Corporate Governance, IFRS 7 Compliance and the Cost of Equity Capital in GCC banks

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Abstract

The purpose of this thesis is to address different aspects related to compliance with IFRS 7 and the relevant determinants and economic consequences. The thesis includes four chapters, each providing a contribution to the knowledge and literature. First, it addresses the essential steps for constructing a compliance index, answering the research question: what are the guidelines for
constructing an index for compliance with IFRS 7? Second, it measures the level of compliance with the disclosure requirements related to IFRS 7 in GCC listed banks from 2011 to 2017. Third, it identifies the effects of corporate governance (CG) determinants on the degree of compliance. Fourth, it examines the impact of compliance on the cost of equity capital. A self-constructed index was employed to measure the compliance level. In addition, content analysis and panel data regression were utilised within this study to obtain the desired results. The findings of the thesis reveal gaps in prior research and provide opportunities for future studies. The results show that the compliance trend remained stable over the seven years with an average of 78%, and the differences between the member countries were very few. Moreover, the results highlight the significant role that CG, in particular, plays in the GCC environment. It shows that board size, board independence, board meeting frequency, and institutional ownership negatively affect the compliance level significantly. In contrast, other factors (AC size, AC independence, AC meetings, blockholder ownership, and governmental ownership) affect the compliance degree positively. However, the firm characteristics which are considered as control variables do not show any significant impact, except profitability which has a positive influence at a significance level of 90%. In terms of the consequences of compliance, the results show that the compliance level reduces the cost of equity capital. The association is affected by some control variables, such as market development, inflation rate, M2B value, and bank size.

This thesis introduces a number of contributions, the first of which is the diversity of the content with which it deals with research issues. This includes the diversity of theories that explain the relationships between study variables, as well as the analytical methods used to conduct the research. In addition, it presents illustrative steps to establish an index under the basic requirements in a descriptive study, building a new index to measure cross-country compliance with IFRS 7. It also adds to the literature new evidence, from a group of developing countries, about the role of CG determinants in enhancing compliance, and from another perspective, the impact of such compliance on COEC.

This research supports the efforts by the International Accounting Standards Board (IASB) to improve the quality of disclosure in particular, and the convergence of accounting practices between countries in general, by enhancing compliance with the standards. It, therefore, reflects a real image of the extent to which institutions comply with these standards in the Gulf region.
Moreover, the research provides support for the initiatives and efforts of policymakers and organisations responsible for monitoring and enforcement of the standards, such as governmental institutions and accounting associations.

Declaration

Whilst registered as a candidate for the above degree, I have not been registered for any other research award. The results and conclusions embodied in this thesis are the work of the named candidate and have not been submitted for any other academic award.
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x

Abbreviations
AAOIFI Accounting and Auditing Organization for Islamic Financial Institutions

AC Audi Committee
CAPM Capital Asset Pricing Model
CG Corporate Governance
COC Cost of Capital
COEC Cost of Equity Capital
CSR Corporate Social Responsibility
EU European Union
FASB Financial Accounting Standards Board
FI Financial Instrument
GAAP Generally Accepted Accounting Principles
GCC Gulf Cooperation Council
GDP Gross Domestic Product
IAS International Accounting Standards
IASB International Accounting Standards Board ICC
Implied Cost of Equity Capital
IMF International Monetary Fund
IFRS International Financial Reporting Standards
IPO Initial Public Offering
JSE Johannesburg Stock Exchange
M2B Market value to Book value of equity
OLS Ordinary Least Squares
ROAA Return on Average Assets
SEC Securities and Exchange Commission
SPSS Statistical Package for the Social Sciences
STATA Statistical software package created by StataCorp
UK United Kingdom

Chapter One: Introduction
1.1 Overview

The economic circumstances in the 1950s, particularly after the Second World War, are considered to be the starting point of the emergence of international accounting homogenisation. The main purpose of this harmonisation was to revitalise the commercial exchanges among countries and increase international capital flows. During the last three decades, the international accounting standards (IAS) have passed through several different stages of progress in order to be acceptable to all countries in the world. Today, the International Financial Reporting Standards (IFRS) are considered the cornerstone of establishing unified accounting standards (Uwaoma & Ordu, 2015). IFRS refers to a single set of accounting standards developed by a specific board (International Accounting Standards Board [IASB]) and is applied by countries around the globe in order to provide understandable, comparable, and unified financial statements for all users and stakeholders equally (Garrett, Mohamad, Shafie, & Sadiq, 2020; Ismail, 2017). Therefore, the main contribution of IFRS is reducing the differences in accounting practices between countries (Camfferman & Zeff, 2008; Deloitte, 2017e). After the decision was made by the European Council of Ministers to mandatorily apply IFRS by 2005 in all European Union (EU) listed firms, the Financial Accounting Standards Board (FASB) and IASB began to study the differences in the accounting systems of EU countries in order to mitigate those differences. As a result, these efforts to unify the accounting standards were mainly based on developed countries’ systems, making the IFRS more suitable for developed countries than for developing ones (Bebbington & Song, 2004; FASB, 2017; IFRS, 2017; Whittington, 2005). From this perspective, the researchers’ efforts are directed at studying any challenges that may hinder the objectives of IFRS. One of the identified challenges is to compel organisations to comply with the requirements of those standards.

In terms of IFRS compliance, certain concepts should be discussed. Firstly, the accounting standards can be defined as ‘accounting regulations’. At best, they restrict the choice of the accounting methods available to management. At worst, they force companies to report their financial information in a way which they would not have voluntarily chosen (Sutton, 1984, p.81, cited in Hassaan, 2012). Hence, based on these definitions, two categories of compliance with the accounting standards can be distinguished: (1) recognition and disclosure, and (2) mandatory and voluntary. Recognition implies the measurement of items to be included into the financial statements (Al-Shammari, Brown, & Tarca, 2008). However, disclosure goes beyond the concept of including items in the financial statements and covers the quantitative and qualitative
information about the firm and its performance, which helps in making sound economic and investment decisions (Al-Zarouni, 2008; Karim & Ahmed, 2005). From the IFRS angle, Sarea and Dalal (2015) define compliance with IFRS as “the degree to which an entity complies with the multitude of issues in IFRS” (Sarea & Dalal, 2015, p.213).

Moreover, with respect to IFRS adoption, mandatory compliance refers to the required items that must be included in financial statements, whereas voluntary disclosure considers the items that are not mandated or required by the accounting standards (Al-Shammari, 2005; Gutierrez Ponce, Hlaciuc, Mates, & Maciuca, 2016). In fact, voluntary disclosure raises an endogeneity concern that the factors or motivations that lead companies to voluntarily adopt IFRS may be the ones that result in changes, rather than the IAS/IFRS adoption itself (de George, Li, & Shivakumar, 2016). In addition, the items of voluntary disclosure may differ from one researcher to another, where they may depend on personal estimations and this in turn may affect studies’ results. Nevertheless, mandatory adoption is based on the country level regulations that force companies to disclose all information, good and bad. Furthermore, mandatory adoption is mostly subject to regulatory and enforcement mechanisms, unlike voluntary adoption. Since IFRS adoption became mandatory in many countries, researchers have concentrated mainly on this compliance type (Boshnak, 2017). Therefore, mandatory disclosure involves the mandated items by standards’ regulators, which were built to achieve the objectives of harmonisation and accounting standardisation. From the researcher’s view, focusing on the mandated X ‘basis’ in the first place achieves the purposes of this study better than focusing on the voluntary X ‘branch’, which supports compliance. Thus, this particular study examines the level of compliance with the mandatory disclosure requirements of IFRS (particularly IFRS 7).

Regarding IFRS 7 selection, the financial instruments have passed through two decades of improvements and updates. Since the early 1990s, the IASB has been concerned with financial instruments (FIs). The complexity of these instruments was the main reason for their being blamed as one of the causes of the financial crisis in 2008 (Duh, Hsu, & Alves, 2012; Pucci, 2017; Siregar, Djakman, Maharani, Farahmita, & Ningrum, 2016). Moreover, the standard IAS 39 (Financial Instruments: Recognition and Measurement) was one of the biggest challenges for many firms, especially in the banking sector, which represented a clear opposition to the use of fair value measurements (Gebhardt, Reichardt, & Wittenbrink, 2004). Currently, this matter leads to increased business risks and affects the financial statements’ reliability when making appropriate
decisions, which in turn increases the cost of capital (Duh et al., 2012; Lim & Foo, 2017). Consequently, it can be said that the emergence of IFRS 7’s disclosure requirements of financial instruments is one of the more important steps taken by the IASB. The IASB’s efforts are centred on this by ensuring that all stakeholders can obtain the information they need about financial instruments. Also, the IASB stress the importance of this standard and indicate that IFRS 7 is a result of extensive efforts and studies, and that any amendments thereto will be made in order to keep pace with the growth of the financial instruments (Deloitte, 2017d). Thus, due to the complex nature of the financial instruments, the current study concentrates only on measuring the disclosure requirements of FIs.

Investigating compliance related to the disclosure requirements of IFRS 7 compels the researcher to concentrate on the determinants that would influence compliance. Through a prior literature review, it is concluded that these determinants vary among countries and are influenced by political, social and economic factors. Additionally, some of these determinants are related to the countries’ enforcement systems and the strength of supervisory bodies in charge of monitoring compliance and ensuring that the effective regulations are implemented through one of their mechanisms: corporate governance (Al-Akra, Eddie, & Ali, 2010; Al Mutawaa & Hewaidy, 2010; Al-Shammari, 2011; Bova & Pereira, 2012; Ebrahim & Abdelfattah, 2015; Hla, Hassan, & Shaikh, 2013; Santos, Ponte, & Mapurunga, 2013; Tsalavoutas, 2011). In addition to the factors associated with the characteristics of the companies themselves, such as size, age, profitability, leverage and liquidity, other external elements that may directly or indirectly affect compliance also exist, including capital markets. Hence, directly focusing on the determinants of corporate governance (independent variables) and attributes of the companies (control variables) is one of the main aims of this study.

In addition to the determinants that affect compliance, researchers also examine the impact of international standards adoption on a number of aspects. Most of these efforts focus on the impact that IFRS has on improving the quality of corporate financial reporting (Beneish, Miller, & Yohn, 2012; Dimitropoulos, Asteriou, Kousenidis, & Leventis, 2013; Elujewute, 2018). Yet another area that prior literature focuses on is the economic aspect that Sir Arthur Levitt (the Chairman of Securities and Exchange Commission [SEC]) points to. He stresses that the availability of high quality standards (assuming that IFRS is such) contributes to lowering the cost of capital, which is more obvious in environments that have strong market regulations and effective enforcement
mechanisms (Levitt, 1998). The argument is that these standards have an impact on reducing the expected business risks and increasing investor confidence, and thus require lower capital cost (Hail & Leuz, 2006; Levitt, 1998). Besides, many studies indicate that IFRS adoption contributes to reducing the cost of capital and consequently increases the revival of the investment environment in many countries (Daske, Hail, Leuz, & Verdi, 2008; Diamond & Verrecchia, 1991; Fahdiansyah, 2016; Leung, 2013; Li, 2010; Sayumwe & Francoeur, 2017; Turki, Wali, & Boujelbene, 2017). What is more, due to the lack of evidence in the existing literature that proves the impact of IFRS compliance in general, and IFRS 7 in particular, on the cost of capital in developing countries, the current study chooses to investigate this phenomenon. This is accomplished by studying the impact of compliance with IFRS 7 on the cost of equity capital in the Gulf Cooperation Council (GCC) countries.

The GCC area includes six countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE). As developing countries, they have a great source of oil production, which provides a good reflection on the global economy in general (Abdelbaki, 2016). As trade openness increased, so did international financial interdependence, making the Gulf States a good bridge between two important cultures: Eastern and Western (Altaee & Al Jafari, 2018). Thus, the focus on the Gulf region includes several aspects. The economic and structural developments in the financial markets have prompted an increased interest in the application of the international accounting standards and the mandatory application expansion, which may raise the investors’ level of confidence in the financial markets of these countries (Abdallah & Ismail, 2017). Accordingly, the strengthening of the relationship between stakeholders on the one hand and companies on the other may occur through disclosure (financial statements) and the extent to which these companies comply with the issued standards and regulations (Palmieri, Perrin, & Whitehouse, 2018). Since the banking sector in the GCC was one of the first sectors to mandatorily apply IFRS, this sector should be an excellent example of measuring its compliance with IFRS regarding the financial instruments, owing to the fact that the banks most widely address the financial instruments and their derivatives. In addition to the lack of studies conducted in GCC countries concentrating on the banking sector, their banking sector makes these countries an appropriate environment for further studies that measure the degree of compliance with financial instruments over the years and compare the results between all member countries.
1.2 Research Motivations

For many years, researchers have put considerable effort into investigating accounting issues at an international level (Abad, Cutillas-Gomariz, Sánchez-Ballesta, & Yagüe, 2017; Albu, Albu, & Gray, 2020; Al Masum & Parker, 2020; El-Helaly, Ntim, & Soliman, 2020; Nurunnabi, Jermakowicz, & Donker, 2020; Zhang, Farooq, Zhang, Liu, & Hao, 2020). Consequently, one of the main accounting harmonisation instruments is the establishment and adoption of IFRS by several countries. Different countries show clear support towards adopting IFRS, whether that adoption is partial or complete, compulsory or voluntary. Given the importance of these international standards to the business convergence between countries, many researchers are encouraged to focus on the actual accounting practices under the basic IFRS set that was issued in order to reach the desired goals (Abdullah, Sulaiman, Ismail, & Sapiei, 2012; Akpomi & Nnadi, 2017; Alade, Olweny, & Oluoch, 2017; Al-Akra et al., 2010; Al-Shammari, 2005; Petre & Albu, 2020). As financial instruments are one of the most important tools that large companies in general and the banking sector in particular deal with (Allini, Ferri, Maffel, & Zampella, 2019), it is necessary to monitor their application and use in light of IFRS application.

Therefore, there are a number of incentives that encouraged the researcher to conduct the current study. By reading the existing literature, the researcher discovered that questions about what financial instruments are and what their importance in business is remain unanswered (Bamber, 2011; Carlo & Steck, 2011; Haddad, Mardini, & Tahat, 2018; Lim & Foo, 2017). Despite the growing interest in financial instruments among academics and practitioners, especially after 2008, and the continuing updates to IFRS 7 and IFRS 9, there is still some uncertainty in clarifying the importance of financial instruments and to what extent they may affect business processes and the quality of financial information. Moreover, the important role played by the banking sector in GCC countries, which represents the largest sector relative to other sectors (Hamdan, 2020), as well as the extent to which banks are associated with the work of financial instruments, add more motivation to focus solely on this sector for measuring the compliance level with IFRS 7.

