determinants of voluntary risk disclosure practices in Saudi listed banks, while the rest of the independent variables of both corporate governance mechanisms and demographic traits are insignificantly correlated with the levels of voluntary risk disclosure practices in Saudi.

Additionally, the findings also show no association between voluntary risk disclosure levels and firm value as measured by the market to book value at the end of the year (MTBV). However, based on the accounting based measure (ROA) the findings demonstrated a positively significant association between the levels of voluntary risk disclosure and firm value.

In terms of the control variable the MTBV, the findings indicate CHS, BSIZE, PROF and DIVID are statistically significant and positively associated to FV, while EDUC is statistically significant and negatively correlated to FV. While, the findings the second model control variables show that board independence, audit committee independence, diversity and type of bank (Islamic vs non-Islamic) have positively significant association with firm value. Where, outside ownership reported a negatively significant link with firm value. However, the rest of the control variables are split between two groups, the first group being negatively insignificant and the second group being insignificantly associated with firm value for both models.

These findings indicate that the association between voluntary risk disclosure and all of the variables (governance characteristics, demographic traits and firm-specific

attributes as control variables) cannot be the same in all capital markets since it relies on a number of factors: first, theoretical justification, where different investigations use different theories and a set of different hypothesis; second, the measure, where some variables can be measured using different measures; third, sample size, for example, small vs. large; and fourth, sector, for example financial vs. non-financial. It can accordingly be concluded that the association between risk disclosure and all of the variables remains worthy of investigation. This conclusion is supported by the mixed outcomes of previous researches.

## **7.4 Implications**

### **7.4.1 Theoretical Implications**

This study has pioneered a novel contribution to the field of disclosure by incorporating the upper echelons theory into investigating disclosure. Particularly in this study this theory is extended into exploring the determinants of voluntary risk disclosure in all Saudi banks. A theory which has only been employed in fields other than disclosure. For instance, Peterson et al. (2003) used the upper echelons theory when examining the determinants of organisational performance, while Tihanyi et al. (2000) used it when exploring the effects of firm international diversification and Mutuku et al. (2013) employed it when studying the quality of decisions and performance. To the best of the researcher's knowledge, no prior research has investigated disclosure in relation to the upper echelons theory. Hence, this is the first study to extend the employment of the upper echelons theory into the area of disclosure. Where, in this investigation a fourth dimension (disclosure) was added to the original framework of the upper echelons theory, which can be directly affected by the upper echelons theory characteristics or indirectly by the outcomes of the overall performance of the company, where in some cases risk disclosure would

mean survival for a bank. This model also plays a vital part in determining key institutional effects, such as the provision of risk disclosure. It also grants us the opportunity to investigate the core determinants of board demography in relation to risk disclosure.

This study has also contributed to the wide literature and discussion on a number of theories. The outcomes of the undertaken studies have particularly contributed to corporate risk disclosure theories in the developing world by examining risk disclosure levels, determinants and economic consequences in Saudi listed banks. According to signalling theory, larger companies rely more on external finance. Hence, they are motivated to release more risk information in order to send a good signal to investors and creditors regarding their ability to manage risk. The results are in line with signalling theory, where this study found that larger banks tend to disclose more voluntary risk information than smaller banks, confirming the above argument. Also this thesis outcome is concurrent with signalling theory, whereby managers tend to provide more risk management information to send a good signal to debt holders regarding corporate ability to meet obligations (Oliveira et al., 2011b). Where, this study reported that the risk disclosure levels decreased in tandem with the leverage ratio year by year over the entire sample period.

The influence of risk disclosure on firm value can also be explained based on signalling theory. Based on the MTBV model the results indicate that there is an insignificant relationship between firm value and the levels of voluntary risk disclosure in Saudi listed banks. This outcome is inconsistent with the signalling theory, which indicates that when a firm's performance is good, directors will signal their firm's performance to their investors and the rest of the market by reporting more information voluntarily, whilst directors of firms that are performing badly will

not do so. However, the finding based on the accounting measure is consistent with the signalling theory argument. Also, signalling theory proposes that highly profitable companies will send signals of their quality to investors; this has been confirmed by the results of the second model.

Also, the current study contributed to the legitimacy theory literature where this theory is established upon the idea that all corporations have a social contact; with their community; where they come into an agreement to conduct their activities in a manner acceptable and desired by the larger community. Legitimacy has come to stress how firms will react to community expectations. Where, this study reported that Islamic banks' report low levels of risk disclosure regarding Islamic values. The weaknesses of disclosure about such values effect the investors' as well as stakeholders' perceptions towards the differences between the two sets of banks. This outcome is inconsistent with the argument of legitimacy theory that expects banks' to act in accordance with the values of the community. For example, stakeholders who choose to deal with Islamic banks expect banks to fully comply with the Islamic values, and disclosure information concerning such actions.

Moreover, the current thesis findings contribute to both agency theory and information asymmetry theory, which both propose that directors are only motivated to provide higher levels of voluntary risk disclosure when there is a widely dispersed ownership structure to mitigate information asymmetries owing to external pressures. By reporting that ownership structure has a significant influence on the levels of voluntary risk disclosure, confirming the above argument. Also, this thesis contributes to the agency theory literature, by reporting that managers of banks with high profitability tend to provide more risk information in order to justify their present performance to the shareholders as well as to justify their compensations to the firm'

owners. This justification is concurrent with agency theory which argues that corporate managers of profitable corporations are driven to report more information to increase their compensation.

Furthermore, outsiders cannot observe internal control activity and conduct in some circumstances due to the lack of regulations and guidance on internal control activity and conduct. Therefore, shareholders tend not to have a full understanding of the nature and scope of internal control systems. This leads to shareholders having difficulty appreciating managers' efforts to counter risks. However, the findings show that banks with high frequency of audit committee meetings are more motivated to disclose more voluntary risk information. This outcome is consistent with the agency theory, whereby internal and external monitoring practices complement each other in reducing agency conflicts and information asymmetry problem between different types of stockholders.

This study contributes to the stakeholder theory, which states that banks always deals with many users as their stakeholders. Thus, banks must uphold good communication channel with their stakeholders by revealing their performance timely and transparently. The results show that disclosure of risk practices can increase the valuation of the firm as exhibited in the ROA model. Investors prefer to buy shares from firms that are perceived to have superior risk management capabilities; because better risk management abilities are associated positively with stock returns. This is consistent with the findings of the current study as this relationship can be explained using stakeholder theory where banks disclose risk disclosure information to satisfy relevant stakeholders' expectations about a bank's performance in order to increase its market valuation and not to reduce information asymmetries.



#### 7.4.2 Practical implications

Examining the current level of voluntary risk reporting in annual reports can help financial reporting experts determine whether risk disclosure in annual reports is an area of best practice for corporate risk communication. Therefore, this investigation could be of great help to banks, managers, investors, regulators and any interested user groups with a keen interest in corporate reporting. Also, all users of annual financial reports might wish to expand their examination and manually confirm disclosure exercises made by their banks by looking at the current investigation.

Increasing demand from shareholders for applicable risk reporting exercises has confirmed the necessity for tighter risk reporting procedures and regulations to re-establish confidence in capital markets and in corporate reporting in general. The findings of this examination lead to the conclusion that risk information requirements made by investors and all stakeholder groups are not fully satisfied at the current time in Saudi banks' annual reports since the level of the reported voluntary risk disclosure is still below the level reported by other investigation done elsewhere (Amran et al., 2008).

Hence, policy makers, accounting organisations, accounting institutes and the academic community are mindful of the importance of the provision of rules and guidance on how to enhance risk reporting practices. Policy makers should develop the means to improve banks' participation in risk disclosure practices. For example, it would be wise to concentrate their efforts on developing a framework for risk reporting practices and guidelines for banks to follow in order to offer appropriate risk information that can be employed by shareholders when assessing the risk profile of the banks.

It also has been established that there is a need to push banks to offer more comprehensive statements on business risk factors since banks are by nature risk management entities, with emphasis on specific risks that are associated with a particular bank. Regulators have to ensure that they encourage banks to make an effort to provide better quality risk information in their annual statements. Banks should also report the potential impact, the details of risk management and the mitigation methods used. Mandating risk reporting practices could however have limited influence on risk reporting quality and could impose adversarial disclosure motivations as well.

This investigation results have a number of important implications for regulatory bodies in the Kingdom of Saudi Arabia as they attempt to ensure information adequacy and the increased efficiency of the most rapidly developing capital market. Particularly, the reported results should be useful to accounting and risk regulatory bodies by providing information about the inadequacies of risk reporting in Saudi banking sector. Regulatory institutions should be above all concerned about the disclosure needs of users. Therefore, SAMA, SOCOPA and CMA are called on to find solutions to improve the reporting of risk information in the Saudi banking industry. Specifically, this study is significant in that it sheds light on the voluntary risk-disclosing practices of banks that operate in an environment that is often considered to be opaque. Saudi Arabia scored zero on the secrecy vs. transparency measure in Hofstede's cultural dimensions. Also, managers could use the results of this study to compare the amount of information reported in their annual reports with other banks to ensure financing. The study also provides information for managers to keep investors satisfied about the risk that their banks encounter. Investors may use the findings for understanding risk disclosure behaviour of listed banks on Tadawul.

It informs investors about the characteristics of risk information in their annual reports.

Secondly, the findings of this study also provide important implications, by supplying banks' stockholders, regulatory bodies and any other interested groups about the importance of corporate governance and demographic determinants, which can be used to augment voluntary risk reporting in the banking industry in an effort to ensure information adequacy and increased market efficiency. The reported findings should be useful to accounting and risk regulators by providing information about the inadequacies of risk disclosure in Saudi and a more complete picture of risk components and determinants in listed banks. Also such findings are useful for exploring corporate governance attributes and demographic traits which are likely to influence risk reporting levels. These implications could extend to the corporate governance, board demography and risk disclosure literature by theoretically justifying and empirically investigating the implications of such determinants and theories in regards to voluntary risk disclosure in the banking sector. This focus is significant because it provides insights into the determinants of voluntary risk disclosure in banks that operate in an environment regarded as being invariably opaque.

Thirdly, this study has several important implications for banks' investors, regulatory bodies and any other interested groups on the importance of corporate voluntary risk disclosure and its economic consequences and can be used to increase the value relevance in the banking sector. It also informs regulators about the current level of risk disclosure in all Saudi listed banks as well as informing them of the influence risk disclosure has on the value of the firm. These institutions are expected to guide firms toward the best practices of disclosures since firms look for such guidance by

performing motivating role in this new era of information disclosure. It also calls on to managers who prefer to withhold from offering information to shareholder to be more transparent if they prefer to increase their banks market value and entice more investment. This can be used to increase the value relevance in the banking sector.

These conclusions imply that regulations should be improved so as to provide clear guidance on risk disclosure practices and risk management. Additionally, mandating risk disclosure could reduce the motivation for managers to improve disclosures; hence, when presenting rules on disclosure, regulators have to carefully weigh the costs and benefits of disclosure for the banks against the information needs of the investors and interested user groups so as to set effective rules for risk disclosures. A typical model would be the concept of “safe harbour” in the Company Act 2006 in the UK, which inspires companies to report more information details, specifically forward-looking and risk disclosure (ASB, 2007, p.3), without the risk of litigation costs arising.

## **7.5 Limitations**

This research widens our knowledge on risk disclosure levels and practices and the empirical knowledge on disclosure in general and risk disclosure quantity in particular. Further, it increases the knowledge on the determinants and economic consequences of voluntary risk reporting practices, for instance demographic traits, corporate governance and firm value.

However, there is no research without any limitations, and this investigation is no exception. First, this study used content analysis to measure the level of voluntary risk disclosure through creating risk disclosure indices by simply adding up the number of words, which have been predetermined in the risk disclosure checklists. The content analysis approach in that interpretation was potentially subjective. Such

subjectivity is inherent in any content analysis research and cannot be completely removed. However, the research attempted to minimise it by employing validity and reliability measures. An interrelated limitation is that the study explores disclosure quantity by counting the number of words reported in annual reports but does not investigate quality. The latter would be a fruitful area of research.

Second, this study relied only on annual reports to measure voluntary risk disclosure levels. However, information about risk can be provided in means other than annual reports, such as interim reports, press-releases, conference calls, web sites or prospectuses. These means, which might be valuable for decision-making processes, were not reflected in this study. It is likely that banks offer additional risk disclosure via these platforms, which could impact upon the amount of risk information available in the annual reports. Hence, the data is to some degree incomplete and thus not definitive regarding the overall risk disclosure levels. However, these other sources of communications could therefore provide a source for significant data collection for future research on voluntary risk disclosure. Such results could determine similarities and differences across both types of data sources.

Third, this study ignored the joint influence of corporate governance, board demography and corporate-specific characteristics on voluntary risk disclosure reporting by financial and non-financial institutions. Future studies may examine both financial and non-financial institutions to provide a bigger picture of the impact of corporate governance, board demography and firm specific characteristics on the levels of voluntary risk disclosure in Saudi Arabia. This investigation only focused on a single setting, namely Saudi Arabia. Therefore, an extension of this investigation may be to compare risk disclosure practices between the emerging markets of the

Middle East and Saudi Arabia. Such investigation would offer valuable insights and add to the literature on disclosure.

Fourth, the sample of this study consisted only of listed Saudi banks, and thus the results may not be valid for other sectors, such as manufacturing and merchandising. Also, the small sample size of this study may limit the generalisability of the study, despite the sample being all available banks on the Saudi stock market during the development of this study. Another related limitation could be the sample period, which was restricted to only five years in order to include all the available data and banks. In spite of the noted limitations, the study did offer important insights into the levels of voluntary risk disclosure practices, determinants and consequences in Saudi Arabia. Also, in spite of the noted limitations, this study is hoped to inspire further investigations in this area of research, particularly in emerging markets.

## **7.6 Suggestions for Further Research**

This study focused on the quantity of voluntary risk disclosure and ignored the quality of voluntary risk disclosure. Therefore, latter area could be the subject of further empirical research in emerging markets. Also, any further research could investigate the levels, determinants and economic consequences of risk disclosure practices in a cross country setting to better understand how disclosure practices in different regulatory settings could affect the extent of risk disclosure. This study only examined banks. Therefore, the non-financial sector and service industry could offer fruitful areas for further studies.

This study also suggests a number of other openings for future research. In the field of corporate risk disclosure in the Middle East, research could extend this study over a longer period of time or alternatively involve comparative studies with other Arab countries, such as the Gulf Co-Operation Council (GCC) member states. Such

studies could investigate the changes in corporate risk disclosures across time and compare potential variations in nations with to a certain extent similar social, political and economic systems. This may also help researchers to understand why managers choose to disclose certain aspects of risk information and why they withhold other aspects. Additional research could also be undertaken to examine the economic consequences of risk reporting in annual reports (e.g. the effect on prices leading earnings, cost of capital, analyst following and characteristics of analysts' forecasts). Although a large body of prior research exists on the economic consequences of general disclosure, there is no prior research on the relationship between risk disclosure and firm value apart from this study. Therefore, this could be a fruitful area of research. Also, the usefulness of risk disclosure could be further researched by investigating the cost of capital and annual reports' risk disclosure and the impact of timely risk disclosure on stock market volatility and share price movement.

It would be of great importance to investigate the determinants and economic consequences of risk disclosure within both types of banking systems in Saudi Arabia namely Islamic vs Non-Islamic to identify what drives risk disclosure levels and to see whether the levels of risk disclosure effect the market valuation or not in both sets of banks. This kind of investigations will allow annual reports users to identify the core determinates of Islamic banks risk disclosure vs non-Islamic banks and at the same time will allow them to identify the potential economic consequences of such bank's risk disclosure on an individual level rather than as a whole industry which this study has successfully accomplished.