Another motivation for conducting this study is to focus on the corporate governance aspect and its impact on compliance with IFRS, particularly with IFRS 7 (Abdallah & Ismail, 2017; Agyei Mensah, 2017a; Agyei-Mensah, 2019a; Almaqtari, 2019; Al-Sartawi, Alrawahi, & Sanad, 2016). Focusing on this aspect will shed more light on the potential effects that may enhance/impede the compliance process. Likewise, focusing on the aforementioned aspect should raise the countries’
interest in improving their corporate governance as one of the main enforcement mechanisms, which is the case in GCC countries. This, in turn, encourages the researcher to further investigate these mechanisms and identify their effects.

Finally, from an economic point of view, the risks involved in the financial instruments and the potential implications of these risks on investment costs raise the following questions: What is the nature of this relationship? How can financial instruments, with their diverse risks such as market and liquidity risks, affect investors’ confidence and investment decisions in terms of asking for high or low cost for their investments?

The issue of dealing with compliance in terms of the financial instruments on one side, and its determinants and economic impacts on the other side, can create a good scenario for the current study, which combines all of these parts into one mould. Accordingly, this study seeks to measure the level of compliance with the mandatory disclosure requirements for financial instruments (IFRS 7) and to identify the key determinants of effective governance. Finally, it deals with the association between such compliance and the cost of equity capital in GCC banks.

1.3 Research Significance

Over the last two decades, the international accounting standards have become an important subject for many researchers. Most of these researchers conduct empirical studies that discuss the implications of adopting IFRS, such as improving quality and transparency of financial statements (DeFond, Hung, Li, & Li, 2015; Jibril, 2019; Yamani & Almasarwah, 2019). Since IFRS 7 focuses on one of the most important components of the financial statements – financial instruments disclosure – it attracts the attention of many researchers, especially when it comes to the growth of the derivative instruments exchange (Jacobs, 2009; Pucci, 2017). Studying and dealing with financial instruments has been a controversial subject for many years, both in the academic and practical spheres. Thus far, the literature does not set a consistent definition of financial instruments, because of the complexity of its own concept. Many researchers realise the importance of focusing on the financial instruments: measuring, disclosing, and applying them appropriately, especially as they were identified as one of the main underlying causes of the 2008 financial crisis (Duh et al., 2012; Ryan, 2012; Siregar et al., 2016). In addition, concentrating on this topic will provide two benefits. Firstly, it will enhance the financial positions of the firms’
performance and cash flows, which will improve the quality of financial statements and investment decisions made by the stakeholders. Secondly, it will help the investors and stakeholders to be aware of all types of risk that the companies are facing and how these risks should be managed and controlled. Consequently, they will be able to assess the firms and make sound decisions related to their investments (Amoako & Asante, 2012; Sahrawat & Davis, 2011).

From another perspective, due to the wide scope of worldwide business, all types of investment have increased, which required additional funds. Since these funds came from different sources, it is necessary to provide adequate collaterals and information that would reassure lenders and investors, which in turn contribute to reducing the cost of equity capital (Pratt, 2003). This matter makes it necessary to pay more attention to conducting more empirical studies on the cost of equity capital and the factors that may affect its reduction. Hence, the importance of this study is to highlight the cost of equity capital and explain its association to one of the most important IFRS standards – IFRS 7 – which is directly related to the disclosure of all risk classes. In addition, the current thesis interprets this association in light of the most related institutions that apply FIs in the financial market: the banking sector, which is considered to be one of the first investment entities that attracts investors.

Lastly, this study seeks to deepen the roles that the financial instruments can play in the banking sector, especially in relation to the cost of equity capital. In other words, the study asks the following question: To what extent does compliance with IFRS 7 affect the cost of equity capital in banks?

1.4 Research Aim and Objectives

The aim of this thesis is to investigate the association between the compliance level with the Financial Instruments: Disclosures (IFRS 7) and the banks’ cost of equity capital (COEC) in the listed banks of GCC countries, namely: Saudi Arabia, Bahrain, Oman, Kuwait, Qatar, and UAE.

Therefore, this thesis seeks to achieve the following objectives:

1. To construct and score a new index based on the disclosure requirements of IFRS 7; 2. To measure the level of mandatory compliance with IFRS 7 in the GCC listed banks; 3. To
identify the effects of corporate governance determinants on the level of compliance with IFRS 7 in the GCC listed banks; and
4. To examine the impact of the level of compliance with IFRS 7 on the cost of equity capital in the listed banks of GCC countries.

1.5 Research Questions

In order to achieve the set research objectives, this study requires answering the following research questions:

1. How can an index that measures the compliance level with the disclosure requirements of IFRS 7 be constructed and scored?
2. To what extent do the GCC listed banks comply with the disclosure requirements of IFRS 7?
3. Do the corporate governance determinants affect the level of compliance with IFRS 7 in the GCC listed banks? and
4. Does the level of compliance with IFRS 7 affect the cost of equity capital in the listed banks in GCC countries?

1.6 Summary of Research Methodology

One of the most important tasks for the researcher is to draw the appropriate research paradigm through which they can solve the research problem and answer the research questions. This would also help the researcher to analyse the research phenomenon in more depth and identify the appropriate tools that may contribute to solving the problem as required (Easterby-Smith, Thorpe, & Lowe, 2002). There are four social science assumptions: namely ontology, epistemology, human nature, and methodology (Holden & Lynch, 2004; Scotland, 2012; Tuli, 2010). Ontology relies on the existence (being) and reality of entities and the main causes of existence, and it includes two concepts: objectivism and subjectivism. Objectivism deals with investigating and analysing the phenomenon away from any interference by the researcher and based on the external reality itself. Subjectivism addresses the researcher’s perceptions towards their study and their testing and evaluation of the phenomenon (Saunders, Lewis, & Thornhill, 2009).

Epistemology refers to the knowledge obtained and the researcher’s belief and justification
towards the study. This assumption has two positions: positivism and interpretivism (Hussey & Hussey, 1997; Scott, 2014). Consequently, positivism is the different associations between certain knowledge and properties of phenomena. Through positivism, researchers can reach their results from the observable social reality, which can be generalised in the same field of the study. For that, this philosophy adopts the first type of research approach which is the deductive approach. The deductive approach tests one theory or more by setting and developing hypotheses between different relationships and variables. These hypotheses can be accepted or rejected which can add more development to the theory tested and encourage further research (Neuman, 2003; Scotland, 2012; Scott, 2014). On the other side, interpretivism philosophy depicts the complexity of external factors and phenomena and the difficulty of measuring them. This makes the environment or the entity under study different from the other, and each entity has its own unique case and its interpretations related to it, which in turn makes it difficult to generalise the results of the findings reached. This trend is dependent on the subjective experiences of individuals, which may have the subjective interpretations of the researcher towards the phenomena. Under interpretivist philosophy is the inductive approach, the research approach that deals with the data collected by the researcher to generate and develop a new theory (Saunders et al., 2009). The third assumption is that human nature reflects the interaction that occurs between human beings (individuals) and their environment and to what extent individuals can be creative or are constrained by their environment (Karami, Rowley, & Analoui, 2006; Saunders et al., 2009).

The last assumption is the methodology, which is a map that guides the researcher to complete their study. The researcher here explains the research problem and clarifies the procedures and techniques used to collect and analyse the data. In addition, the research methods used must be explained, whether quantitative (numerical data) or qualitative (non-numerical data). Therefore, it is supposed that researchers have the ability to adopt the proper processes and methods that help them to achieve the research objectives and solve the research problem in the most convenient way (Kumar & Phrommathed, 2005; Saunders et al., 2009).

To explain the philosophical stance that this research follows, the current study includes the natural principles of authenticity and humanity (ontology), philosophical and theoretical information for investigation (epistemology), and the process and tools applied (methodology) (Popkewitz, 2011; Scott, 2014) (see Figure 1.1). Based on the above, this research adopts the positivism philosophy, deductive approach, and quantitative methods (panel data regression). It also uses content analysis.
for the data collection process. Further, to achieve the research objectives, the numerical data is collected from different sources, such as Bloomberg, DataStream, the official websites of banks and capital markets, besides the theoretical data from the literature review. For constructing the compliance index based on the disclosure requirements with IFRS 7, a guideline has been followed (as mentioned later in the research findings). Statistical analysis is employed for the different chapters (statistical programs include the Statistical Package for Social Science [SPSS] version 24 and STATA version 15). In Chapter Three, content analysis are applied to score the index and the dichotomous approach for measuring it. Descriptive statistics, testing the differences over years and countries, are presented. In Chapter Four, to identify the associations between the CG mechanisms and the level of compliance, a descriptive statistic, Pearson’s coefficient of correlation, and logistic regression are applied. In Chapter Five, to find out the impact of compliance with IFRS 7 on the COEC, a descriptive statistic, bivariate analysis, and multivariate analysis (transforming OLS, Tobit, and Quantile regressions) are applied. Finally, the endogeneity problem is discussed in Chapters Four and Five. Each of these chapters is prepared as a single study.
Figure 1.1 shows a brief summary of the philosophical stance followed for conducting research. It also highlights the paradigm followed by the current research.
The Impact of the Compliance Level with IFRS 7 on the COEC and CG Determinants.

**Institutional Features:**
- Age
- Size
- Profitability
- Leverage
- Liquidity
- Complexity
- C. Domicile
- Year dummies

**Corporate Governance**
(Board/Ownership/Audit committee)

**Market Factors:**
- Market Development
- Inflation rate
- M2B value
- ROA
- Total assets

**Firm**
(Compliance with IFRS 7)
1.7 Research Contributions

This study focuses on covering several gaps in the prior literature and presenting a new contribution to the overall literature, particularly in the context of the GCC countries. Several gaps and contributions are listed by achieving the objectives of the current study, including the empirical, theoretical, and methodological contributions.

❖ There is a significant gap in the prior literature in which, to the best of the researcher’s knowledge, no study has focused on IFRS 7 adoption through three different aspects: (1) measuring the compliance of the mandatory requirements of IFRS 7; (2) identifying the corporate governance (CG) determinants of the level of compliance; and (3) investigating the
The current study provides the first in-depth analysis of IFRS 7 compliance in the banks of GCC countries. It also concentrates on the last updates of the standard from 2010, which became effective in 2011. Therefore, this study provides a newly constructed index, which is based on the latest updates and passed through different stages of validity, which will be addressed in detail in Chapter Two of the thesis.

This study is different from the prior literature since its main focus is on the financial (banking) sector. Most of the prior studies focus solely on non-financial sectors and exclude financial sectors, such as banks, on the basis that financial sectors are subject to specific regimes and policies. In addition, many researchers exclude financial firms from their studies because of the difficulties in comparing banks’ accounting measures with other, different sectors. Consequently, this study focuses on the banking sector for two reasons. Firstly, the financial sector has been forced to mandatorily adopt IFRS at an earlier stage than other sectors in GCC countries. Secondly, the banking sector is one of the best sectors to represent financial instruments, due to the rich employment of financial instruments in banking operations.

The current study measures the compliance level with IFRS 7 in all GCC countries, which belong to one region (Gulf), and compares the results between these countries. The researcher believes that a set of countries that share common interests in a politically, culturally and economically important region would minimise the differences in practices and increase levels of compliance. Likewise, investigating a new environment will expand the literature regarding the progress towards the international business environment and improve the comparability and quality of the financial statements.

Although prior studies find that the differences in applying accounting standards (non compliance) can affect the financial reporting quality, they do not provide sufficient explanation of the corporate governance determinants’ effects on the compliance level with IFRS in general and IFRS 7 in particular. Shedding more light on the corporate governance mechanisms will expand the sphere of interpretations related to the factors that may affect the
This study contributes to the existing literature on the economic consequences of the mandatory IFRS implementation related to the disclosure requirements by conducting an empirical study to identify the association between mandatory IFRS 7 adoption and the cost of equity capital in banks in a cross-country study. This will provide more evidence and further data about the main relationship and other effects.

From a theoretical stance, the current study provides two theoretical contributions. Firstly, it interprets the increasing level of compliance with IFRS 7 based on legitimacy theory. It also discusses a group of theories to explain the relationships between CG determinants and the compliance level rather than focusing on one theory (agency theory). Moreover, it interprets the association between the compliance and cost of equity capital from the perspective of economic theory. To the best of the researcher’s knowledge, there is no previous study discussing the range of those theories in the frame of CG or employing legitimacy and economic theories in the same relationships as used for this study.

1.8 Research Findings

Setting the study objectives, choosing the appropriate research methods, and identifying the study sample and a certain time scale have yielded the desired results. In this part, the results obtained from the four chapters applied in this thesis are presented. The first part discusses the necessary steps to create an index that measures the degree of compliance with the disclosure requirements of IFRS 7. This part uses five steps to construct the index: basic source, materiality, reliability, validity, and scoring techniques. Since the index is considered the cornerstone of the thesis topic on which all of the upcoming results of the three subsequent studies are based, it is important to discuss and describe the relevant steps for conducting the index as accurately and validly as possible.

The second part, which focuses on measuring the degree of compliance with IFRS 7, shows that the degree of compliance has not changed significantly from 2011 to 2017 in GCC banks. The
highest compliance score is 96%, the lowest is 47%, and the average compliance score is 78%. It also provides a comparison regarding the compliance level among the included countries; Qatar represents the highest level with an average of 89%, while Kuwait has the lowest level at 66%.

The results of the next study clarify the extent to which the determinants of corporate governance affect the degree of compliance with IFRS 7 in GCC banks. The results show that all CG determinants employed in this study have a significant association with the compliance degree. Board size, board independence, board meeting frequency, and institutional ownership all have a negative effect, whereas audit committee (AC) size, AC independence, AC meeting frequency, blockholder ownership, and governmental ownership have a positive influence. The control variables included in the model (bank size, profitability, leverage, liquidity, age, complexity) all show insignificant effects on the compliance level, except profitability which has a positive influence of 90%.

The last study’s findings outline the impact of the compliance level with IFRS 7 on the cost of equity capital. After applying three types of regression: OLS, Tobit and Quantile, it is discovered that the compliance level can reduce the rate of the cost of equity capital. Even though this result is only confirmed by two regressions, a negative direction related to that relationship and significance demonstrated in the first two regressions still exists. Moreover, some of the control variables have a strong negative relationship with COEC (market development and market to book (M2B) value), unlike ROAA, which does not have any effect. Mixed results related to the rest of the variables are obtained (inflation rate and size). Table 1.1 presents a summary of the research hypotheses tested to reach the findings and the obtained direction of the relationship. Eleven hypotheses were tested. The first one tests whether the compliance level actually improved over the study period, and is rejected due to the stable compliance found over years. Chapter Four investigates nine hypotheses related to CG, and all of them are accepted. Chapter Five tests the association between the compliance level and the COEC, and it is also accepted.
Findings

H 3.1 The level of compliance with IFRS 7 improved from 2011 to 2017 in the listed banks in GCC countries.