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## Appendices

### Non-Islamic Risk-Related Disclosure Index

Category and type of reported risks	References
<b>Accounting Policies</b>	
Risk Management	Abdullah et al., 2015; Alfredson et al., 2007; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000;
Objective of Holding Derivatives/ instruments	Alfredson et al., 2007; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Abdullah et al., 2015;
Use of Estimates	Abdullah et al., 2015; Alfredson et al., 2007; ICAEW, 1997, 2000; Hassan, 2009
Collateral Assets against Loans	Alfredson et al., 2007; Abdullah et al., 2015; Hassan, 2009
Financial Assets Impairment	Abdullah et al., 2015; Alfredson et al., 2007; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Hassan, 2009
Other Assets Impairment	Alfredson et al., 2007; Abdullah et al., 2015; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Hassan, 2009
Contingent Liabilities	Alfredson et al., 2007; ICAEW, 1997, 2000; Abdullah et al., 2015; Hassan, 2009
Contingent Assets	Alfredson et al., 2007; ICAEW, 1997, 2000; Abdullah et al., 2015; Hassan, 2009
Detailed risk management	Lopes and Rodrigues, 2007; Alfredson et al., 2007;
Contingency	Abdullah et al., 2015; Hassan, 2009;
<b>Financial and other risks</b>	
Pricing Risk	ICAEW, 1997, 2000; Abdullah et al., 2015, Lipunga, 2014;
Commodity risk	Abdullah et al., 2015;
Liquidity risk	Abdullah et al., 2015; Alfredson et al., 2007; ICAEW, 1997, 2000; Lipunga, 2014; Hassan, 2009
Credit risk	Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Lipunga, 2014
Capital Adequacy	Lipunga, 2014; Abdullah et al., 2015
Changes in Interest Rates	Abdullah et al., 2015
Credit Risk Exposure	Abdullah et al., 2015
Operational Risk	Abdullah et al., 2015; ICAEW, 1997, 2000; Lipunga, 2014
Insurance Risk	Abdullah et al., 2015; ICAEW, 1997, 2000
Market Risk	Abdullah et al., 2015; Ahmed et al., 2004; Lipunga, 2014
Interest Rate	Lipunga, 2014; Abdullah et al., 2015;
Currency risk	Lipunga, 2014
Exchange Rate	Abdullah et al., 2015
Sustainability Risk	
Sensitivity Analysis	Abdullah et al., 2015; Ahmed et al., 2004
<b>Derivatives hedging and general risks</b>	
Cash flow Hedge	Alfredson et al., 2007; Lopes and Rodrigues, 2007; Abdullah et al., 2015
Equity Risk	Abdullah et al., 2015
Customer Satisfaction	Abdullah et al., 2015
Competition (Service Market)	Abdullah et al., 2015; ICAEW, 1997, 2000
Natural Disasters	ICAEW, 1997, 2000; Abdullah et al., 2015; Lipunga, 2014
Communications	Abdullah et al., 2015
Outsourcing	Abdullah et al., 2015
Reputation	Abdullah et al., 2015; Lipunga, 2014
Reputation risk	Abdullah et al., 2015; Lipunga, 2014
Physical disasters (Explosions and Fire)	Lipunga, 2014
Changes in Technology	Abdullah et al., 2015;
<b>Financial instruments</b>	
Derivatives	Hassan, 2009; Abdullah et al., 2015
Cumulative Change in Fair value	Lopes and Rodrigues, 2007; Alfredson et al., 2007; Abdullah et al., 2015;
<b>Reserves</b>	
General Reserves	Hassan, 2009; Abdullah et al., 2015
Statutory Reserves	Hassan, 2009; Abdullah et al., 2015
Other Reserves	Hassan, 2009; Abdullah et al., 2015
<b>Segment information</b>	
Geographical Concentration	Alfredson et al., 2007; Abdullah et al., 2015; ICAEW, 1997, 2000;

Customer Concentration	Hassan, 2009; Abdullah et al., 2015; ICAEW, 1997, 2000
<b>Business risk</b>	
General Financial Problems	Hassan, 2009
Regional Financial Problems	Hassan, 2009
Political risk	Abdullah et al., 2015
Diversification	
Performance	Abdullah et al., 2015;
<b>Compliance</b>	
Compliance with listing rules	Lipunga, 2014
Compliance with financial regulations	Lipunga, 2014
Compliance with companies act requirements	Lipunga, 2014
Compliance with other regulations and laws	Lipunga, 2014
Litigation risk	Lipunga, 2014
Health and Safety	Lipunga, 2014

## Islamic Risk-Related Disclosure Index

Category and type of reported risks	References
<b>Accounting Policies</b>	
Risk Management	Abdullah et al., 2015; Alfredson et al., 2007; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000;
Objective of Holding Derivatives/ instruments	Alfredson et al., 2007; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Abdullah et al., 2015;
Use of Estimates	Abdullah et al., 2015; Alfredson et al., 2007; ICAEW, 1997, 2000; Hassan, 2009
Collateral Assets against Loans	Alfredson et al., 2007; Abdullah et al., 2015; Hassan, 2009
Financial Assets Impairment	Abdullah et al., 2015; Alfredson et al., 2007; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Hassan, 2009
Other Assets Impairment	Alfredson et al., 2007; Abdullah et al., 2015; Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Hassan, 2009
Contingent Liabilities	Alfredson et al., 2007; ICAEW, 1997, 2000; Abdullah et al., 2015; Hassan, 2009
Contingent Assets	Alfredson et al., 2007; ICAEW, 1997, 2000; Abdullah et al., 2015; Hassan, 2009
Detailed risk management	Lopes and Rodrigues, 2007; Alfredson et al., 2007;
Contingency	Abdullah et al., 2015; Hassan, 2009;
<b>Financial and other risks</b>	
Pricing Risk	ICAEW, 1997, 2000; Abdullah et al., 2015, Lipunga, 2014;
Commodity risk	Abdullah et al., 2015;
Liquidity risk	Abdullah et al., 2015; Alfredson et al., 2007; ICAEW, 1997, 2000; Lipunga, 2014; Hassan, 2009
Credit risk	Lopes and Rodrigues, 2007; ICAEW, 1997, 2000; Lipunga, 2014
Capital Adequacy	Lipunga, 2014; Abdullah et al., 2015
Changes in Interest Rates	Abdullah et al., 2015
Credit Risk Exposure	Abdullah et al., 2015
Operational Risk	Abdullah et al., 2015; ICAEW, 1997, 2000; Lipunga, 2014
Insurance Risk	Abdullah et al., 2015; ICAEW, 1997, 2000
Market Risk	Abdullah et al., 2015; Ahmed et al., 2004; Lipunga, 2014
Interest Rate	Lipunga, 2014; Abdullah et al., 2015;
Currency risk	Lipunga, 2014
Exchange Rate	Abdullah et al., 2015
Sustainability Risk	
Sensitivity Analysis	Abdullah et al., 2015; Ahmed et al., 2004
<b>Derivatives hedging and general risks</b>	
Cash flow Hedge	Alfredson et al., 2007; Lopes and Rodrigues, 2007; Abdullah et al., 2015
Equity Risk	Abdullah et al., 2015
Customer Satisfaction	Abdullah et al., 2015
Competition (Service Market)	Abdullah et al., 2015; ICAEW, 1997, 2000
Natural Disasters	ICAEW, 1997, 2000; Abdullah et al., 2015; Lipunga, 2014
Communications	Abdullah et al., 2015

<b>Category and type of reported risks</b>	<b>References</b>
Outsourcing	Abdullah et al., 2015
Reputation	Abdullah et al., 2015; Lipunga, 2014
Reputation risk	Abdullah et al., 2015; Lipunga, 2014
Physical disasters (Explosions and Fire)	Lipunga, 2014
Changes in Technology	Abdullah et al., 2015;
<b>Financial instruments</b>	
Derivatives	Hassan, 2009; Abdullah et al., 2015
Cumulative Change in Fair value	Lopes and Rodrigues, 2007; Alfredson et al., 2007; Abdullah et al., 2015;
<b>Reserves</b>	
General Reserves	Hassan, 2009; Abdullah et al., 2015
Statutory Reserves	Hassan, 2009; Abdullah et al., 2015
Other Reserves	Hassan, 2009; Abdullah et al., 2015
<b>Segment information</b>	
Geographical Concentration	Alfredson et al., 2007; Abdullah et al., 2015; ICAEW, 1997, 2000;
Customer Concentration	Hassan, 2009; Abdullah et al., 2015; ICAEW, 1997, 2000
<b>Business risk</b>	
General Financial Problems	Hassan, 2009
Regional Financial Problems	Hassan, 2009
Political risk	Abdullah et al., 2015
Diversification	
Performance	Abdullah et al., 2015;
<b>Compliance</b>	
Compliance with listing rules	Lipunga, 2014
Compliance with financial regulations	Lipunga, 2014
Compliance with companies act requirements	Lipunga, 2014
Compliance with other regulations and laws	Lipunga, 2014
Litigation risk	Lipunga, 2014
Health and Safety	Lipunga, 2014
<b>Islamic Bank Risk characteristics</b>	
Mudarabah risk	IFSB 2007
Musharakah risk	IFSB 2007
Murabaha risk	IFSB 2007
Ijarah risk	IFSB 2007
Qard Hasan risk	IFSB 2007
Al-Istisna risk	IFSB 2007
Salam risk	IFSB 2007
Sukuk risk	IFSB 2007
Wakalah risk	IFS B2007
<b>Islamic Standards</b>	
Unusual supervisory restrictions	AAIOFI 2014
Earnings or expenditures prohibited by shari'a law	AAIOFI 2014
The method used by the Islamic bank to allocate investment profits (loss) between unrestricted investment account holders or their equivalent and the Islamic bank as a Mudarib or as an investment with its own funds	AAIOFI 2014
Statement of restricted investments	AAIOFI 2014