Chapter Four

H 4.1 There is an association between the board size and extent of the banks’ compliance with IFRS 7 in GCC.

H 4.2 There is an association between the extent of banks’ compliance with IFRS 7 and board independence.

H 4.3 There is an association between the extent of banks’ compliance with IFRS 7 and frequency of board meetings.

H 4.4 There is an association between the extent of banks’ compliance with IFRS 7 and the audit committee size.

H 4.5 There is an association between the extent of banks’ compliance with IFRS 7 and audit committee independence.

H 4.6 There is an association between the extent of banks’ compliance with IFRS 7 and frequency of the audit committee meetings. H 4.7 There is an association between the extent of banks’ compliance with IFRS 7 and blockholder ownership.

H 4.8 There is an association between the extent of banks’ compliance with IFRS 7 and governmental ownership.

H 4.9 There is an association between the extent of banks’ compliance with IFRS 7 and institutional ownership.

Study five

H 5.1 A higher degree of compliance with the financial instruments related to the mandatory disclosure requirements of IFRS 7 is negatively associated with the cost of equity capital.

--- Rejected

1.9 Structure of the Thesis

The current thesis consists of four chapters under the umbrella of one main research theme. Since
the main research aim is to measure the degree of compliance with IFRS 7 and find the determinants and consequences of such compliance, the chapters are as follows:

The second chapter is entitled ‘Compliance with IFRS 7 by Financial Institutions: Evidence from GCC’. In this descriptive chapter, the theoretical and practical steps of how to construct an index to measure the degree of compliance are explained. In practice, it focuses on the disclosure requirements of IFRS 7. The first step is reading the standard; the second is choosing the index items and confirming their validity and reliability; and the third consists of using the coding method to calculate the compliance level. The researcher is encouraged to conduct this chapter for two reasons: firstly, to explain the practical methods used by the researcher in constructing the disclosure index employed for the research, and secondly, a clear gap is found in the literature in terms of how to construct an index that measures compliance within a theoretical and practical framework.

The third chapter is entitled ‘Measuring the Compliance Level with the Disclosure Requirements of IFRS 7: Evidence from GCC Listed Banks’. This chapter measures the degree of compliance with the disclosure requirements of IFRS 7 over seven years in all Gulf listed banks. This study investigates the direction of this compliance over the seven-year period and explains the differences in compliance between the sample countries (GCC countries).

The fourth chapter is entitled ‘The Impact of Corporate Governance on the IFRS 7 Compliance in GCC Listed Banks’. Throughout this chapter, a number of determinants of corporate governance are addressed: the board of directors’ characteristics (board size, board independence, board meeting frequency), characteristics of the audit committee (AC size, AC independence, AC meeting frequency), and the ownership structure characteristics (blockholder, governmental, institutional). In addition to CG variables, a number of control variables that are related to banks’ features, such as size, age, profitability, liquidity, complexity, leverage, and year and country dummies are included.

The fifth chapter is entitled ‘The Impact of IFRS 7 Compliance on the Cost of Equity Capital in GCC Listed Banks’. This last study examines the impact of compliance with IFRS 7 on the cost of equity capital. This study is considered the most significant due to its different contributions to the
existing knowledge and literature on empirical, theoretical, and methodological levels. Moreover, besides the year and country dummies, it includes some control variables that are related to both the bank attributes (ROAA and bank size) and the capital market attributes (market development, inflation rate, and market to book value).

Therefore, this thesis consists of six chapters. The first chapter is the introduction, whereas the second, third, fourth and fifth chapters represent the four empirical studies, respectively. Finally, Chapter Six discusses the conclusion, which summarises the main findings of the research, its limitations, and suggestions for future research.
Chapter Two: Compliance with IFRS 7 by Financial Institutions:
Evidence from GCC

2.1 Introduction

The emergence of IFRS and their adoption by many countries has been shown to be one of the most important challenges affecting global accounting harmonisation: i.e., the proper application of these standards as required. More clearly, this issue revolves around compliance with the application of the standards, which may vary from one country to another due to the different infrastructure of each country as well as other aspects (Baazaoui, 2019; Black, 2012). For that, many researchers measure the degree of compliance with the standards in order to enhance the accounting harmonisation and help to achieve the desired objectives, such as understanding of the standards and comparability between countries. To do so, the most common instrument that researchers use to measure compliance levels is the index (Tsalavoutas, Tsoligkas, & Evans, 2018; Urquiza, Navarro, & Trombetta, 2010).

Due to the increasing challenges of IFRS, it has become important to focus on all the components of financial reporting, such as financial statements, notes, and information related to the different ratios and financial instruments, which is probably the most significant one. As defined by Lim and Foo (2017, p.49), a financial instrument is “a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity”. Financial instruments have been discussed extensively over many years by the International Accounting Standards Board (IASB). After different stages of updates and processes, the mandatory application of IFRS 7 was enforced in 2007. IFRS 7 contains all the requirements that should be included in financial statements related to financial instruments’ disclosures, as well as all the risks arising from the implementation of financial instruments (Deloitte, 2017a, 2017b, 2017d, 2017e).

In addition, financial disclosure is considered one of the most important elements of the financial reporting process in particular, and to the firms’ life in general. Accounting researchers even point to financial disclosure as the business language that can facilitate financial communication...
to introduce a definition of financial disclosure as: “any deliberate public release of financial information, whether voluntary or required, numbers or words, formal or informal, at any time during the year”. This disclosed information may comprise financial (quantitative) and non-financial (qualitative) information. Different parties have a certain role in this circle of financial disclosure process, such as accountants, management, auditors, and analysts. Besides, the way of introducing financial disclosure may take different forms: periodic bulletins, official websites, analysts’ research, or through the most common type which is corporate annual reports (Crawford Camiciottoli, 2013; Ng & Ayub, 2018).

In light of the above, the importance of the compliance issue highlights the need to focus on the instrument used to measure the compliance (index) to achieve the desired results and, in turn, to reduce the differences in application of standards across countries. In addition, in focusing on the disclosure requirements related to one of the most important components of financial statements – financial instruments – the researcher addresses this compliance tool in detail in this chapter by stating the following question: what are the steps (guidelines) for constructing and scoring the compliance index with IFRS 7?

The motivations for this chapter are centred on several points: (1) the chapter discusses the required steps for constructing an index, which is considered a ‘map’ for informing future researchers looking to construct an index; (2) the chapter outlines the different methods used in literature for scoring the index, and then concentrates on the most appropriate for the current research to apply (Cooke’s formula); and (3) in response to calls by prior studies (Hassan & Marston, 2018; Tsalavoutas et al., 2018), this chapter highlights the role of three aspects – materiality, validation and reliability – in constructing an index, which are essential components.

It has been found empirically that every step (basic source, materiality, reliability, validity and scoring techniques) mentioned as a part of constructing and measuring the compliance index plays a significant role. However, there are some forms that can be considered alternatives for one another, as will be explained later. Overall, clarifying these steps for constructing an index and discussing them in detail will no doubt increase the effectiveness of the compliance tool used for measuring the compliance level. The two main issues discussed in the literature regarding disclosure indices are the items selection for the index, and the scoring formula employed for measuring the index. Prior literature does not show clear, accurate basics that can be followed to select the applicable disclosure items for a disclosure index (Alanezi & Albuloushi, 2011; Alanezi,
Alfaraih, Alrashaid, & Albolushi, 2012; Demir & Bahadir, 2014). There is also no consideration of different methods for scoring the index, and the main focus is only on the Cooke’s formula (Tsalavoutas et al., 2018).

Furthermore, Tsalavoutas et al. (2018) and Hassan and Marston (2018) stress the importance of validity and reliability due to their impact on the robustness of the research methodology. They also point to the existing gaps related to these aspects in compliance studies. Therefore, this chapter contributes to the knowledge by filling the gaps in literature related to measuring compliance levels, especially with regard to financial instruments. It provides a clear map and guiding principles for future researchers who tend to adopt the index method for various research purposes. It also gives an extensive discussion about validity, reliability, materiality and scoring, and what role they may play in enhancing the compliance instrument and reducing the contradictions found in previous findings.

In addition, this chapter provides a methodological contribution by constructing a new compliance index to measure the mandatory disclosure requirements of the International Financial Reporting Standards related to financial instruments (IFRS 7). It will shed light on the significant parts of IFRS 7, and the significance of the financial instruments. This index will be applied to a group of developing countries from the Gulf Cooperation Council (GCC), and this consequently will provide new empirical evidence of the disclosure practices in the GCC countries. Moreover, the chapter contributes to the IASB by supporting their efforts towards improving disclosure, especially with mandatory requirements. From another side, the chapter supports all the initiatives and efforts of policy makers, state legislators, government institutions, formal associations, and corporate governance that are responsible for monitoring organisations’ performance, especially now since the adoption of IFRS has become mandatory in most countries of the world.

Hence, the originality and novelty of this chapter lies in presenting illustrative descriptive steps in order to establish an index under the basic requirements (narrative study). In addition, the researcher applies these steps practically on a specific single standard of the IFRS which is Financial Instruments: Disclosures (IFRS 7). The outcomes of this chapter are centred on presenting a disclosure index with items covered by the selected standard, and scoring that index (using Cooke’s method) for a sample of listed banks from GCC countries from 2011 until 2017.

The remainder of this chapter is organised as follows. The next section reviews literature related
to compliance levels, including the methods (proxies) of compliance measurements employed in previous studies, and discusses the existing gaps. Following that, section three highlights the research design adopted for conducting this study, including the sample and the suggested guideline. Section four demonstrates the significant results of the study, and finally, a summary of the key outcomes of the chapter (conclusion) is provided in section five.

2.2 Literature Review

2.2.1 Financial Reporting Quality: Compliance

Literature regarding IFRS compliance shows mixed results (Agyei-Mensah, 2019b; Alfraih & Almutawa, 2017; Allini, Ferri, Maffei, & Zampella, 2019; Al Mutawaa & Hewaidy, 2010; Al Shammarri, 2011; Ballas, Sykianakis, Tzovas, & Vassilakopoulos, 2018; Bova & Pereira, 2012; Demir & Bahadir, 2014; Ebrahim & Abdelfattah, 2015; Fekete, Matis, & Lukács, 2008; Halbouni & Yasin, 2016; Hla et al., 2013; Tauringana & Chithambo, 2016; Tsalavoutas, 2011) which leads many researchers to investigate these contradictory findings by conducting more studies in the area.

The reality reveals that the quality of financial accounting is influenced obviously by the quality of financial disclosure, which in turn affects the assessment of companies, the decision-making process, and the efficiency of the capital markets (Pivac, Vuko, & Cular, 2017). Consequently, after global developments in the business environment – especially after adopting IFRS – researchers have increased interest in measuring disclosure levels by focusing on the compliance issue2 (Abdul Rahman & Hamdan, 2017; Al-Akra, Eddie, & Ali, 2010; Alfaraih, 2009; Alfraih & Almutawa, 2017; Al Mutawaa & Hewaidy, 2010; Al-Shammari, 2011; Ebrahim & Abdelfattah, 2015; Hla, Hassan, & Shaikh, 2013; Juhmani, 2017). They also have attempted to

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2 There is a distinction between the degree of compliance and the degree of disclosure. The degree of compliance includes all possible compliance elements that are under consideration, for example measurement requirements, presentation requirements, etc. This is in contrast to the degree of disclosure, which focuses only on disclosure requirements. In this study, the two terms will be used as an alternative to each other.

23 determine the impact of the compliance with IFRS mandatory/voluntary disclosure on various aspects such as economic and social factors and the performance of capital markets.

Accordingly, disclosure is classified into two main categories: mandatory disclosure and voluntary disclosure. Mandatory disclosure, which is the focus of this chapter, refers to the
financial/non-financial information or items that must be disclosed based on legal obligations such as IFRS. However, voluntary disclosure encompasses all the information that an entity wishes to disclose, for example the transparency and strength of its position within an increasingly competitive environment. This information is not considered binding or required by certain rules or accounting standards (Al-Shammari, 2005; Elshandidy, Fraser, & Hussainey, 2015; Gutierrez Ponce, Hlaciuc, Mates, & Maciuca, 2016; Li & Yang, 2016).

Previous studies state that there is considerable controversy among academics based on the concept of financial reporting quality. Bamber (2011) explains that the quality of financial reporting implies qualitative characteristics, such as relevance, understandability and comparability. The difficulty of constructing a measure based on this dimension means that some research has failed to overcome this obstacle (Jonas & Blanchet, 2000; Lee, Walker, Christensen, & Zhao, 2010). Therefore, researchers have so far relied on the principle that capturing the qualitative characteristics can be achieved through surveying and interviewing individuals. Moreover, they consider compliance as one of the financial reporting quality proxies, particularly as it is related with disclosure requirements (Bamber, 2011). From a critical view, compliance cannot reflect the whole quality of financial reporting, since it represents only a part, or one side, of financial reporting. However, due to the difficulty of measuring qualitative characteristics, most researchers have adopted disclosure as one of the more appropriate tools to measure compliance somewhat satisfactorily. Therefore, it can be seen that financial disclosure builds a bridge for providing the information directly between business enterprises on the one hand, and all relevant parties from outside the company on the other (Achim & Chis, 2014; Ahmed, 2012; Crawford Camiciottoli, 2013).

2.2.2 Proxies for Measuring Compliance Level

The difficult nature of measuring disclosure and its quality leads to considerable debate between researchers about what the most appropriate method is for measuring disclosure levels; that is, disclosure is sometimes based on an intangible stand which is not directly captured (Hassan & Marston, 2018; Ibrahim & Hussainey, 2019; Urquiza et al., 2010; von Alberti-Alhtaybat, Hutaibat, & Al-Htaybat, 2012). This is demonstrated by the study of Hassan and Marston (2018), who review 280 studies on disclosure and find that prior studies used different methods as a proxy of disclosure. These methods vary between disclosure count (to measure disclosure quantity),
properties of reported earnings (to measure the quality of disclosure), and disclosure index (to measure the quantity/quality of disclosure). In addition, other methods such as classification approach, sentiment analysis, market-based variables and adopting high-quality standards are used to measure different dimensions of financial disclosure (Hassan & Marston, 2018). However, measuring compliance levels by employing an index is found to be the most common method in previous literature (Agyei-Mensah, 2019b; Bravo Urquiza, Abad Navarro, & Trombetta, 2009; Coy & Dixon, 2004; Hossain, 2002; Tsalavoutas et al., 2018). IFRS compliance literature relies on constructing/developing a disclosure index that comprises a range of items to check manually from the corporates’ annual reports for certain years to determine the level of compliance (Agyei-Mensah, 2017a; Al-Akra et al., 2010; Alanezi & Albuloushi, 2011; Al-Jabri & Hussain, 2012; Alfaraih, 2009; Alfraih & Almutawa, 2017; Al Mutawaa & Hewaidy, 2010; Al-Shammari, Brown, & Tarca, 2008; Amoako & Asante, 2012; Demir & Bahadir, 2014; Fekete et al., 2008; Gutierrez Ponce et al., 2016; Juhmani, 2012, 2017; Karim & Ahmed, 2005; Lopes & Rodrigues, 2007; Mazzi, André, Dionysiou, & Tsalavoutas, 2017; Tahat, Dunne, Fifield, & Power, 2016; Tauringana & Chithambo, 2016).

Buzby (1975) and Stanga (1976) were the first researchers to apply the notion of a disclosure index. Accordingly, the disclosure index is considered a ratio to measure the actual disclosure level to the extent required, that does not result in the company being subjected to legal accountability for failing to disclose such information (Chavent, Ding, Fu, Stolowy, & Wang, 2006). A recent review was carried out by Tsalavoutas, Tsoligkas and Evans (2018) of 81 studies related to compliance with IFRS mandatory disclosure requirements. They discuss a number of relevant issues, including the different types of disclosure indices used in literature, in addition to the disclosure scoring, validity, reliability, and materiality, which will be discussed extensively in later sections. They find that the majority of researchers use a self-constructed index, while the remaining few develop indices from previous studies or adopt indices from audit firms. They also find that around 44% of the sample adopts the Cooke’s method for scoring the index. On the other hand, very few studies mention index validity and reliability together, despite their importance, but do discuss the materiality. Thus, despite the considerable controversy surrounding the diversity of measuring compliance levels, which still continues, it has been demonstrated that the most common measurement used in previous studies is the index.

2.2.3 Scoring the Compliance Index
After constructing the index, the next key issue that has been widely debated is determining the most suitable approach for scoring the items on the checklist. There are several methods for scoring the compliance checklists, and Tsalavoutas, Tsoligkas, and Evans (2018) present the six main methods used by researchers as being: Cooke’s method, Cooke’s adjusted, the partial compliance (PC) method, Saidin index, item by item, and counting items. For the first method, Cooke’s method – also referred to as the ‘unweighted dichotomous approach’ – is considered the most common approach adopted by several studies (Abdul Rahman & Hamdan, 2019; Agyei Mensah, 2017a; Alanezi & Albuloushi, 2011; Al-Shammari, 2005; Demir & Bahadir, 2014; Gutierrez Ponce et al., 2016; Juhmani, 2012, 2017; Marfo Yiadom & Atsunyo, 2014; Mohammadi & Mardini, 2016; Tauringana & Chithambo, 2016; Tsegba, Semberfan, & Tyokoso, 2017). The dichotomous approach considers the total of all applicable items disclosed by a company to the maximum possible number of disclosure items that should be disclosed. Consequently, it is a ratio that excludes non-applicable items from the index. This approach is scored as 1 if an item is disclosed, and 0 if an item is not disclosed. By adding more choices in the scoring process, Cooke’s adjusted method relies on 1 for disclosed items, 0.5 for partial disclosure, and 0 for non-disclosed items (Hossain, 2014).

In partial compliance (PC), the ratio is measured by dividing the number of items disclosed by the firm by the sum of the items for each standard, and then dividing the output by the whole total of items. Cooke’s method and the PC approach are considered to be unweighted, which gives equal weight to each item required to be disclosed. That means that the number of items included in each standard will not be affected, which gives objectivity a value to each item on its own. Moreover, using the PC unweighted approach can be applicable for measuring the

3 The equation of the PC method is \( PC_j = \frac{\sum x_i}{R_j} \), where \( PC_j \) = Total compliance score for each company and \( 0 \leq PC_j \leq 1 \), \( x_i \) = Level of compliance with each part of disclosure requirement, and \( R_j \) = Total number of compliance parts of each company (Islam & Haque, 2015).

compliance level for more than one standard, since the calculation for this approach requires the total items for each standard or classification (Tsalavoutas et al., 2010). Therefore, for the purposes of this study, the dichotomous approach is employed.

The Saidin method measures the disclosure of items by finding the ratio of companies that do not disclose the items (Mazzi et al., 2017). This method, in turn, is described as a weighted measure,
because it gives a certain range of weights for every IFRS disclosure item, and this indicates that companies with lower weights disclose more items, and vice versa (Hodgdon, Tondkar, Harless, & Adhikari, 2008). Following the item by item method means that each item is tested separately and mandated by a certain authority, such as the accounting standards (Tsalavoutas et al., 2018). Finally, the counting items method, in short, sums the total of the disclosed items in the index (Ebrahim, 2014).

In fact, the Cooke’s and PC methods are considered the most commonly used approaches in literature, separately or together. Some studies show that there is no significant difference between the two approaches, since each method has its own criticisms and merits (Alsaeed, 2006; Lopes & Rodrigues, 2007). However, Tsalavoutas, Evans and Smith (2010) conclude that there is a clear relative difference between the two approaches, which in turn makes a difference to the expected effects of the issue that is measured. They clarify that using the two approaches together in a study enhances the results and sheds light on other influences concerning issues under study. In addition, using two methods or more for scoring the index can be considered as increasing the robustness, enhancing the efficiency of the index and the compliance outcomes related to the selected sample under investigation (Tsalavoutas, Tsoligkas, & Evans, 2018).

It is also important to discuss the techniques that have been used by researchers during scoring of the index, and one of the most known techniques is content analysis. Content analysis can take one of two forms: manual or computerised. The manual approach uses keywords for counting the disclosure by reading through every single observation (annual report) manually, which may be time consuming and take a significant amount of effort. In contrast, computerised content analysis can be completed in a shorter time with less effort as it relies on advanced software designed for this specific purpose (Ibrahim & Hussainey, 2019; Weber, 1990). Both techniques have positive and negative points, but each researcher can decide which is the most suitable approach for his/her study based on the different justifications.

2.2.4 Critical Evaluation in the Literature

By reviewing the previous literature, some of the gaps in the following points can be summarised. Although compliance studies consider the index instrument as one of the most common techniques for measuring the compliance level, this instrument is subject to personal estimates. In spite of the common usage of this tool, as far as the researcher knows, there is no specific reference that clearly shows the steps for preparing the index and the alternatives available of
reliability, materiality, and validity. There is also a clear overlap related to certain concepts, such as reliability and validity. This was confirmed by the study of Tsalavoutas et al. (2018) in which they point out the lack of studies that discuss the materiality, reliability, and validity of the index in combination, despite the importance of each. Besides, the methods for scoring the index applied in previous studies are mostly limited to two methods: Cooke’s method (Abdul Rahman & Hamdan, 2019; Alanezi & Albuloushi, 2011; Al-Shammari, 2005; Gutierrez Ponce et al., 2016; Juhmani, 2012, 2017; Mohammadi & Mardini, 2016; Tauringana & Chithambo, 2016; Tsegba, Semberfan, & Tyokoso, 2017), and partial compliance (PC) (Santos, da Silva, Sheng, & Lora, 2018; Tsalavoutas et al., 2010), with clear disregard to using the other methods.

Consequently, the researcher faced a number of dilemmas when starting to prepare and score the index of the study. It was hard to find a particular reference that explains the necessary steps to prepare and score the index. Through these difficulties, and in addition to the gaps in the literature found in this respect, the researcher decided to focus deeply on this aspect and clarify the necessary steps to prepare and score an index to measure the level of compliance. These steps lay down the principal lines in front of any researcher seeking to create an index to measure the level of compliance and the methods for recording this indicator. This chapter provides an integrated image of the most important aspects identified for preparing the index and ensuring its validity and robustness. In addition, it discusses the different methods for scoring the index and uses one of these methods as a robustness step.

2.3 Research Design

This section outlines the process that can be followed for constructing and measuring an index, which is the most common instrument used in disclosure literature. The section is divided into two parts: the first provides a description of the selected sample, and the second discusses the guideline,
2.3.1 Sample and Data Collection

This chapter provides a descriptive and practical guideline in order to construct and score a disclosure index to measure compliance levels. The sample selected is one of the IFRS standards, specifically the disclosure requirements of the financial instruments related to IFRS 7. IFRS 7 has been selected to highlight the importance of financial instruments and their impact on financial information quality in general. It also reflects the growing interest in financial instruments among academics and practitioners, especially after the financial crisis of 2008, and frequent updates on IFRS 7. The constructed index is applied to a number of listed banks from the GCC countries, namely: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. The main focus is on the financial sector (banking sector), as it is considered to be one of the best sectors representing financial instruments, making it the most appropriate choice for application of the requirements of IFRS 7 (Allini et al., 2019). Besides, other aspects can be highlighted as there are differing business environments, especially between Middle Eastern (developing countries) and Western countries (developed countries). In addition, GCC countries share similar cultures, religion, and legal systems among one another and have all experienced early mandatory adoption of IFRS in the financial sector. Lastly, the lack of studies conducted in such an environment all lead towards a focus on developing a new index to measure IFRS 7
compliance levels among GCC countries.

The whole sample consists of the listed banks from the GCC countries that have already adopted IFRS mandatorily, except the Islamic banks as they adopt Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). However, a pilot study was considered for certain parts of the research which includes a section of the whole sample. The pilot study firstly consists of listed banks in Saudi Arabia only, and then a limited number of banks from other GCC countries are included to check the validity and reliability of the index. Table 2 shows in detail the number of banks included for the pilot study to complete the process for constructing the index. The period selected for the study is from 2011 to 2017. 2011 is selected to be the starting point for the annual reports, based on the latest amendment issued by the International Accounting Standards Board (IASB) of IFRS 7 in 2010, which came into effect at the beginning of 2011. Likewise, 2017 was chosen as the latest period that would be covered by the study. Secondary sources were used to collect sample data, namely annual reports (whether from the stock markets’ websites or the official websites of the banks), information from the official IFRS website, as well as any other useful sources, such as prior literature and auditing company websites.

\[^4\] AAOIFI is an independent international organisation that issues standards of auditing, accounting, ethics, governance, and Sharia for Islamic financial institutions. It is supported by institutional members from different countries (AAOIFI, 2020).

<table>
<thead>
<tr>
<th>Sample Years</th>
<th>Countries</th>
<th>No. Banks</th>
<th>No. Annual Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-2017</td>
<td>GCC</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2.3.2 Guidelines for Constructing the Index

In order to create and score an index that can measure the degree of compliance, the researcher suggests a number of steps. These steps are assumed to be followed by researchers who attempt to measure the degree of compliance in general, and with emphasis here on the accounting standards (IFRS). This guidance may lay down a number of significant basics which might be taken into consideration during construction and scoring of the index, and thus may help to develop research methodology and convergence between results. This guidance contains five steps – the main source, materiality, reliability, validity, and finally a scoring formula, which will be explained in the following sections.

2.3.2.1 The basic source (original standard)

With respect to mandatory disclosure, there are required elements that must be included in the annual reports. These elements are also subject to materiality (this concept is discussed later in the chapter) and some other conditions which make them more suitable to a certain sector. In this sense, researchers point to the need to refer to the main source of the requirements – the original standards issued by the IASB – and to ensure the mandated items that should be included for disclosure are indeed included (Alanezi & Albuloushi, 2011; Demir & Bahadir,
Reading the entire standard and understanding every section is an important step when building a measurement index. Therefore, an important question must be answered: what kind of item is being looked for? If the purpose of the index is measuring disclosure, it is necessary to focus only on all the disclosure’s requirements and ignore those relating to presentation items or measurement methods used in financial operations. In addition, a researcher should recognise the repeating items sometimes mentioned in different places of the standard, which must be avoided when creating the index. Another significant point that the researcher must be aware of is recognising significant dates: the issue date of the standard, the effective date for applying the standard by firms, dates of any changes/updates done on the standard, as well as the effective date of such updates.

By concentrating on IFRS 7, the complex nature of financial instruments makes the reading task of the standard much more difficult, especially when it comes to differentiating between presentation and disclosure requirements; this can lead to much confusion for researchers and financial statements preparers. This issue leads the IASB to make continuous amendments to this standard (Deloitte, 2017a, 2017c). However, the standard covers all required disclosure items related to financial instruments in financial statements and their notes, in addition to the qualitative information, such as the accounting policies followed by firms. Moreover, this standard has passed through many stages of development over several years. From the 1990s until 2014, the IASB repeatedly amended IFRS 7 (Deloitte, 2017a, 2017b, 2017e, 2017d) (see Table 3). As a result, the version of the standard after update in 2010 has been taken into consideration for this chapter. This version covers the updates carried out to improve the standard, such as including more clarification regarding the required disclosures. For the purpose of this chapter, this version has been chosen because the effective date for applying these amendments is the beginning of year 2011, which is within the range of the research period.

Table 2.2 Dates of Issuance and Change of Financial Instruments Standards

<table>
<thead>
<tr>
<th>Standard</th>
<th>Date of Issuance</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 7</td>
<td>2010</td>
</tr>
</tbody>
</table>
Details Issued Effective

**IAS 30:** Disclosures in the Financial Statements of Banks and Similar Financial Institutions

Requirements for the presentation of financial instruments: assets, liabilities, equity, interest, dividends and gains/losses. Requirements for the recognition and measurement of financial assets, financial liabilities, and some contracts of non financial items. Requirements for disclosure of information about the significance of financial instruments to an organisation 1990-1991 Replaced by IFRS 7

**1995-1996**

**IFRS 7:** Financial Instruments: Disclosures

Requirements for presentation and disclosure concerning financial instruments by financial institutions.

1998-2001 Replaced by IFRS 9 in 2018

**IFRS 7:** Amendments Some amendments were made to improve the standard (clarification of disclosures)

2010-2011

**IFRS 9:** Financial Instruments

Requirements for recognition and derecognition and general hedge accounting. (Permitted apply in 2015)

2005-2007

2014-2018 (Permitted apply in 2015)

2.3.2.2 Item materiality

Reading the standard as the main source for obtaining the required information and disclosure items is considered to be the first step in establishing an index. Being aware of the standard and its history gives a good indication of the compliance process requirements. The next important step is the materiality of the items, or in other words, the relevance of the chosen items. Most compliance studies that construct an index as a research tool pass through this step; however, they do not clearly indicate the details. Despite the importance of this step, many researchers may not be aware of the significant discussion and clarification needed during this step as a part of the process for preparing the index. Therefore, materiality is one of the factors that leads the researcher to address this matter in this section of the chapter. The researcher has faced difficulties relating to this issue while constructing the index, and there are no clear points or
directions show how to exclude irrelevant items and choose the most appropriate ones.
Materiality has been defined as “presenting a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available” (Khan, Serafeim, & Yoon, 2016, p.9). Accordingly, this process is a kind of items revision, where judgements are made towards the content of the index for it to become more rational in measuring the degree of compliance, and more fair in demonstrating the compliance results.