### A chorological summary of all empirical risk disclosure studies in the developed world

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
ICAEW, 1999	1998	UK	Content analysis, Benchmark study	14	-----	-----	-----	-----	Companies provide some risk information voluntarily. Regulatory reform in the UK includes risk related requirements. Best practice would be achieved within the current reform. Companies need to explain risks, action and measurements applied.	-----
Solomon, Solomon and Norton, 2000	1999	UK	Questionnaire	Total 552 (97 satisfactorily completed)	-----	Attitudes of the UK institutional investors towards risk disclosure	Environment Level of risk disclosure Investor's attitudes Location Form of risk disclosure Risk disclosure preference	Financial	Conceptualization of a framework to report risk information. Risk disclosures were inadequate. Managers should provide detailed information about risk exposures and strategies to mitigate them. All types of risk should be disclosed equally. Increased risk disclosures help in portfolio investment decision. Risk disclosure is an important issue within corporate governance. Voluntary framework of disclosure should be maintained and include risk disclosure.	Their methodology presents a static picture of the state of emerging issues in CG. Research may indicate more of the dynamic nature of the risk disclosure issue.
Carlton, Loftus and Miller, 2003	1998	Australia	00000000	54	-----	Risk related disclosure - Identification and management of risks	Nature of operations Risk concentrations Estimates used in financial statements Insurance and uninsured risks Treasury Risks	Nonfinancial	Diverse application of risk reporting requirements related to financial instruments. Significant variation in the content and level of detail in the disclosures on the identification and management of risks.	This study is limited by the reliance on public disclosures for information about risks known to management and, consequently, ignorance of undisclosed risks.
Linsley and Shrides, 2003	2000	UK, Germany	Content analysis, Regression analysis	11	-----	Risk related disclosure	Leverage Size Book to market value of equity	-----	German and UK companies disclose similar levels of risk information. There are few quantitative disclosures. The most disclosed category is "non-monetary/future" explanations of the company's general risk management and internal control systems. Size: Positive Book-to-market values of equity: Not association Leverage: Not association	-----
Beretta and Bozzolan, 2004	2001	Italy	Content analysis, Disclosure Index, Regression analysis	85	75	Amount of risk disclosure	Size Industry	Nonfinancial	Risk disclosure is mostly qualitative, with few disclosures of interrelations between risk factors and their potential impact. Risk disclosure is not significantly associated with size and Industry	-----
Cabedo and Tirado,	1991-2001	Spain	Regression analysis	1000	10000	Risk related disclosure	Financial risks	Mixed	Value At Risk is a suitable method for quantifying most of a firm's risks	

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
2004			-Bootstrap techniques				Business risks Strategic risks		The measure of risks would enhance the users estimations of 'expected return and risk' when used in the investment decision-making.	
Linsley and Shrives, 2005	2001	UK	Content analysis, Disclosure Index, Regression analysis	79	-----	Risk related disclosure	Size Gearing ratio Beta factor Book-to-market value of equity Quiscore Asset cover ratio Leverage	Nonfinancial	Most disclosed risk categories were strategic, financial, and integrity risk. There is minimal disclosure of quantified risk information and a significant proportion of risk disclosures consist of generalized statements of risk policy. The principal driver affecting levels of risk disclosure is company size and not company risk level. Forward-looking risk information is significantly higher than in the past. Dearth of monetary disclosure.	Lack of research in different areas of RD e.g. RD studies within specific industry sectors and cross-country investigations. The sentence-based methodology does not measure the quality of risk disclosure.
Korosec and Horvat, 2005	2003	Slovenia	Content analysis, Disclosure Index, Regression analysis	36	-----	Risk related disclosure	-----	Mixed	Partial compliance with institutionalized requirements. Disclosure of general definitions of risks was mostly financial. Little information about how risk management is organised within a company. Tendency to hide information about certain risks. The banking sector reports in more detail about risk management activities or about ensuring safety. Disclosure of credit ratings awarded by international rating agencies and reporting of operational risk is neglected.	-----
Lajili and Zeghal, 2005	1999	Canada	Content analysis	300	-----	Risk related disclosure	-----	Mixed	Large variation, in particular in voluntary risk reporting. Risk reporting mostly qualitative. Few disclosures of risk assessment, risk analysis is limited and lacks valuable. Few risk forecasts.	-----
Mohobbot, 2005	2003	Japan	Content analysis, Disclosure Index, Regression analysis	90	-----	Risk related disclosure	Size Profitability Leverage Ownership structure	Nonfinancial	Large variation in risk reporting Risk disclosures are descriptive and little quantitative. Larger firms report more risk information than smaller firms. Little forward-looking risks Firm size: Positive Level of risk: Not significant Profitability: Not significant Ownership distribution: Not significant	-----
Linsley and Shrives, 2006	2000	UK	Content analysis, Disclosure Index, Regression analysis	79	-----	Number of risk disclosures  Level of environmental	Size Gearing ratio Beta factor Book-to-market value of equity Quiscore	Nonfinancial	Large variation in risk disclosure Few quantitative disclosures Size: Positive Level of environmental risk: Positive Level of risk mixed results	Lack of research is in many different areas of RD. It's also beneficial to adopt multi-disciplinary

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
						risk	Asset cover ratio Leverage Environmental risk		Overall the dominance of statements of general risk management policy and a lack of coherence in the risk narratives implies that a risk information gap exists and consequently stakeholders are unable to adequately assess the risk profile of a company.	approaches as insights drawn from areas such as sociology may present alternative methodological approaches to assist future RD research.
Linsley, Shrivs and Crumpton, 2006	2002	UK, Canada	Content analysis, Regression analysis	18	-----	Risk related disclosure	Risk Definitions Size Profitability Leverage	Financial	Disclosures are forward-looking, qualitative and neutral. The most frequent risks disclosed are credit risk, capital structure and adequacy risk, and market risk. Similar levels of disclosure between Canadian banks and UK banks. Risk disclosures are correlated positively with size and the number of risk definitions.	Little quantitative risk information is disclosed. There is a very strong bias to disclosing past rather than future risk-related information. Risk disclosure is still evolving within the academic literature and therefore suggestions are made for further empirical research.
Combes-Thuélin, Henneron and Touron, 2006	2002	France	Qualitative analysis based on Huberman and Miles, 1994	3	-----	Risk related disclosure	-----	Nonfinancial	Lack of harmonization between different companies, institutional context and company practice. No consensus between the different pieces of legislation, the terminology referred to by companies tends to differ from one to another. The reporting of risk related information favours risk management over risk description.	This research focused on risk disclosure within annual reports of listed companies and on risk reporting within mandatory provisions.
Konishi and Ali, 2007	2003	Japan	Content analysis, Disclosure Index, Regression analysis	100	-----	Risk related disclosure	Size Level of risk Profitability Cross corporate shareholding pattern Ownership structure	-----	Risk reporting varies across industry. Companies are reluctant to quantify risk. They disclose more good news than bad/neutral news. Size: Positive Level of risk: Insignificant Profitability: Insignificant Ownership distribution: Insignificant. Cross-firm shareholding: Insignificant Industry type: Insignificant	-----
Abraham and Cox, 2007	2002	UK	Content analysis, Disclosure	71	-----	Risk related disclosure	Ownership structure Executive directors Independent non-	Nonfinancial	Only 40% of sample firms publish information about business risk. Limited variation in firms' reporting of internal control. Size, risk and	Examined one dimension of risk disclosure by only

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
			index, Regression analysis				executive directors Dependent non-executive directors Leverage Size Level of risk Industry US dual listing		independent non-executive directors were associated positively with risk reporting. Ownership by long-term stakeholders is linked negatively with risk reporting. Short-term is positively linked to financial risk reporting. The number of dependent nonexecutive directors is not related to the level of risk reporting UK firms with a US stock exchange listing do disclose more risk information within the UK annual report than non-US-listed UK firms.	counting the words in sentences. Also this study is missing the relationship between RD and ownership and governance variables
Deumes, 2008	1997-2000	Netherland	Content analysis Disclosure index	90	-----	Risk related disclosure	Size Industry type Type of offering Cross listing at foreign exchange	Nonfinancial	Positive association with firm size, type of industry, type of offering, cross-listing at a foreign exchange, and the language in which the prospectus was written. The results further showed that when it comes to predicting future risk, the information extracted from the texts is more successful than market information on past risk.	One of the limitations of the research is that it entirely focuses on what the risk sections contain rather than how risks are reported and why?
Deumes and Knechel, 2008	1997-1999	Netherland	Content analysis, Disclosure index Regression analysis	192	6	Risk related disclosure	Firm Size Foreign operations Profitability Sales Growth Inventory Industry classification Cross-listing of shares Audit Quality Independent outside directors Leverage Managerial ownership Ownership structure	Nonfinancial	Negative relationship between the extent of risk disclosure and block holder ownership and managerial ownership. Positive relationship between the extent of disclosure and financial leverage. Company size and profitability were positively associated with risk disclosure. Industry classification was positive and significant indicating that companies from the trade sector were significantly more transparent about risk disclosure.	Proxy for ownership concentration reflects agency issues among managers and investors. Blockholder monitoring reduces blockholders and small investor may increase at the same time, affecting management's incentive to disclose.
Rajab and Schachler, 2009	1998,2001, 2004	UK	Content Analysis, Regression analysis	52	-----	Non-financial risk disclosures	Size Leverage Industry Listing status	Nonfinancial	There is an increasing risk disclosure trend in the annual report over the six-year period in response to accounting regulation and accounting institutes' recommendations. Qualitative, non-time and good news risk disclosures dominate. US dual-listing and industry are significantly and positively related to risk disclosure. Size and leverage were not associated with risk disclosure.	Disregarded medium-sized and smaller companies. Their analysis was restricted to disclosure available only on the annual report. Yet, it is know that companies communicate with