Many researchers believe that including as many items as possible is a good indicator of the quality of the index, but there may be a large part of bias in this. It is necessary to distinguish between those required items that can be scored as non-compliance, and items that are not appropriate/relevant for that sector or entity (‘not applicable’). Inserting the items in an index is therefore subject to certain judgements that are made by researchers and other parties such as auditors, management, or financial statements preparers. The lack of references in this area is confirmed by Tsalavoutas, Tsoligkas and Evans (2018) in their review study. They find that very few studies (eight studies out of 81) discuss, to some extent, the materiality issue. They also note that all of these studies are conducted in disclosures relating to goodwill and impairment. This may indicate a lack of knowledge of the importance of this aspect by researchers, and therefore they do not take much of their attention, and so, perhaps this is considered one of the reasons why different results and contradictions are found in some of these findings in previous studies related to compliance issues.

When preparing the disclosure index for IFRS 7, assistance was requested from a professional accredited auditor from one of the Big 4 auditing companies (KPMG) to check the appropriate items for the index. As a specialised auditor in this field in reality, this auditor has relevant, practical experience with IFRS implementation, and he is aware of the required items that must be included in financial statements. After a careful reading of IFRS 7 by the researcher and the auditor, it was agreed that the original standard includes some repeated items as well as irrelevant items within the period of the selected sample, such as those correlated with IFRS 9. Consequently, there were a number of phases to go through before arriving at the last version of the index. As a starting point, we took into consideration all the items mentioned in the

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5 Some items in note 10 required some judgement by the researcher, as some of these items are subject to several requirements belonging to IFRS 9, the standard dealing with financial instrument measurements. 6 Repeated items, such as the amount of maximum exposure to credit risk, were repeated in note 9 and 36.

34
standard (n=292), and not in any specific order or category. Following this, all repeated items were removed as well as any items relating to presentation or measurement, or any items that were considered to be supplementary information rather than clear requirements. Therefore, a new total of items was reached and came to 130. All requirements related to the last updates in 2010 but effective after June 2011 were then eliminated, along with all periods after that date, and the new total came to 103. Then, the items were categorised under specific titles, for example the titles of basic financial statements, and this reduced the total to 82 items. A final review was made to identify the items that were not applicable for the selected sample (banks), and the final number of items for the index totalled 76 (Table 2.3).

### Table 2.3 Materiality Phases for Final Index

<table>
<thead>
<tr>
<th>Phases</th>
<th>Items Removing Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase 1</td>
<td>292 Repeated items, items related to presentation or measurement, items were supplementary</td>
</tr>
<tr>
<td>Phase 2</td>
<td>130 Effective requirements after June in 2011, and all the periods after that date</td>
</tr>
<tr>
<td>Phase 3</td>
<td>103 Categorising and grouping the items under specific titles</td>
</tr>
<tr>
<td>Phase 4</td>
<td>82 Identifying non-applicable items</td>
</tr>
<tr>
<td>Last phase</td>
<td>76 (Final index)</td>
</tr>
</tbody>
</table>

#### 2.3.2.3 Index reliability

Reliability refers to the consistency in measuring the index’s results. This means that the coding or measuring done by one or more than one person, and for more than one time, leads to the same result without differences. Accordingly, reliability has three forms: stability, reproducibility, and accuracy (Hussainey, 2004). Stability means that measuring or scoring the index is completed many times by one person – the researcher or the index’s constructor. Reproducibility can be conducted by a group of people (more than one individual) when scoring the index. However, the researchers noticed that the agreement between the coders might be a result of chance or randomicity. Therefore, different tests (Scott’s pi, Krippendorff’s alpha, Cohen’s kappa) have been addressed to overcome this issue. Accuracy explains the internal consistency between items within the index. Each form is expressed in a particular method, and
it is assumed that all of these methods support the reliability approach (Hassan & Marston, 2018; Hussainey, 2004; Kavitha & Nandagopal, 2011).

After completing the disclosure index related to IFRS 7 in its final version of items, its reliability was verified as a part of the pilot study, and accordingly, a number of tests were conducted for that purpose. The researcher (one coder) took a part from the whole sample (12 observations out of 396) to check the stability by scoring 12 annual reports of six listed banks in Saudi Arabia from 2015 and 2016. Then, after a month, the researcher re-scored the same 12 annual reports. The results of the index scoring were the same both times. In addition to the stability, the researcher checked the reproducibility (more than one coder) by consulting two groups. The first group consisted of three academics and one professional accountant, and due to the limited timescale, one annual report was sent to them for coding. Two items were discussed with one participant regarding clarification of the desired context. Forty-two annual reports, one bank from each country from 2011 until 2017, and 10% of the whole sample were coded by one auditor from KPMG and the researcher who comprised the second group. The coding errors between the two coders were limited to two annual reports, otherwise there was agreement among the rest of the annual reports. The issue of the differences arose because of two points. Firstly, there was a difference in the understanding and interpretation of certain terms, such as those relating to the financial assets and those related to property and equipment assets. The second point relates to the search terms or words used in the content analysis. All points of disagreement were discussed and understood to the point where all parties agreed. Consequently, the coefficient of agreement was 95% (40/42), which increases the level of reliability of the measurement instrument (index) used for the study. With respect to accuracy, a Cronbach’s alpha test is typically used in most literature, which helps to measure the internal consistency between the items in the index. Here, alpha is equal to 89%, which is considered a good score, and this in turn increases the level of reliability of the index employed for this study (Rouf & Akhtaruddin, 2018).

2.3.2.4 Index validity

Validity is another aspect that enhances the ability of the index (measurement tool) to measure
the phenomenon under study, and to identify the concepts that the researcher wants to study. Carmines and Zeller (1979) define validity as “the extent to which any measuring instrument measures what it is intended to measure” (Carmines & Zeller, 1979, p.17). There are three common forms of validity, namely: content validity (face validity), criterion validity, and construct validity (Hassan & Marston, 2018; Hussainey, 2004). However, reviewing prior literature revealed that discussions of the precise concept of validity and in deep detail with the different forms are very few.

Content validity, also known as ‘face validity’, points to the role of the various judgements made by different parties, whether professionals or not, in evaluating the quality of the index and whether it is capable of effectively measuring what the researcher wants it to. Despite the role of these judgements being important, it may not be considered in some cases as an effective and convincing step, as those individuals/arbitrators may differ in their perceptions on which their judgements or assessments may be based (Hassan & Marston, 2018). Criterion validity simply provides a comparison between the indices either existing in literature or predicted, and the one that is employed for a study. The higher the correlation between them, the stronger the validity that can be achieved. This type of correlation promotes the validity of the index and its ability to measure and reflect the issue. Construct validity has been widely accepted among researchers in science research, as this form enhances the link between the prepared index and external variables mentioned in previous literature, such as the firms’ characteristics (Babaghaderi, Bhabra, & Kolahgar, 2018; Hassan & Marston, 2018; Weber, 1990).

Based on the sample of this study, content validity has been waived, because the researcher has already considered a similar step in the reliability process (reproducibility). An annual report was sent to four individuals (three academics and one accountant), and accordingly, a discussion took place about some items and amendments thereeto. Moreover, criterion validity was checked through comparing the present index with another study’s index, namely that of Tahat, Mardini, and Power (2017). A sample of six annual reports (one from each country from 2017) was scored with the two indices. The correlation coefficient is 89%, which is considered as a strong correlation between the two indices, and this in turn enhances the validity of the current

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7 A discussion took place to clarify some concepts implied in the items of the index which could be taken to have different meanings. Besides, some the items were too long and branching, which dispersed the focus on the specific point. This led to the reformulation of those items in a shorter and more concise way.
To check the last form of validity (construct), three variables related to corporations’ features were taken into consideration: firm size, profitability, and leverage ratio. In fact, several studies investigate compliance determinants, such as firm size, firm age, leverage ratio, profitability, and industry, and they consequently reveal mixed results (Samaha & Khliif, 2016; Tsalavoutas et al., 2018). However, Samaha and Khliif (2016) in their meta-analysis study show that the determinants that can influence compliance with IFRS in developing countries the most are firm size (Abdul Rahman & Hamdan, 2017; Al Mutawaa & Hewaidy, 2010; Alrawahi, & Sanad, 2016; Al-Sartawi, Al-Shammari et al., 2008; Bova & Pereira, 2012; Hodgdon, Tondkar, Adhikari, & Harless, 2009; Hossain, 2014; Samaha & Stapleton, 2009; Tahat et al., 2017; Tauringana & Chithambo, 2016; Tsegba et al., 2017), leverage (Al-Akra et al., 2010; Al-Sartawi et al., 2016; Al-Shammari et al., 2008; Bova & Pereira, 2012; Hossain, 2014; Karim & Ahmed, 2005; Tauringana & Chithambo, 2016), profitability (Al-Akra et al., 2010; Al Mutawaa & Hewaidy, 2010; Alrawahi & Sarea, 2016; Bova & Pereira, 2012; Elshandidy, 2011; Tsegba et al., 2017) and the type of auditor’s firm (Alrawahi & Sarea, 2016; Appiah, Awunyo-Vitor, Mireku, & Ahiagbah, 2016; Juhmani, 2017). For the present study, the variables that are examined are firm size, leverage, and profitability. The type of auditor’s firm is not suitable for this study because after checking all the banks in the sample, it was found that all the banks adopt at least one, usually two, of the Big 4 auditing companies. The results of the correlation test show a correlation between the disclosure index and the selected variables. The correlation coefficients between the index and firm size, profitability, and leverage are 0.29, 0.27, and -0.24, respectively, and have p-values of less than 1% (see Table 2.4).

Table 2.4 Pearson Correlations (Validity Construct)

<table>
<thead>
<tr>
<th></th>
<th>D.INDX</th>
<th>F.SIZE</th>
<th>PROF</th>
<th>LEVR</th>
</tr>
</thead>
<tbody>
<tr>
<td>D.INDX</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2.3.2.5 Index scoring

In line with prior literature (Abdul Rahman & Hamdan, 2019; Agyei-Mensah, 2017a; Al Shammar, 2005; Alanezi & Albuloushi, 2011; Gutierrez Ponce et al., 2016; Juhmani, 2012, 2017; Tauringana & Chithambo, 2016; Tsegba, Semberfan, & Tyokoso, 2017), and for the purposes of the current study, Cooke’s method has been applied to score the disclosure index of IFRS 7 requirements: 1 for disclosed items, 0 for non-disclosed items, excluding non-applicable items. Moreover, for robustness purposes, the counting items method has been applied as additional analysis for scoring the index. By applying the two methods of scoring – Cooke’s and counting items methods – on 12 listed banks from Saudi Arabia (pilot study on a partial sample; 84 annual reports) from 2011 until 2017, it is notable that the differences between the two methods are very small and almost negligible (Table 2.5). A Mann-Whitney test shows that the p-value of 0.293 (29.3%) is greater than 5%, and therefore the calculation of compliance levels under Cooke’s method does not differ from the method of counting items; that is, the difference between the two methods is insignificant. This in turn increases the robustness of scoring the index employed for the current study.

Table 2.5 Robustness Test for Scoring the Index Method Applied

<table>
<thead>
<tr>
<th>Scoring Banks</th>
<th>Cooke’s Method</th>
<th>Counting items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011-2017</td>
<td>0.8183</td>
<td>0.8250</td>
</tr>
<tr>
<td>2011-2013</td>
<td>0.8250</td>
<td>0.8267</td>
</tr>
<tr>
<td>2012</td>
<td>0.8267</td>
<td>0.8308</td>
</tr>
<tr>
<td>2013</td>
<td>0.8308</td>
<td>0.8325</td>
</tr>
<tr>
<td>2014</td>
<td>0.8325</td>
<td>0.8308</td>
</tr>
<tr>
<td>2015</td>
<td>0.8308</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2.4 Findings and Discussion

The table provided in Appendix 1 summarises the entire process conducted above for constructing and scoring the disclosure index. It shows all the different stages that the index passed through for measuring the compliance level with regards to the requirements of IFRS 7. The table shows that the processes followed to construct and code the index are basic source, materiality, reliability, validity, and scoring formula. The explanation for each process is provided as follows: (1) basic source includes reading and analysing the original source of the items (IFRS 7); (2) materiality focuses carefully on revising the relevant items and classifying them as a way to meet the purpose of the study without neglecting any important items that may affect the achievement of the desired results; (3) reliability checks the consistency in measuring the index’s total; (4) validity tests the extent to which the index can measure the compliance level; and (5) the scoring formula, among a number of techniques, as an unweighted dichotomous approach (Cooke’s method) is adopted for scoring the index for the current study. Accordingly, these results can answer the study’s question of what the steps are for constructing and scoring a compliance index with IFRS 7, by applying the previous steps.

The results show that item materiality is considered the cornerstone that the index can be built upon; that is, this stage needs some assistance regarding the judgements related to the relevant items from different parties – the researchers and professionals. Moreover, reliability and validity are two sides of a single coin, intended to determine the robustness and ability of the index to interpret the expected results as correctly as possible. For this reason, the distinction between these two concepts is important for the researcher in order to complete validation procedures. Consequently, it can be seen that reliability and validity have similarities in some aspects, such as the first form of validity (content) and the second form of reliability (reproducibility), however it is necessary to distinguish between reliability and validity in order to obtain a high degree of confidence with the index employed. While reliability focuses on reaching the same coding results by multiple individuals, validity is concerned with the extent to which variables can interpret the phenomenon that the researcher wants to test.
2.5 Conclusion

This study, as mentioned previously, explains one of the most significant parts related to measuring compliance levels. One main research question is addressed in this thesis: what are the steps (guidelines) suggested for constructing and scoring a compliance index? This question sheds light on the relevant steps that might be considered by researchers in order to construct and score an index for compliance purposes in general. These steps are basic source, materiality, reliability, validity, and scoring methods, and every step has been discussed in detail in this study. To provide empirical evidence on these steps, the disclosure requirements of IFRS 7 have been considered for constructing an index, being applied on a sample of listed banks from the GCC countries. The content (materiality) of the index varies from 292 items at the first stage, to a total of 76 items at the final stage. The three forms of reliability (stability, reproducibility, and accuracy) and the other three forms of validity (content, criterion, and construct) have been applied to ensure the robustness of the constructing and scoring of the IFRS 7 index. Moreover, this chapter presented the different methods for scoring and calculating the index, indicating that the most common method is Cooke’s method, which is subsequently applied in the research. Thus, the diversity in the means of constructing an index, ensuring its reliability and validity, or the choice of calculation of the index may consequently lead to a variety of results in compliance studies. The application of the aforementioned steps may help to reduce these differences in research findings, however this does not mean that it is necessary to go through all the forms mentioned in the study. It might be prudent to conduct at least one form from each stage, which will promote the measurement instrument (the index).