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
										investors through other channels, like internet
Hill and Short, 2009	1991-2003	UK	Content analysis, Regression analysis	420	-----	Risk related disclosure	Ownership structure Managerial structure Leverage Industry type Age of the company	Nonfinancial	Deficient in the provision of information in relation to internal controls and risk management. High proportion of forward-looking information. Low proportion of information on internal controls and risk management. Disclosure has increased across time. Managerial ownership is associated negatively with risk disclosure. Risk disclosure is not preferred by all firms as a means of reducing information asymmetry.	-----
Taylor, Tower and Neilson, 2010	2002-2006	Australia	Disclosure Index, Regression analysis	111	27	Financial risk management categories	Corporate governance strength Capital raising events Size Leverage Overseas listings Profitability Ownership structure Auditor type Book value of tangible fixed assets Quality advisors	Nonfinancial	Demonstrates that corporate governance and capital raisings of firms are significant and positively associated with FRMD patterns. The findings show that the introduction of IFRS changes corporation's willingness to communicate risk information. Adoption of IFRS: Positive Strength of Corporate governance: Positive Capital raising: Positive Overseas listing: Negative Firm size: Positive Leverage: Positive Sub-industry: Not significant ROA: Not significant	-----
Oliveira, Rodrigues and Craig, 2011a	2006	Portugal	Content analysis, Disclosure Index Regression analysis	190	-----	Risk disclosure	Risk management Credit risk Market risk Liquidity risk Operational risk Capital structure and Adequacy	Financial	The adoption of IAS/IFRS has brought a greater flow of risk-related information, but has not assured increased transparency across the Portuguese banking sector, consistent with previous studies. The Portuguese banking system has prominent visibility as a consequence of the greater (relative) number of branches. The two commercial banks with the best risk reporting performance had the highest number of branches, and are listed on a regulated market (Euronext Lisbon) and on a foreign stock exchange market. However, among the PCIs with a lower number of branches (CFIs and other entities), transparency flaws were more intense compared to commercial banks, and previous findings.	-----
Oliveira, Rodrigues	2005	Portugal	Content analysis,	42	-----	Risk disclosure	Ownership structure Indep' Non-executive	Nonfinancial	Implementation of IAS/IFRS and the European Union's Modernisation Directive in 2005 did	-----



Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
and Craig, 2011b			Disclosure index Regression analysis			quantity	directors External auditor quality Audit committee Independence Leverage Size Company listing status Accounting standards		not affect the quantity and quality of RRD positively. Disclosures are generic, qualitative and backward-looking. Public visibility (as assessed by size and environmental sensitivity) is a crucial influence in explaining RRD: companies appear to manage their reputation through disclosure of risk-related information. Agency costs associated with leverage are important influences also. In listed companies, the presence of independent directors improves the level of RRD.	
Dobler, Lajili and Zeghal, 2011	2005	UK, Germany, US, Canada	Content analysis, Regression analysis	160	-----	Risk disclosure quantity	Size Systematic risk Leverage Degree of operating leverage Share of foreign revenue Major customer	Nonfinancial	There is a consistent pattern where risk disclosure is most prevalent in management reports, concentrates on financial risk categories, and comprises little quantitative and forward looking disclosure. Firms from US disclose more risk information, followed by German firms. Cross-country variation in risk disclosure attributes can only be partly linked to domestic regulation. Disclosure incentives play a vital part. Riskier firms from US disclose more risk information. The opposite relationship was found among German firms. Risk disclosure quantity appears to be positively associated with proxies of firm risk in the North American settings. Where there is a negative relation with leverage for Germany.	The focus was on quantity of risk disclosure disregarding the quality of risk disclosure.  The study did not analyse risk disclosure over time. Thus, the development or harmonization of risk disclosure cannot be assessed.
Elzahar and Hussainey, 2012	2009-2010	UK	Content analysis, Regression analysis	72	-----	Risk related disclosure - Total number of risk related sentences	Industry type Firm size Profitability Gearing Liquidity Cross listing Institutional ownership Duality Size of the board Board composition Size of AC	Nonfinancial	Company size and industry were positively associated with risk disclosure. However, leverage, liquidity, profitability and cross-listing were not significant in explaining variations in risk disclosure. Industrial companies report more risk information than service companies	It simply adds up risk-related scores by adding the number of R-R sentences. This ignores the fact that the usefulness varies from sentence to sentence. Small sample size, therefore the findings might not be generalized.
Elshandidy, Fraser and Hussainey, 2015	2005-2010	UK, Germany, USA	Computised Textual analysis, Regression	339, 219, 320	-----	Risk related disclosure  -Mandatory	<b>Firm characteristics:</b> Total risk Systematic risk Unsystematic risk	Nonfinancial	Significant variations in MRR and VRR between firms across the three countries.  German firms tend to disclose significantly	-----

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
			analysis			risk reporting -Voluntary risk reporting	Financing risk Liquidity risk Size Profitability Growth Dividends The length of the annual report Industry Classification <b>Country characteristics:</b> Legal system Power distance Uncertainty avoidance Individualism Masculinity Long-term orientation		higher levels of risk information mandatorily than UK (US) firms. German firms also tend to reveal considerably higher levels of VRR than US (UK) firms. MRR and VRR variations are significantly influenced by systematic risk, the legal system and cultural values. Country and firm characteristics have higher explanatory power over the observed variations in MRR than over those in VRR.	
Maffei et al., 2014	2011	Italy	Content analysis, Disclosure index Regression analysis	66	-----	Risk disclosure quantity	Credit risk Exchange Risk Interest rate and price risk Liquidity risk Operational risk Securitization	Financial	Italian banks formally comply with the Bank of Italy's instructions, but there is discretion to choose the characteristics of the information provided. Despite different risk categories to disclose in each report, disclosure is quite uniform, although banks tend to provide denser information in the notes to the financial statements and the difference in the economic signs between the two reports decreases as the level of risk increases	-----

### A chorological summary of all empirical risk disclosure studies in the developing world

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
Amran, Bin and Hassan, 2009	2005	Malaysian	Content analysis, Disclosure Index, Regression	100	-----	Risk related disclosure	Size Industry type Product diversification Leverage Market diversification	Mixed	The total number of sentences dedicated for discussion of risk information by the sampled Malaysian companies is very low when compared to a 2006 study done by Linsley and Shrides in the UK. Size: Positive Industry: Positive Leverage: Not significant Product diversifications: Not significant Market diversifications: Not significant	This study is purely based on the Linsley and Shrides (2006) checklist as it may not reflect local stakeholders demand. The development of a local risk measurement checklist will help researchers to better reflect on the findings in the local context.
Hassan, 2009	2005	UAE	Content analysis, Disclosure index, Regression analysis	41	45	Risk related disclosure	Size Reserves Industry type Leverage	Mixed	Size is not significantly related with risk disclosure. Leverage and industry type are positive and significant in explaining the variation of risk disclosure. Reserve is not significant and negatively related with risk disclosure.	The risk disclosure index items reflect their existence in annual reports rather than their level of importance. Results could have changed if number and importance of the disclosure items are changed.
Abdullah and Hassan, 2013	2008	GCC Countries	Content analysis Disclosure index Regression analysis	424	45	Risk related disclosure	Size Leverage Basic No. of years using IFRS Financial/ Nonfinancial Sharia compliance/ Non Sharia compliance Reserves	Mixed	A positive relation between CRD and the firm's size, leverage, and number of years using IFRS. We also find that financial and non-Islamic financial institutions disclose more risks than other firms in the same sample. Using the BASIC score, a corporate governance index developed by the Institution of Corporate Governance (HAWKAMA) in Dubai-UAE. There is a positive link between the firm's level of corporate governance and CRD. Also a positive and significant link between the level of CRD and a corporation's communication and disclosure. However, the link weakens after controlling the country's characteristics, which suggests that the effect of the country is more important than the corporation's own practice.	
Mousa and Elmir2013	2011	Bahrain	Content analysis, Regression analysis	46	-----	Systematic risk disclosure Unsystematic risk	Size Beta of the firm Profitability Issuance of shares	Nonfinancial	Corporate risk disclosures are very limited in annual reports of the companies sampled. Also company size, company listing, issuance of shares, and profitability are significantly associated with risk disclosure.	The findings of this study cannot be generalised to other countries due to industrial composition, regulations, CG rules and

Studies	Period	Country	Method	Sample	Disclosure Items	Dependent Variables	Independent Variables	Sector	Findings	Limitations
						disclosure Total risk disclosures	Percentage of free float Leverage Listing Percentage of foreign ownership Industry Liquidity		However, leverage, Beta of the company, liquidity, foreign ownership, percentage of free float and industry were insignificant.	economic status
Al-Shammeri, 2014	2012	Kuwait	Content analysis, Regression analysis, Disclosure index	109	-----	All categories risk related disclosure	Size Profitability Leverage Liquidity Audit type Complexity Industry type	Nonfinancial	Corporate risk disclosure is associated positively with size, liquidity, and complexity and auditor type. The association between CRD and other corporate-specific characteristics (leverage and profitability) is insignificant	Only 30% of the variation of risk disclosure was explained. The impact of corporate governance on CRD was not considered
Abdullah, Hassan and McClelland, 2015	2009	GCC Countries	Content analysis, Disclosure index Regression analysis,	424	45	Risk related disclosure	Size Leverage Basic No. Of years using IFRS Islamic/Non-Islamic Financial/ Nonfinancial Sharia compliance/ Non Sharia compliance Reserves Country Dummies	Mixed	Islamic financial institutions disclose less corporate risk than do their non-Islamic peers. Also, found that the risk disclosure practices of GCC firms vary by country	

## A chorological summary of all empirical studies on the economic consequences of disclosure

Studies	Research Issue	Sample Size	Disclosure Proxy	Country	Findings
Baek, Kang and Park, 2004	Importance of corporate governance measures in determining firm value during a crisis	644 nonfinancial firms	-----	Korea	The economic crisis in Korea has a significant and negative effect on the market value of firms, but with large cross sectional variations. Firms with larger equity ownership by foreign investors experience a smaller drop in share value. Firms with higher disclosure quality and those with access to alternative sources of external financing also suffer less from the shock.
Ball and Shivakumar, 2004	Timeliness in financial statement recognition of economic losses	54, 778 (1475) firms and 141,649 (6,208) firm years for private (public) companies.	This study employed Basu's (1997) time series measures of timely loss recognition and a new accruals-based method.	UK	Average earnings quality is measurably lower in UK private companies than in public companies, though their financial statements are audited and certified as complying with the same accounting standards. Accounting standards are not absolute givens, and their effect on actual financial reporting is subject to market demand.
Francis, Khurana and Pereira, 2005	Examines disclosure incentives and consequences on the cost of capital outside USA	672 firm-years	Self-constructed index	Different Countries	The results showed that voluntary disclosure incentives appear to operate independently of country level factors, which suggest the effectiveness of voluntary disclosure gaining access to lower cost of external financing around the world
Gietzmann and Ireland, 2005	The relationship between timely strategic disclosures and the expected cost of capital	164 firms, 1,640 observations	Self-constructed measure of timely disclosure	UK	Showed that the effect of disclosure on cost of capital is only significant for those firms that make aggressive accounting choices.
Xi Li, 2005	The persistence of relative performance in stock recommendations of sell-side analysts	341 buy-side and 226 sell-side brokerage houses	Risk-adjusted returns	USA	Indicated significant persistence in relative performance differences among individual analysts. Also the evidences are consistent with the hypothesis that 1- past winners' recommendations are more informative and 2- investors underreact to past winners' recommendations and overreact to past losers' recommendations.
Lopes and Rodrigues 2007	The determinants of disclosure level in the accounting for financial instruments of Portuguese listed companies.	55 firms	Self-constructed index	Portugal	The results could not find any significant influence of corporate governance structure or of financing structure. They concluded that the disclosure degree is significantly related to size, type of auditor, listing status and economic sector.
Hassan et al., 2009	The association between mandatory and voluntary disclosures and firm value for Egyptian listed companies	80 nonfinancial listed firms	Self-constructed disclosure index	Egypt	Showed a highly significant negative association between mandatory disclosure and firm value. Also showed a weaker positive relationship between voluntary disclosure and firm value
Kothari et al., 2009	The effect of disclosures by management, analysts, and business press on cost of capital, return volatility, and analyst forecasts	100,000 firm-year observations	-----	USA	Found that when content analysis indicates favorable disclosures, the firm's risk, as proxied by the cost of capital, stock return volatility, and analyst forecast dispersion, declines significantly. In contrast, unfavorable disclosures are accompanied by significant increases in risk measures.
Heitzman et al., 2010	The joint effects of materiality thresholds and voluntary disclosure incentives on firms' disclosure decisions	1184 firms observations	Herfindahl index	USA	The empirical tests isolating the impact of materiality on firms' disclosures have greater explanatory power over empirical tests that do not. Voluntary disclosure incentives better explain disclosure when the information is less likely to be material. Tests of voluntary disclosure theories ignoring materiality likely lead to incorrect inferences
Armstrong et al., 2011	When Does Information Asymmetry Affect the Cost	-----	Fama–French model	USA	Information asymmetry has a positive relation with firms' cost of capital in excess of standard risk factors when markets are imperfect and no relation when

Studies	Research Issue	Sample Size	Disclosure Proxy	Country	Findings
	of Capital?				markets approximate perfect competition. Also showed that the degree of market competition is an important conditioning variable to consider when examining the relation between information asymmetry and cost of capital.
Uyar and Kilic, 2012	Value relevance of voluntary disclosure: evidence from Turkish firms	129 firms	Self-constructed index	Turkey	Showed that voluntary disclosure is value-relevant; i.e. impacts firm value. This implies that market participants value voluntary disclosure. The more information firms disclose voluntarily, the higher value they have in the eyes of investors. Therefore, this finding might be accepted as a signal to corporations to disclose more information to the stakeholders. However, the finding varied based on the dependent variable used; hence, the result was not supported by all models.
Hwang et al., 2013	Does information risk affect the implied cost of equity capital? An analysis of PIN and adjusted PIN	791 firm-year observations	ICOE	Korea	Found a positive cross sectional relation between the implied cost of equity capital and bias-free AdjPIN, even after controlling for a liquidity-related component (PSOS). Their finding suggests that information risk derived from trades affect stock investors' expected returns.
Miihkinen, 2013	The usefulness of firm risk disclosures under different firm riskiness, investor-interest, and market conditions: New evidence from Finland	386 firm-year observations	-----	Finland	Demonstrated that the quality of risk disclosure has a direct negative influence on information asymmetry. Also documented that risk disclosures are more useful if they are provided by small firms, high tech firms, and firms with low analyst coverage. Also found that momentum in stock markets affects the relevance of firms' risk reports
Kravet and Muslu, 2013	The association between changes in companies' textual risk disclosures in 10-K filings and changes in stock market and analyst activity around the filings	28,110 firm-year observations, 4,315 firms	-----	USA	Annual increases in risk disclosures are associated with increased stock return volatility and trading volume around and after the filings. Increases in risk disclosures are also associated with more dispersed forecast revisions around the filings. Our findings suggest that textual risk disclosures increase investors' risk perceptions. These results support arguments that firm-level risk disclosures are more likely to be boilerplate.
Campbell et al., 2014	The information content of mandatory risk factor disclosures in corporate filings	9,076 firm-year observations	-----	USA	Firms facing greater risk disclose more risk factors, and that the type of risk the firm faces determines whether it devotes a greater portion of its disclosures towards describing that risk type. That is, managers provide risk factor disclosures that meaningfully reflect the risks they face. Secondly, find that the information conveyed by risk factor disclosures is reflected in systematic risk, idiosyncratic risk, information asymmetry, and firm value.
Moumen et al., 2015	The Value Relevance of Risk Disclosure in Annual Reports: Evidence from MENA Emerging Markets	809 firm-year observations	Disclosure Index	MENA countries	Found a positive relationship between voluntary risk information and the market's ability to anticipate two-year ahead future earnings change. The positive association provides us with the first empirical evidence of the usefulness of risk disclosure in annual reports. Second, found that the level of proprietary costs tends to moderate the perceived relevance of risk information, thereby making investors rely on another source of information in forecasting future earnings change.
Volkov and Smith, 2015	Corporate diversification and firm value during economic downturns	113,888 firm quarters, 4583 firms	-----	USA	Found that the improvement in relative valuation of diversified firms during economic downturns is attributed to the ability of diversified firms to utilize broader external capital markets. Demonstrated that the improvement in relative valuation is largely driven by diversified firms that are financially constrained, and, therefore, attribute the observed improvement to more efficient internal capital allocation during recessions.
Elzahar et al., 2015	Economic consequences of Key Performance Indicators' disclosure quality	448 firm-year observations.	-----	UK	Found a significantly negative (weakly positive) relationship between disclosure quality of financial KPIs and the implied cost of capital (firm value). These results inform regulatory bodies as well as the academic literature about the potential

Studies	Research Issue	Sample Size	Disclosure Proxy	Country	Findings
					economic consequences of this type of disclosure.