Like any research, this study has some shortcomings. It focuses only on disclosure requirements, and therefore it would benefit from a focus on other types of requirement such as measurement and presentation requirements. Since it addresses only one standard, this in turn can limit the application of some methods of scoring, such as the PC method which requires more than one standard with different categories. Further, review of previous literature as well as Tsalavoutas, Tsoligkas, and Evans’ (2018) study shows that the most common methods applied when scoring indices are Cooke’s and PC methods. This, in turn, suggests that more attention might be given to the other methods by future researchers, providing they can be demonstrated as being robust enough to enhance the validity of the index and are able to interpret the phenomenon under study. This study did not consider the differences between Islamic and non-Islamic banks, and this issue
could also be addressed in the future. Lastly, more attention may be paid in future studies to include measurement of non-financial sectors.

Chapter Three: Measuring the Compliance Level with Disclosure Requirements of IFRS 7: Evidence from the GCC Listed Banks

3.1 Introduction

The EU Council’s decision to apply the International Financial Reporting Standards (IFRS) in
2002 has also affected countries outside of Europe. A number of these countries started following suit, and that number has continued to increase until the present day (Ismail, 2017). Consequently, the application of a new system such as IFRS might face several difficulties and challenges. Some studies point to the lack of IFRS implementation guidance and knowledge among employees and auditors (Aljifri, 2013; Farima, 2018), and the fact that the IFRS adoption process is costly, complex, and somewhat burdensome (de George et al., 2013; Jermakowicz & Gornik Tomaszewski, 2006). Moreover, cultural obstacles, economic issues, insufficient enforcement mechanisms, taxation, and fair value measurements are considered as some of the key challenges that countries face during IFRS application (Abedana & Gayomey, 2016; Alexander, 2019; Alsaqqa & Sawan, 2013; Boateng, Arhin, & Afful, 2014; Dowa, Elgammi, Elhatab, & Mutat, 2017; Odia & Ogiedu, 2013; Odo, 2018; Rai, 2012; Tesfu, 2012; Zakari, 2014). Overall, the countries that have already adopted or plan to adopt IFRS in the future are likely to face a number of difficulties, which may vary from one country to another. These variations might be caused by variations in political, cultural and other aspects (Burton, Frost & Lin, 2012; Pownall & Wieczynska, 2018). Thus, researchers study the differences between countries that could affect the standardisation of accounting practices and impede accounting harmonisation. To be more precise, they examine the actual practices of the entities in reality by measuring the level of compliance and the extent to which they are complying with the binding standards, considering that IFRS is a standardised and uniformly applied accounting language that enhances global convergence in accounting practices (Lin, Riccardi, Wang, Hopkins, & Kabureck, 2019).

From another angle, the long history of financial instruments since the 1990s has established its role in the business environment. The difficult nature of financial instruments, especially with regard to their measurements and estimations, raises a controversial issue concerning the aforementioned instruments. Furthermore, financial instruments have been criticised as one of the causes of the financial crisis in 2008 (Duh et al., 2012; Pucci, 2017; Siregar et al., 2016), particularly in the banking sector, which represents a clear opposition to the use of fair value measurements (Gebhardt et al., 2004). This matter led to increased business risks, which affected the reliability of financial statements when making appropriate decisions (Duh et al., 2012; Lim & Foo, 2017). Consequently, the IASB updated a number of standards related to financial instruments, until it reached the final update that addresses the disclosure requirements: IFRS 7 (Financial Instruments: Disclosures). The preparers and users of financial statements call for the need to improve financial reporting related to financial instruments. They also stress the
importance of increasing the transparency of the financial information disclosed by institutions and
the risks related to financial instruments (Pucci, 2017; Ryan, 2012). Therefore, the current study concentrates on measuring compliance with the disclosure requirements of IFRS 7.

With a sole focus on the studies that have been applied in all GCC countries (without taking into account the individual studies of each country), the studies conducted to measure the compliance (disclosure) levels in GCC countries are divided into different streams. Some studies focus on measuring corporate governance disclosure and its various effects (Grassa, 2018; Grassa & Chakroun, 2016; Shehata, 2016; Srairi, 2015), while others focus on the disclosure of corporate social responsibility (CSR) (Abduh & AlAgeely, 2015; Platonova, Asutay, Dixon & Mohammad, 2018). Yet another study stream focuses on the disclosure of financial information on the Internet (Ismail, 2003; Mohamed & Basuony, 2016; Sarea, Al-Sartawi, & Khalid, 2018; Zakari, 2014), as well as the disclosure of intellectual capital (Al-Ebel & Ishak, 2018). There are also studies that focus on measuring the degree of compliance with the international accounting standards altogether, such as Al-Shammari’s (2005), which measures the degree of compliance with IAS in the GCC from 1996 to 2002. In contrast, other studies measure IFRS compliance levels in individual Gulf countries, on both individual and group planes. Thus, it can be observed that a focus on all GCC countries (cross-country study), especially regarding their compliance levels with IFRS, is very scarce. Accordingly, this encourages more studies to be conducted to investigate the disclosure environment in the Gulf region and to achieve results that would enhance the literature in developing countries.

Based on the above discussion, the issue of compliance with IFRS is considered an important issue that many researchers have focused on in the past. Regarding financial instruments, it is obvious that there is a need to focus on this aspect as one of the more important financial reporting components. This study provides an evaluation of the level of compliance with IFRS 7 in GCC listed banks and answers the following research questions: Did the compliance level with IFRS 7 improve in GCC banks from 2011 until 2017? Are there any significant differences in the degree of compliance between GCC member countries?

Hence, there are a number of factors that have encouraged the conducting of the current study. Through reading the existing literature, the researcher finds that there are still some unanswered
questions about what exactly financial instruments are and what their importance in business is. Despite the growing interest in financial instruments among academics and practitioners, especially after 2008, and the continuing updates to IFRS 7 and IFRS 9, there is still some uncertainty around the importance of financial instruments and how they may affect business processes and the quality of financial information. Moreover, the important role played by the banking sector in GCC countries, which represents the largest sector relative to other sectors, as well as the extent to which banks are associated with the work of financial instruments, added more motivation to focus solely on this sector for measuring IFRS 7 compliance.

The findings show that the compliance level of the GCC listed banks did not significantly improve from 2011 until 2017. After scoring 396 observations, it was found that the degree of compliance with IFRS 7 ranged from 96% (maximum) to 47% (minimum), with an average of 78% over the entire period. The seven-year compliance trend is fairly consistent, changing from 77% in 2011 to 78% in 2017. In addition, Qatar achieved the highest degree of compliance with 89%, while Kuwait had the lowest degree of compliance with 66%. The rest of the countries converged between 77% and 78%.

Furthermore, while there are obvious efforts in prior studies to address the issue of compliance with IFRS in general and IFRS 7 in particular, several gaps are found in this area. Review of the preceding literature reveals that only a few studies deal with IFRS 7 compliance, and cover short time periods of two or three years (Lopes & Rodrigues, 2007; Tahat, Dunne, Fifield, & Power, 2016). Other studies (Amoako & Asante, 2012; Hossain, 2014; Mohammadi & Mardini, 2016) include a small study sample: six, four, and eight banks, respectively. Some studies do not include the financial sector while measuring compliance (Adznan & Nelson, 2014), while others focus on a single country (Adznan & Nelson, 2014; Agyei-Mensah, 2017a; Amoako & Asante, 2012; Hossain, 2014; Lopes & Rodrigues, 2007; Mohammadi & Mardini, 2016; Tahat et al., 2016; Tahat, Mardini, & Power, 2017; Tauringana & Chithambo, 2016). In addition, there is a lack of studies conducted in developing countries – especially in GCC countries – when it comes to measuring the compliance level with IFRS 7. Therefore, the current study fills all of these gaps by measuring IFRS 7 compliance in a cross-country study (GCC countries) for all listed banks. Likewise, it provides a methodological contribution by constructing a new index for measuring compliance with IFRS 7, including the recent updates to the standard in 2010. It also includes a large sample (all listed banks in the GCC) and measures compliance over a longer period of time (seven years).
from 2011 to 2017. Moreover, this study employs legitimacy theory to interpret the compliance level trend over time, if any, which, to the best of the researcher’s knowledge, has never been applied by any previous studies.

Finally, the remainder of this study is outlined as follows. The next section provides a review of the literature related to compliance levels with IFRS in general and IFRS 7 in particular. The third section discusses the theoretical stance and developing the hypothesis of the study. In the fourth section, the research methodology is addressed by including the sample, data collection and data analysis. The fifth and sixth sections present the findings of the study and conclusion, respectively.

3.2 Literature Review

3.2.1 IFRS Compliance Around the World

Recognising the meaning of IFRS compliance and its significant role in achieving accounting harmonisation, especially when some studies show that IFRS adoption does not improve the accounting environment as expected (Ahmed et al., 2013; Jeanjean & Stolowy, 2008), has raised questions among researchers. Therefore, there is a motivation to conduct further empirical studies that would shed more light on IFRS application practices worldwide and identify the factors that may enhance the quality of these practices. The literature pertaining to IFRS compliance and its determinants exposes different results when considering the national, economic and social differences between countries. Thus, researchers examine the level of compliance with IFRS in different countries and address the impact of different corporate attributes on such compliance (Abdul Rahman & Hamdan, 2017; Affes & Makni-Fourati, 2019; Al-Akra, Eddie, & Ali, 2010; Alanezi, Alfraih, & Alshammari, 2016; Alanezi & Albuloushi, 2011; Alanezi, Alfaraih, Alrashaid, & Albolushi, 2012; Alfaraih, 2009; Alfaraih, 2016; Alfraih & Almutawa, 2017; Aljifri, Alzarouni, Ng, & Tahir, 2014; Almasarwah, Omoush, & Alsharari, 2018; Al Mutawaa & Hewaidy, 2010; Alrawahi & Sarea, 2016; Al-Sartawi, Alrawahi, & Sanad, 2016; Al-Shammari, 2011; Appiah, Awunyo-Vitor, Mireku, & Ahiagbah, 2016; Awodiran, 2019; Bagudo, Ishak, & Manaf, 2018; Ballas, Sykianakis, Tzovas, & Vassilakopoulos, 2018; Demir & Bahadir, 2014; Ebrahim & Abdelfattah, 2015; Fekete, Matis, & Lukács, 2008; Gutierrez Ponce, Hlaciuc, Mates, & Maciuca, 2016; Halbouni & Yasin, 2016; Hla, Hassan, & Shaikh, 2013; Juhmani, 2012, 2017; Karim & Ahmed, 2005; Khamees, 2018; Marfo Yiadom & Atsunyo, 2014; Okoye & Nwoye,
Compliance with international accounting standards (IAS) is investigated in 137 firms from GCC countries (developing countries) from the period 1996 to 2002 by Al-Shammari et al. (2008). The degree of compliance in their study is somewhat elevated at a rate of 82%. Nevertheless, Nobes and Zeff (2008) discover that Australia, France, Germany, Spain and the United Kingdom (developed countries) did not comply fully with IFRS from 2005 to 2006, despite the mandatory adoption by the EU. There is a duplication between IFRS and local standards, as well as of the auditors’ reports, which raised certain doubts about the credibility of financial statements. Moreover, Tsalavoutas (2011) and Al-Jabri and Hussain (2012) also find similar levels of compliance with IFRS in Greece and Oman (79%). Having been audited by a ‘Big 4’ auditor, the shareholders’ equity and net income affect the levels of compliance in Greece (Tsalavoutas, 2011). In addition, failure to properly understand the standards and the high cost of compliance may have been some of the reasons for non-compliance in Oman (Al-Jabri & Hussain, 2012). Fekete et al. (2008) also find a low level of compliance with IFRS in Hungary (62%) and conclude that this result is actually affected by the firms’ size and industry type. Another study conducted by Zureigat (2015) consisting of 176 observations in the financial sector (banking and insurance firms) in Saudi Arabia reveals that there is a positive correlation between audit quality, auditor experience, and level of IFRS compliance on disclosure.

Further study is conducted in this field by Bova and Pereira (2012), who discuss the determinants of IFRS compliance in Kenya. They find that leverage, firm size, profitability, stock turnover, and foreign ownership all affect the extent of compliance. Moreover, they note that public firms tend to comply more than private firms. Alanezi et al. (2012) point out that compliance with mandatory IFRS adoption in Kuwait is positively affected by the dual-auditing of the firms. In Malaysia, interviewing of accountants, auditors and managers, in addition to reviewing 225 annual reports, has shown that the most problematic factors that contribute to low IFRS compliance are the impairment of assets, leases, and employee benefits (Abdullah, Sulaiman, Ismail, & Sapiei, 2012). Saidu and Dauda (2014) also claim that the low level of IFRS compliance in Nigerian banks is influenced by the lack of accountants’ knowledge and the extent of the global capital market openness in the country. Similarly, Mokhtar, Elharidy and Mandour (2018) state
that besides insufficient accounting education and a weak monitoring system, the competitive environment negatively affects compliance with disclosure requirements in Egypt.

Additionally, Boshnak (2017) compares IFRS compliance levels between mandatory disclosure and voluntary disclosure in GCC countries, covering the period from 2010 to 2013. By utilising two different disclosure indices for measuring both the mandatory and voluntary disclosure items for 120 listed firms, he obtains similar results. These results indicate that the average level is 0.73; the highest average level of compliance in the UAE is 0.77, while the lowest level of 0.71 is in Bahrain. Some determinants show a positive effect on compliance, such as firm size, international presence, firm age, governmental ownership, board independence and the educational level of the board of directors. On the other hand, other factors, such as firm profitability, institutional ownership, board size and CEO duality, have negative effects on compliance.

### Table 3.1 Summary of Literature Related to IFRS Compliance

<table>
<thead>
<tr>
<th>Study Sample (country/period/no. firms)</th>
<th>Standards Compliance level % (mean)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh/2002/188 IASs</td>
<td>39.75</td>
</tr>
<tr>
<td>Al-Shammari et al. (2008) GCC countries/1996-2002/137 IFRSs</td>
<td>82</td>
</tr>
<tr>
<td>Fekete et al. (2008) Hungary/2006/18* IFRSs</td>
<td>62</td>
</tr>
</tbody>
</table>


Al Mutawaa and Hewaidy (2010) Kuwait/2006/48* IFRSs 69


49


Jallad (2020) Qatar/2015-2017/24* IFRSs 86 * This sample excludes the financial sector
3.2.2 Compliance with IFRS 7

Bearing IFRS 7 adoption in mind, previous studies discuss the compliance level of the financial instruments, both with the first versions of the standards (IAS 32, IAS 39), as well as with the newest updates (IFRS 7, IFRS 9). Lopes and Rodrigues (2007) measure the disclosure compliance with IAS 32 and IAS 39 in 55 Portuguese listed companies for the year 2001, and for four years before the mandatory application. They notice that a range of characteristics, including size, industry, auditor type, listing status, and multi-nationalism, have an impact on disclosure. An important point can be added regarding this study, which is that many Portuguese firms in fact do not comply with IAS 32 and IAS 39, nor with the local Accounting Directive 18 (Portuguese accounting standards). This indicates that the Portuguese accounting system is in need of improvements to and strengthening of its monitoring systems in order to be more effective.

As the financial sector is the most common sector using financial instruments, Amoako and Asante (2012), Hossain (2014), and Mohammadi and Mardini (2016) investigate the degree of compliance with IFRS 7 in the banking sector in Ghana, Bangladesh, and Qatar, respectively. Amoako and Asante (2012) find that the level of mandatory compliance with IFRS 7 increased from 2008 to 2009 in six banks, reaching 96%. However, Hossain (2014) observes a low rate of compliance in four banks, at 61.36%. Although Mohammadi and Mardini (2016) detect a rise in the compliance level in Qatar’s banks from 52% to 71%, this compliance remains low. Mohammadi and Mardini (2016) capture a number of factors that have a positive effect on compliance, such as bank size and the existence of a risk management committee. On the other hand, net assets value, cost to income, and earning per share have negative effects on compliance. Furthermore, Sarea and Dalal’s (2015) findings show that firms in Bahrain for the year 2013 generally complied with IFRS 7, with the highest level of compliance shown by the investment sector.

Based on another overview, some studies have concentrated solely on specific elements of IFRS 7, such as on the items related to risks disclosure. In Malawi, the level of compliance has a very low average (40%), while firm size, leverage and board independence play a significant role in that average (Tauringana & Chithambo, 2016). Similarly, Agyei-Mensah (2017a) examines IFRS 7 risk disclosure and finds that Ghanaian firms displayed a low level of compliance from 2011 to
2013. Later, further study by Agyei-Mensah (2017b) identifies the compliance of 28 firms from Botswana and 30 firms from Ghana during a period of three years: 2013, 2014 and 2015. Once again, he discovers a low level of compliance. He attributes the second study’s low compliance to corrupt practices in both countries, which are controlled by specific parties that prevent the disclosure of sufficient information. Furthermore, Allini, Ferri, Maffel, and Zampella (2019) measure the level of compliance with IFRS 7 in Italy’s listed banks from 2007 to 2013. They concentrate only on the requirements related to the three types of risks: credit risk, market risk, and liquidity risk, which are included in IFRS 7. They find that the compliance levels of the risk types are very close to each other: credit risk (53%), market risk (55%) and liquidity risk (59%). They also point out that banks are not inclined to improve compliance for several reasons, including the high cost.

Bamber (2011) examines the IFRS 7 compliance of non-financial firms listed in the UK for the year 2008. The level of compliance was high and sufficient. However, he uses a different method for measuring the quality of disclosure by surveying and interviewing stakeholders’ views to closely identify the determinants. It is found that higher levels of visibility (news stories versus analysts following), share issues during the year, and higher volume of derivative assets held are statistically very significant for the compliance level. Bamber (2011) concludes that analysts following the stocks during the year, and the volume of derivative assets, directly affect disclosure quality. These results may raise controversy about whether the quality of the disclosure is more qualitative than quantitative. In a subsequent study by Leote, Pereira, Brites, and Godinho (2020) in measuring the degree of compliance with IFRS 7 in a number of Portuguese companies from 2015 to 2017, it is found that there was an average commitment for those companies equivalent to 60%.

In addition, Tahat et al. (2016) compare IAS 30/32 compliance with the compliance under IFRS 7 in 2006 and 2007, respectively. They examine 82 Jordanian listed companies. The results indicate that the firms were in compliance with IFRS 7 in 2007 to a greater degree than in 2006 with IAS 30/32, especially in the banking sector. Moreover, it is concluded that compliance with IFRS 7 enhances the quality and comparability of financial reporting. Afterward, Tahat et al. (2017) measure the compliance level with IFRS 7 for the same sample, but covering a different period of time: 2013 and 2014. The results indicate a low compliance level at 52%, which is
affected by the firm size and auditor type, while industry and ownership structure have no effect whatsoever. Haddad, Mardini and Tahat (2018) measure the level of compliance with the financial instruments’ requirements related to IAS 30, IAS 32 and IFRS 7 for 42 listed firms from Qatar. They find that level of compliance increased from 23.97% in 2005 to 47.31% in 2012. They attribute this low level of compliance to a number of reasons, such as social and cultural life in Qatar, institutional ownership, and family businesses in the country.

Similarly and by employing different variables, Malaquias and Zambra (2018) examine the impact of firm size, leverage, listing status, profitability, auditor type, country infrastructure, and internet access on the level of compliance with IFRS 7 and IFRS 9. The study focuses on firms from four Latin American countries: Brazil, Chile, Peru and Mexico, and only on the mining industry, for the year 2015. Interestingly, the firms show a good overall compliance, with the highest being in Mexico, even though none of the variables except firm size show any significant impact.

Table 3.2 Summary of Literature Related to FI Compliance

<table>
<thead>
<tr>
<th>Study Sample (country/period/No. firms)</th>
<th>Standards Compliance level % (mean)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mohammadi and Mardini (2016) Qatar/2007-2012/8 IFRS 7 65.50</td>
<td></td>
</tr>
<tr>
<td>Post IFRS 7: 47</td>
<td></td>
</tr>
<tr>
<td>Malaquias and Zambra (2018) Brazil, Chile, Peru and Mexico (Latin American)/2015/72* IFRS 7 &amp; IFRS 9 47.81 (IFRS 7) 24.07 (IFRS 9)</td>
<td>Allini, Ferri, Maffel, and Zampella (2019)</td>
</tr>
<tr>
<td>Tahat, Mardini, and Haddad</td>
<td>Qatar/2005-2012/42 IAS 30,</td>
</tr>
</tbody>
</table>
3.2.3 Critical Evaluation in the Literature

Previous studies demonstrate that great interest has been shown in IFRS compliance from academics and researchers (see Table 3.2). This illustrates how important it is to investigate this issue and contribute towards narrowing the scope of differences in the application of IFRS between different countries. Moreover, it is also concluded that most of the previous studies focus on measuring compliance with a set of IFRS standards. Alternatively, focusing on a single standard is rare, such as the studies of Sarea and Al Nesuf (2013), Halbouni and Yasin (2016): IAS 21; Ebrahim and Abdelfattah (2015): IAS 12; Budaraj and Sarea (2015): IAS 18; Alrawahi and Sarea (2016), Al-Sartawi et al. (2016), and Abdul Rahman and Hamdan (2017): IAS 1; and Alanezi et al. (2016): IFRS 8. Therefore, the current study focuses on one particular standard: Financial Instruments: Disclosures (IFRS 7). IFRS 7 has been chosen because of its significance to the purpose of the study, based on the above discussion in the introduction. Studying one specific standard can imply a group of benefits. Firstly, it helps to identify the weaknesses of that standard and overcome any challenges during its application. Secondly, it enhances the existing knowledge with a deeper investigation all of the details. Thirdly, it gives us an opportunity to more accurately understand and interpret its relationships with other variables and its effects in different circumstances.

It should be noted that the review of the literature in relation to compliance with IFRS 7 shows varying results between high compliance (Amoako & Asante, 2012; Bamber, 2011; Sarea & Dalal, 2015) and low compliance (Agyei-Mensah, 2017a; Hossain, 2014; Lopes & Rodrigues, 2007; Mohammadi & Mardini, 2016; Tauringana & Chithambo, 2016) (see Table 3.2). However, the results do not demonstrate any examples of full compliance, which confirms the existence of an ongoing problem regarding the application of IFRS 7. This, in turn, means that gaining the benefits of improving the role of financial instruments is still early. Consequently, this matter
limits and impedes the objectives of accounting harmonisation in view of the rapid progress in business. From a larger perspective, the researcher believes that the differences in IFRS application do not provide additional benefits from adopting GAAP. As this non-compliance issue conflicts with the consolidation of accounting practices, it makes it difficult to say ‘international standards’ rather than ‘local standards’. This makes the proper application of IFRS and its compliance a matter that needs to be considered by the IASB and adopting countries.

3.3 Theoretical Framework and Developing Hypotheses

From reviewing the compliance literature, it is concluded that most researchers focus on explaining the effect of different determinants on the compliance level, such as company attributes, corporate governance, etc. Moreover, their studies use various theories to interpret these relationships, such as agency theory, signalling, political costs, and others. However, to the extent of the researcher’s knowledge, none of the prior studies have used legitimacy theory to explain the concept of compliance itself and its trend over time. Consequently, the current study concentrates on this aspect by employing legitimacy theory in order to explain the nature and varying degrees of compliance between countries.

3.3.1 Compliance over Years: Legitimacy Theory

The theories employed in the risk disclosure literature are varied (Appiah-Kubi & Rjoub, 2017; Samaha & Khlf, 2016; Tauringana & Chithambo, 2016) and it is found that the most common ones are agency theory (Nahar, Azim, & Jubb, 2016a), signalling theory (Dey, Hossain, & Rezaee, 2018), legitimacy theory (Agyei-Mensah, 2017b), and political costs theory (Zadeh, Rasid, Basiruddin, Zamil, & Vakilbashi, 2016). Consequently, it is hard to rely on a specific theory in order to interpret the issue of disclosure and its different relationships. Depending on the purposes and objectives of the study, the researcher can determine the appropriate theory that serves him/her in interpreting the study’s hypotheses. Accordingly, it can be said that legitimacy theory has been chosen for this study in order to explain the improvement in IFRS 7 compliance over time and the impact on the entity’s continuity. Relying on the notion of legitimacy theory, legitimacy, and the continuity of the organisations, this chapter develops one of the thesis’ hypotheses related to the behaviour of organisations’ compliance toward society in developing countries.

The theory of legitimacy relies on the principle of interaction between organisations and society,
which makes these organisations operate according to the values of the prevailing social system in which they are located. This supports organisations obtaining acceptance from their community and thus continuing their work. Besides, acceptance by society enables organisations to obtain legal standing that provides the authority to own and employ natural and useful resources (de Luca & Prather-Kinsey, 2018; Dey et al., 2018; Wangombe, 2015). Therefore,

legitimacy can be defined as “a generalised perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman, 1995, p.574). Consequently, the strength of this legitimacy may be influenced by several factors, such as the availability of resources, the speed of response by an organisation, the compatibility between an organisation’s output and the values of society, and the means used to achieve the goals of the organisation. This may expose the legitimacy of organisations to a threat or challenge, such as showing the negative impact of an organisation on the environment (Wangombe, 2015). Therefore, it can be said that the literature on disclosure related to environmental issues has a great share in testing this theory (legitimacy theory) (Chariri, Januarti, & Yuyetta, 2017; Gerged, Al-Haddad, & Al-Hajri, 2020; Hassan & Guo, 2017; Khaireddine, Salhi, Aljabr, & Jarboui, 2020; Ren et al., 2020).

Within the scope of IFRS, de Luca and Prather-Kinsey (2018) believe that the IASB has been able to gain legitimacy by obtaining acceptance of one set of standards (IFRS) by many countries. This would provide a good solution to bridge the legitimacy gap in the adoption and application of IFRS globally. To do so, the IASB stresses the credibility, independence, and competence of its members, in addition to the quality of standards and their ability to reflect the values of society (de Luca & Prather-Kinsey, 2018). Phan, Joshi, and Mascitelli (2018) also explain that a country’s decision to adopt and accept IFRS is affected by the legitimate desire of those countries. For (particularly developing) countries that seek to comply with legitimate and high-quality standards, which may be lacking in their local standards, this will enhance the legitimacy of the organisations and businesses of these countries (Phan et al., 2018).

Given the evidence from previous studies on risk disclosure, there is clear assurance that companies can refer to their legitimacy through financial disclosure by disclosing risk information, which enhances their survival and sustainability (Agyei-Mensah, 2017b; Al-Hadi, Hasan, & Habib, 2016; Appiah-Kubi & Rjoub, 2017; Dey et al., 2018; Oliveira, Rodrigues, &
Craig, 2011; Tauringana & Chithambo, 2016). Further, the theory of legitimacy is seen as a major driver that motivates companies to disclose risk information in order to improve the transparency of financial statements (Al-Hadi et al., 2016). Some studies have employed legitimacy theory to explain the different relationships between risk disclosure and the theory, such as the study of Al-Hadi et al. (2016). The authors use legitimacy theory to explain the impact of legitimacy on companies’ disclosure and how that legitimacy is a key motivator in the process of risk disclosure and increasing the degree of transparency. Also, Appiah-Kubi and Rjoub (2017) and Tauringana and Chithambo (2016) posit that the legitimacy perspective supports the legitimacy of organisations and their continuity through the disclosure of risk information in annual reports, on the basis of maintaining the contract between organisations and stakeholders (Appiah-Kubi & Rjoub, 2017; Tauringana & Chithambo, 2016). It is clarified to the researcher through reviewing the literature on risk disclosure that despite the importance of legitimacy theory in interpreting and understanding the disclosure behaviour of organisations, very few researchers employ it. Therefore, discussion of the theoretical framework supporting legitimacy theory underlying the disclosures of financial instruments is very limited.

By focusing on the hypothesis of the current study, and based on legitimacy theory, there is a contract between companies and their society, and this contract can be broken when society’s expectations are unfulfilled (Agyei-Mensah, 2017b; Appiah-Kubi & Rjoub, 2017; Chariri et al., 2017; de Luca & Prather-Kinsey, 2018; Hussain & Kakakhel, 2018; Tauringana & Chithambo, 2016). From the angle of the financial instruments, specifically IFRS 7, it is supposed that companies adhere to the requirements of IFRS 7 and reveal their financial information clearly and fairly (Tauringana & Chithambo, 2016). Companies (banks) should show their commitment toward their country firstly by following the regulations and rules, and then by sustaining their interactions with society by considering that society’s values in order to maintain their reputation and ensure survival. This legitimacy that banks seek to obtain in their community, and grow over time, is considered a strong impetus towards compliance with IFRS 7 in order to prepare more transparent reports. Therefore, companies must confirm that they work legitimately, follow the rules, and apply the requirements properly and in a high-quality manner (Deegan, 2019).

In a predictable manner, it can be said that success in gaining legitimacy and developing compliance with IFRS 7 over the years may bring benefits to two important parties – first, to the organisation, which benefits from maintaining its continuity and development over the years; and
second, to the stakeholders, who are an integral part of society and benefit from accepting the organisation and trusting them. In particular, this applies to the segment of investors and shareholders who may be encouraged to invest their money, which in turn increases investments, reduces risks, and enhances the strength of these companies within the community.