# Saudi Arabian Disclosure act

## Chapter Seven

### Disclosure

#### *Article Forty*

- a. The contents of the prospectus set forth under Article 42 of this Law, or portions thereof, shall be published in such a manner and for such duration as required by the regulations and rules of the Authority.
- b. An issuer or an affiliate of an issuer or an underwriter may not offer Securities of the issuer or the issuer's affiliate unless he has submitted a prospectus to the Authority, published the prospectus in the manner set forth in paragraph (a) of this Article, and has paid the requisite fees. The Authority may exempt the issuer from some requirements based on the manner of the offering, the amount of the offering, the number of investors and their characteristics, or the characteristic of the issuer of the Security or the Security itself.
- c. Upon satisfying the requirements of paragraphs (a) and (b) of this Article, offers may be made in any of the forms listed below:
  1. Verbally;
  2. Through a prospectus satisfying the conditions of Article 42 of this Law;
  3. Through an announcement containing a summary of the prospectus and any other information required by the Authority or authorized by it in accordance with the rules specified by the Authority;
  4. Through other means, including electronic media, provided that such mean has been approved by the Authority.

#### *Article Forty One*

An issuer, an affiliate of the issuer or an underwriter may not sell any Security owned by that issuer before the prospectus is approved by the Authority and becomes effective, provided that the approved prospectus shall be sent to the buyer prior to the sale date in accordance with such rules as the Authority may issue.

#### *Article Forty Two*

The prospectus must contain the following information and statements:

- a. Information required by the Authority's rules which give an adequate description of the issuer, the nature of its business, the individuals in charge of its management such as members of the board of directors, executive officers, senior staff and its major shareholders.
- b. Information required by the Authority's rules which give an adequate description of the Securities to be issued, their number, price, and related rights, preferences or privileges of the issuer's other Securities, if any. The description will set forth how the issue proceeds will be disbursed, and the commissions levied by persons connected with the issue.
- c. A clear statement of the financial position of the issuer and any significant financial data including the audited financial balance sheet, profit and loss account and cash flow statement as the rules of the Authority may require.



- d. Any other information required or authorized by the Authority in accordance with rules issued by the Authority which it deems necessary to assist investors and their advisers in making decisions about investing in the Securities to be issued.

#### ***Article Forty Three***

- a. After its review of the prospectus, the Authority shall announce its approval or rejection of the prospectus. If it approves the prospectus, the Authority may define a period of time during which the prospectus remains valid.
- b. Every issuer offering Securities to the public through a prospectus must notify the Authority in writing of any material change to the statements set forth in the prospectus immediately upon becoming aware of such change provided such change may affect the price or value of the Security. The issuer should also prepare and publish a press release to disclose such change. The Authority's regulations and rules shall set forth the information to be disclosed and the conditions applicable regarding the press release.

#### ***Article Forty Four***

The Board of the Authority may reject a prospectus in any of the following cases:

- a. If the prospectus does not contain the information required by Article 42 of this Law.
- b. If the prospectus contains incorrect information pertaining to material matters, false or misleading statements or omits to state material information or statements that would under the circumstances render the prospectus misleading or incorrect.
- c. The prospectus issuance fees have not been paid in full to the Authority.
- d. The issuer has failed to provide any of the reports stipulated in Article 45 of this Law.

#### ***Article Forty Five***

- a. Every issuer offering Securities to the public or whose Securities are traded on the Exchange must submit to the Authority quarterly and annual reports. Annual reports must be audited as required by the rules of the Authority. These reports shall contain the following:
  - 1. The balance sheet;
  - 2. The profit and loss account;
  - 3. The cash flow statement; and
  - 4. Any other information as required by the rules of the Authority.
- b. In addition to the information required in paragraph (a) of this Article, the annual report must contain the following:
  - 1. An adequate description of the issuing company, the nature of its business and its activities as required under the rules of the Authority;
  - 2. Information regarding the members of its board of directors, executive officers, senior staff and major investors or shareholders as required under the rules of the Authority;
  - 3. An evaluation of the issuing company management of current and future developments and any future possibilities that may have significant effect on the business results or financial position of the company as required under the rules of the Authority.

4. Any other information as may be required by the rules of the Authority as it deems necessary to assist investors and their advisers in making a decision to invest in the issuer's Securities.
- c. All information and data described in paragraphs (a – 1, 2, 3) and (b.3) of this Article shall be deemed confidential. Before providing and disclosing such information and data to the Authority, the issuing company shall be prohibited from disclosing such information to parties not bound by a confidentiality obligation and an obligation to protect such information.

#### ***Article Forty Six***

- a. A party who issues Securities must inform the Authority in writing upon becoming aware of any material developments which may affect the prices of the Securities issued by such party. If such party has a Security traded on the Exchange, the Exchange must be informed of such developments in writing.
- b. The Authority or the Exchange may request the party issuing Securities to provide any information or data pertaining to such party and the issuing party shall provide the same within the period of time specified in the request.
- c. The Board of the Authority or the Exchange may, after reviewing the facts, require the issuing party to disclose any information or data related to that party. The Board or the Exchange shall also have the right to publish such information and data at the expense of the issuing party.

#### ***Article Forty Seven***

The public shall be allowed, in return for fees to be determined by the Authority, to review and make copies of the prospectuses, periodical reports, and information and data which have been filed with the Authority, made public and obtained.

#### ***Article Forty Eight***

- a. The Authority shall specify the disclosure forms and instructions, including the information which must be included in the prospectuses and periodical reports which must be provided to the Authority by the parties that are subject to its control and supervision or which must be announced to the public, as the case may be.
- b. The Authority shall have no responsibility for the omission in prospectuses, periodical reports, advertisements, or any other document filed with it by any party of any important information or data or for including misleading information or data.
- c. The publisher of the advertisement shall be responsible for any errors committed by it in publishing the contents of the advertisement pursuant to the regulations applicable in the Kingdom.

## Additional Tests

### One-Sample Test

In order to identify any differences in the levels of risk disclosure of the sample banks over the examined period, levels of risk disclosure between the years will be examined using the one sample t-test. The criteria is significant value or the value probability is less than 0.05, it means data derived from a different variance of population, while if the probability value significant more than 0.05 it means data derived from a same variance of population.

Although a statistically significant difference was found between the examined years of the levels of risk disclosure against the normal level of risk disclosure, it does not necessarily mean that the difference encountered is enough to be practically significant. Indeed, the researcher might accept that although the difference is statistically significant. However, the differences are not large enough to be practically significant (the levels of risk disclosure can be treated as normal).

**One-Sample Test**

	Test Value = 60						
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference		
					Lower	Upper	
ALJAZIRA	4.975	4	.008	6.60000	2.9166	10.2834	Accept
ALRAJHI	2.128	4	.100	7.60000	-2.3178	17.5178	Reject
ALINMA	-6.128	4	.004	-6.60000	-9.5903	-3.6097	Accept
ALBILAD	-1.095	4	.335	-2.80000	-9.9003	4.3003	Reject
Saudi Hollandi Bank	11.159	4	.000	8.20000	6.1597	10.2403	Accept
SAAB	8.573	4	.001	8.40000	5.6797	11.1203	Accept
Riyad Bank	15.501	4	.000	5.80000	4.7611	6.8389	Accept
Saudi Investment Bank	7.779	4	.001	9.40000	6.0452	12.7548	Accept
Arab National Bank	6.080	4	.004	12.40000	6.7371	18.0629	Accept

National Commercial Bank	58.788	4	.000	14.40000	13.7199	15.0801	Accept
Banque Saudi Fransi	3.536	4	.024	10.00000	2.1470	17.8530	Accept

### Normality Test of the Levels of Risk Disclosure

The result of the normality test can be detected by Kolmogorov-Smirnov and Shapiro-Wilk tests. If the p-value or the the sig value is more than 0.05 it shows that the data is normal and if it is less than 0.05 the assumption of normality is rejected. Thus, the p or the Sig values for Kolmogorov-Smirnov and Shapiro-Wilk in this study are found to be more than 0.05, which mean the hypothesis of normality is accepted at 95% level of significance

**Tests of Normality<sup>b</sup>**

	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
ALJAZIRA	.210	5	.200*	.897	5	.391
ALRAJHI	.270	5	.200*	.880	5	.307
ALINMA	.319	5	.105	.793	5	.071
ALBILAD	.312	5	.125	.816	5	.108
Saudi Hollandi Bank	.367	5	.026	.684	5	.006
SAAB	.372	5	.022	.828	5	.135
Riyad Bank	.231	5	.200*	.881	5	.314
Saudi Investment Bank	.359	5	.034	.820	5	.117
Arab National Bank	.243	5	.200*	.884	5	.329
National Commercial Bank	.367	5	.026	.684	5	.006
Banque Saudi Fransi	.136	5	.200*	.987	5	.967

### Heteroscedasticity/Homoscedasticity Tests

Heteroscedasticity test is used to assure whether there is an indifference variance in the regression model between a residual and other residuals. The variance of the residual terms should be constant. This means that the residuals at each level of the predictor should have the same variance (homoscedasticity) (Field, 2009). A variable is free from heteroscedasticity problems when the significant number is more than 0.05. All variables

have a significant number which is more than 0.05, which indicates that all variables for Model 1, 2 and Model 3 are free from heteroscedasticity

**ANOVA<sup>b</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	19	.000	.847	.643 <sup>a</sup>
	Residual	.000	40	.000		
	Total	.000	59			

a. Predictors: (Constant), ISLAMIC, Y2013, ACSIZE, NOSH, Y2012, BOARDSIZE, TENURE, Y2009, EDUCATION, GENDER, INDEP, ROA, Y2011, ACINDEP, ACMEET, CHS, NON, DIVERSITY, SIZE

b. Dependent Variable: RES2

**ANOVA<sup>b</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	22	.000	1.131	.361 <sup>a</sup>
	Residual	.000	37	.000		
	Total	.000	59			

a. Predictors: (Constant), ISLAMIC, Y2013, ACSIZE, LEV, NOSH, LIQ, Y2010, BOARDSIZE, TENURE, Y2012, EDUCATION, GENDER, INDEP, DIVID, Y2011, ACMEET, ACINDEP, RISKD, CHS, NON, DIVERSITY, SIZE

b. Dependent Variable: RES12

**ANOVA<sup>b</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	23	.000	1.131	.370 <sup>a</sup>
	Residual	.000	31	.000		
	Total	.001	54			

a. Predictors: (Constant), ROA, LIQ, Y2011, DIVERSITY, ACMEET, EDUCATION, Y2013, ACSIZE, LEV, Y2010, GENDER, INDEP, DIVID, Y2012, ACINDEP, TENURE, RISKD, BOARDSIZE, CHS, NON, SIZE, NOSH, ISLAMIC

### Normality Tests

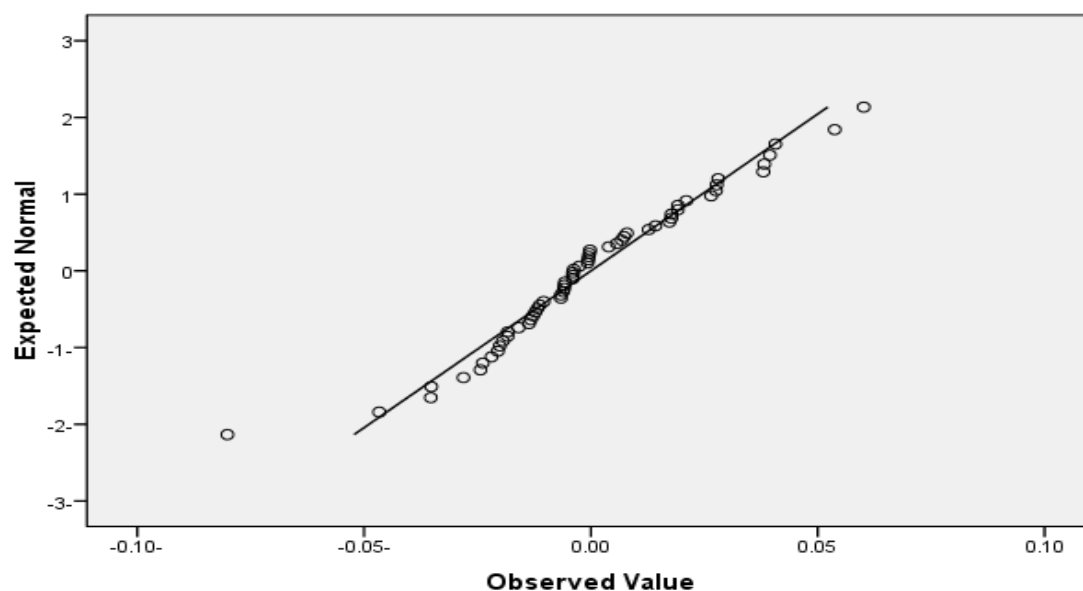
The result of the normality test can be detected by Kolmogorov-Smirnov and Shapiro-Wilk tests. If the p-value or the the sig value is more than 0.05 it shows that the data is normal

and if it is less than 0.05 the assumption of normality is rejected. All variables have a significant number which is more than 0.05, which indicates that all variables for Model 1, 2 and Model 3 follow a normal distribution pattern as the p-value in Kolmogorov-Smirnov and Shapiro-Wilk tests are more than 0.05

Tests of Normality						
	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Unstandardized Residual	.120	60	.052	.971	60	.160

a. Lilliefors Significance Correction

**Normal Q-Q Plot of Unstandardized Residual**

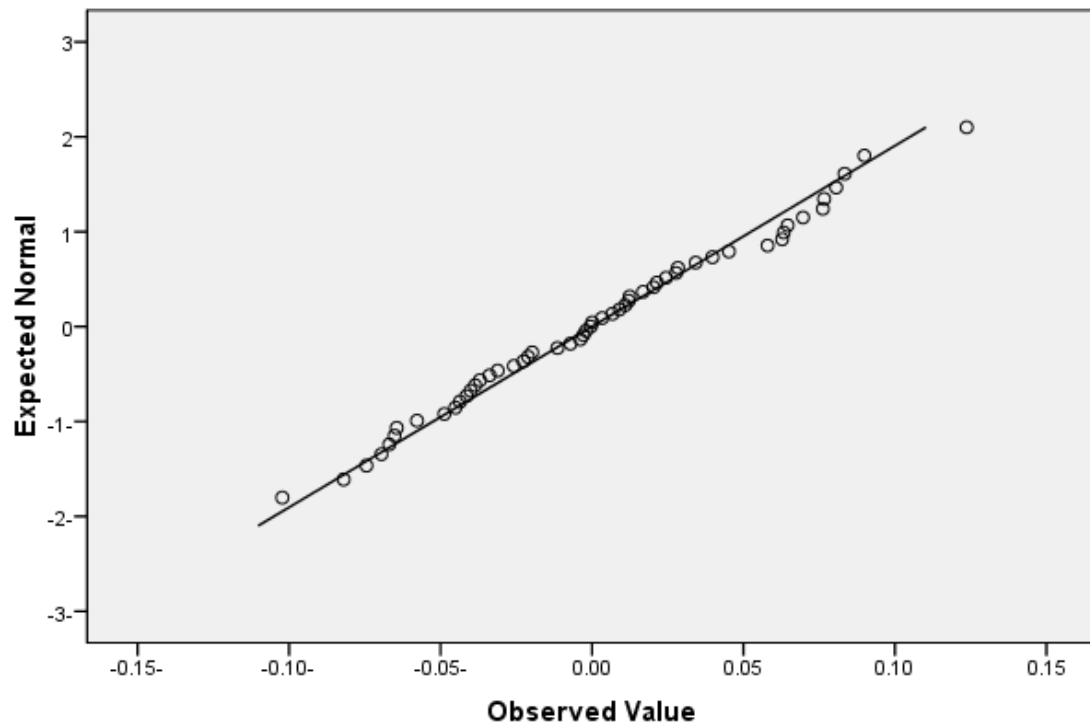


Tests of Normality						
	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Unstandardized Residual	.066	55	.200 <sup>*</sup>	.985	55	.740

a. Lilliefors Significance Correction

\*. This is a lower bound of the true significance.

Normal Q-Q Plot of Unstandardized Residual



Tests of Normality

	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Unstandardized Residual	.063	55	.200 <sup>*</sup>	.954	55	.053

a. Lilliefors Significance Correction

\*. This is a lower bound of the true significance.

Normal Q-Q Plot of Unstandardized Residual