Thus, both individuals and firms expect that compliance with regulations, or accounting standards in our case, should be high and increase over time, or at least be kept at a high level in order to maintain their survival and continuity. Accordingly, the first hypothesis assumes that the banks strive to comply with IFRS 7 and disclose the mandatory requirements in their financial statements. Based on that, the following hypothesis is proposed:

**H 3.1**: The level of compliance with IFRS 7 improved from 2011 to 2017 in the listed banks in GCC countries.

### 3.4 Research Methodology

Since research is defined by Kumar and Phrommathed (2005, p.45) as “a careful investigation or inquiry, especially new search for new facts in any branch of knowledge”, methodology is considered a map that guides the researchers to follow the proper path in order to obtain the desired results. Thus, the following sections describe the research methodology that is employed to conduct the current study. It provides a clear and detailed map of the research phases, including the sample selected, data collection process and data analyses. Moreover, it discusses the instrument that is used to measure the compliance level with IFRS 7 (self-constructed index).

**3.4.1 Study Sample and Data Collection**

This study investigates the financial reporting of 57 listed banks from GCC countries, namely: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates (UAE). By relying on IFRS 7 as a base for measuring compliance, it identifies the level of compliance of the aforementioned GCC banks. The financial sector is the only one that is taken into consideration, chiefly the banking sector, since it is one of the best sectors in which financial instruments can be clearly dealt with in its operations. Besides, the banking sector is considered to be one of the first investment entities to attract investors in general. The study sample includes all of the listed GCC banks that have compulsorily adopted IFRS within the period of this study, excluding the
Islamic banks which have adopted Islamic standards (AAOIFI). Table 3.3 shows the number of banks and observations included in the study sample. The data is collected from the banks’ annual reports, published on their official websites by the stock exchange from 2011 to 2017. For the purposes of this study, this period of time is selected based on the latest updates of IFRS 7 in 2010. Hence, the study takes effect in 2011 and is completed in 2017.

Table 3.3 Selected Banks for Sample

<table>
<thead>
<tr>
<th>GCC</th>
<th>All Listed Banks</th>
<th>Meeting Criteria</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017 Total Obs.</th>
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</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>12 12 12 12 12 12</td>
<td>12 12 12 12 12 12</td>
<td>84</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Kuwait</td>
<td>12 12 12 12 12 12</td>
<td>12 12 12 12 12 12</td>
<td>69</td>
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<td></td>
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<tr>
<td>Oman</td>
<td>8 12 12 12 12 12 12</td>
<td>84</td>
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<td></td>
<td></td>
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<tr>
<td>Qatar</td>
<td>9 4 5 5 5 5 5 5 5 5 35</td>
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<td></td>
<td></td>
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<td></td>
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<tr>
<td>Bahrain</td>
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<td></td>
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<tr>
<td>UAE</td>
<td>25 6 19 18 18 19 19 19 19 19</td>
<td>131</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>81 24 57 55 56 57 57 57 57 57 396</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3.4.2 Measuring Compliance Level (Constructing Index)

The difficult nature of measuring the disclosure and its quality leads to a considerable debate between researchers about what the most appropriate method is for measuring the level of disclosure. The disclosure is sometimes based on an intangible stand which is not directly captured (Hassan & Marston, 2018; Ibrahim & Hussainey, 2019; Urquiza et al., 2010; von Alberti-Alhtaybat, Hutaibat, & Al-Htaybat, 2012). This is also demonstrated by the study of Hassan and Marston (2018). Through their review of 280 studies of the disclosure literature, they conclude that the prior studies show different methods used as a proxy of disclosure. These methods vary between the disclosure count (to measure disclosure quantity), properties of reported earnings (to measure the quality of disclosure), and disclosure index (to measure the quantity/quality of disclosure). In addition, other methods such as the classification approach, sentiment analysis, market-based variables, and adoption of high-quality standards are used to measure different dimensions of financial disclosure (Hassan & Marston, 2018). However, measuring the compliance level by employing an index is the most common method utilised in
the previous literature (Agyei-Mensah, 2019a; Bravo Urquiza, Abad Navarro, & Trombetta, 2009; Coy & Dixon, 2004; Hossain, 2002; Tsalavoutas et al., 2018). IFRS compliance literature relies on constructing/developing a disclosure index that contains a range of items that have to be manually checked from the corporates’ annual reports in order to determine the level of compliance (Agyei-Mensah, 2017a; Al-Akra et al., 2010; Alanezi & Albuloushi, 2011; Alfaraih, 2009; Alfraih & Almutawa, 2017; Al-Jabri & Hussain, 2012; Al Mutawaa & Hewaidy, 2010; Al Shammari et al., 2008; Amoako & Asante, 2012; Demir & Bahadir, 2014; Fekete et al., 2008; Gutierrez Ponce et al., 2016; Juhmani, 2012, 2017; Karim & Ahmed, 2005; Lopes & Rodrigues, 2007; Tahat et al., 2016; Tauringana & Chithambo, 2016; Tsalavoutas, 2011; Tsegba et al., 2017).

Furthermore, Buzby (1975) and Stanga (1976) were the first researchers to apply the notion of the disclosure index. Accordingly, the disclosure index is considered as a ratio that compares the actual disclosure level to the extent required level, which does not result in a company being subject to legal accountability for not disclosing such information (Chavent et al., 2006). Tsalavoutas, Tsoligkas and Evans (2018) recently provided a rich review of 81 studies related to compliance with IFRS mandatory disclosure requirements. They discuss a number of relevant issues, including different types of disclosure indices used in literature, as well as disclosure scoring, validity, reliability and materiality, which will be extensively discussed in later sections. They emphasise that the majority of researchers used a self-constructed index, while the remaining few develop the indices from previous studies or adopt ones from audit firms. They also find that around 44% of the sample (81 studies) embrace the Cooke’s method for scoring the index. On the other hand, very few studies discuss the materiality or mentioned the index validity and reliability together, despite their importance. Thus, regardless of the ongoing controversy surrounding the diversity of measuring the compliance level, it is demonstrated that the most common measurement used in previous studies is the index.

Consistent with the prior literature (Al-Akra et al., 2010; Alsaeed, 2006; Al-Sartawi et al., 2016; Al-Shammari et al., 2008; Lopes & Rodrigues, 2007; Street & Gray, 2002; Tsalavoutas, 2011), an index for measuring the compliance level with IFRS 7 has been created. The steps outlined in the first study of this thesis (Chapter Two) are followed in order to construct this index: basic source, materiality, reliability, validity, and scoring. The index is prepared based on the original standard and the examination of preceding relevant studies (Tahat et al., 2016; Tauringana and Chithambo, 2016) in order to concentrate on 76 most relevant and mandated items. In addition,
this index passed through stages of validation and reliability, which enhances both the validity and the outcomes of the study. Content analysis is applied to score the index. The index scores are calculated for each bank and then used for measuring the compliance level to test the study hypothesis.

Previous studies discuss a number of approaches to score the checklist items. However, the two most common approaches that are adopted are: the dichotomous approach (EQ1), and the partial compliance (PC) unweighted approach. The current study measures the level of compliance with the requirements for one standard (IFRS 7), which makes the dichotomous approach is the most appropriate method for measuring compliance. This is because the unweighted approach (PC) requires specific categories or a number of standards.

**EQ1:**

\[
\begin{align*}
C_j &= \frac{1}{T} \sum_{i=1}^{M} D_i \\
D_i &= \begin{cases} 
1 & \text{if item } i \text{ is disclosed} \\
0 & \text{otherwise} 
\end{cases}
\end{align*}
\]  

Where \((C_j)\) is the total compliance score for each bank \((j)\); \(T\) is the total number of items disclosed \((d_i)\) by bank \((j)\); \(M\) is the maximum number of applicable disclosure items for a bank \((j)\) and \((d_i) = 1\) if item \((i)\) is disclosed, 0 otherwise; \(m\) is the maximum number of items.

### 3.5 Findings and Discussion

Table 3.4 shows the descriptive statistical test results of the compliance obtained from a total of 396 observations of the selected GCC banks from 2011 to 2017. The maximum score for the compliance level for all seven years is 96%, while the minimum compliance level score is 47%. In addition, 130 observations (33% of the total study sample) comply with the requirements and vary between 71% and 80% (see Table 3.5). In general, the mean of the compliance level increased from 77% in 2011 and 2012, and then reaches and stays at 78% for the remaining years. This means that the GCC banks do not improve their implementation of IFRS 7 requirements during this seven-
year period. In fact, reaching 78% degree of compliance is considered a good rate when compared to the compliance levels with the financial instruments’ requirements from the previous studies, where the highest scores range from 44% to 65% (Agyei-Mensah, 2017a; Hossain, 2014; Malaquias & Zamba, 2018; Mohammadi & Mardini, 2016; Tahat et al., 2016). Prior studies also show that the change in compliance level is often as little as those found by Amoako and Asante (2012), Mohammadi and Mardini (2016), and Haddad et al. (2018), whereas any visible changes are hardly be seen by Allini et al. (2019). Accordingly, the faintness in these improvements may be attributed to different factors, such as weak enforcement systems in each country, low levels of practitioner knowledge in institutions (banks), and the absence of an internal monitoring system in each entity.

Table 3.4 Descriptive Statistics of Compliance by Year

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>Mean</th>
<th>Min.</th>
<th>Max.</th>
<th>S.D.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>55</td>
<td>0.775</td>
<td>0.470</td>
<td>0.960</td>
<td>0.108</td>
</tr>
<tr>
<td>2012</td>
<td>56</td>
<td>0.775</td>
<td>0.470</td>
<td>0.960</td>
<td>0.114</td>
</tr>
<tr>
<td>2013</td>
<td>57</td>
<td>0.780</td>
<td>0.490</td>
<td>0.960</td>
<td>0.115</td>
</tr>
<tr>
<td>2014</td>
<td>57</td>
<td>0.780</td>
<td>0.490</td>
<td>0.960</td>
<td>0.114</td>
</tr>
<tr>
<td>2015</td>
<td>57</td>
<td>0.786</td>
<td>0.490</td>
<td>0.960</td>
<td>0.115</td>
</tr>
<tr>
<td>2016</td>
<td>57</td>
<td>0.786</td>
<td>0.490</td>
<td>0.960</td>
<td>0.115</td>
</tr>
<tr>
<td>2017</td>
<td>57</td>
<td>0.789</td>
<td>0.500</td>
<td>0.960</td>
<td>0.109</td>
</tr>
<tr>
<td>2011-2017</td>
<td>396</td>
<td>0.782</td>
<td>0.470</td>
<td>0.960</td>
<td>0.112</td>
</tr>
</tbody>
</table>

Table 3.5 Frequency of IFRS 7 Disclosure Compliance by Year

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
<td>No. %</td>
</tr>
<tr>
<td>41–50</td>
<td>1</td>
<td>0.02</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td>1</td>
<td>0.02</td>
</tr>
<tr>
<td>61–70</td>
<td>15</td>
<td>0.27</td>
<td>14</td>
<td>0.25</td>
<td>14</td>
<td>0.25</td>
<td>14</td>
<td>0.25</td>
</tr>
</tbody>
</table>

Since the change in compliance levels over the years is very slight, two tests – t-test and Mann
Whitney test – were applied to confirm the results (Table 3.6). The tests show that all of the results for each pair of years are over by 0.05%, which does not indicate any significant differences between the periods and emphasises the stable level of compliance of the GCC banks over time. Hence, the study hypothesis \( H_{3.1} \): The level of compliance with IFRS 7 has improved from 2011 to 2017 in the listed banks in GCC countries, is not met and is therefore rejected.

Table 3.6 Test for Significant Differences over Years

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-2012</td>
<td>0.716</td>
<td>0.952</td>
<td>0.987</td>
</tr>
<tr>
<td>2012-2013</td>
<td>0.970</td>
<td>0.693</td>
<td>0.992</td>
</tr>
<tr>
<td>2013-2014</td>
<td>0.998</td>
<td>0.928</td>
<td>0.995</td>
</tr>
<tr>
<td>2014-2015</td>
<td>0.952</td>
<td>0.730</td>
<td>0.753</td>
</tr>
<tr>
<td>2015-2016</td>
<td>0.965</td>
<td>0.998</td>
<td>0.775</td>
</tr>
</tbody>
</table>

Mean

90.0%
80.0%

70.0% 60.0% 50.0% 40.0% 30.0% 20.0% 10.0%
In addition, the results show that the differences between the GCC countries in regard to the compliance level are minor. At the country level, the lowest and highest degree of compliance in Bahrain is 47% and 96%, respectively. Qatar has the highest compliance level between countries with 89.74%, followed by Saudi Arabia with 82.77%. At the opposite end of the spectrum, Kuwait has the lowest compliance degree among countries at 66.91%. Moreover, the degree of compliance is very close between Oman, Bahrain and the UAE, with means of 78.21%, 77.88% and 78.24%, in that order (see Table 3.7, Table 3.8, Figure 3.2 and Figure 3.3). These minor differences may indicate that the convergences in the systemic and cultural basis between these countries already exist, and that the implementation and regulatory systems may also be convergent. At last, these results motivate the study of the role of different determinants on compliance levels.

Table 3.7 Descriptive Statistics of Compliance by Country

<table>
<thead>
<tr>
<th>Country</th>
<th>N</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
<th>S.D.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>35</td>
<td>0.77</td>
<td>0.47</td>
<td>0.96</td>
<td>0.184</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.49</td>
<td>0.78</td>
<td>0.067</td>
<td>0.06</td>
</tr>
<tr>
<td>Qatar</td>
<td>35</td>
<td>0.89</td>
<td>0.82</td>
<td>0.93</td>
<td>0.038</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>84</td>
<td>0.82</td>
<td>0.61</td>
<td>0.93</td>
<td>0.109</td>
</tr>
<tr>
<td>UAE</td>
<td>131</td>
<td>0.78</td>
<td>0.61</td>
<td>0.92</td>
<td>0.086</td>
</tr>
</tbody>
</table>

Table 3.8 Mean of Compliance Score by Country and Year

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>81.85%</td>
<td>82.50%</td>
<td>82.73%</td>
<td>83.18%</td>
<td>83.29%</td>
<td>83.06%</td>
<td></td>
</tr>
<tr>
<td>Mean/ country</td>
<td>82.84%</td>
<td>84</td>
<td>82.77%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Kuwait 67.78% 66.50% 66.80% 65.90% 66.70% 66.60% 68.10% 69 66.90%
Oman 76.17% 78.00%
78.00% 78.33% 79.00% 79.00% 42 78.21% Qatar 87.00% 88.40% 90.40% 90.40% 90.60%
90.60% 90.80% 35 89.74% UAE 77.67% 77.28% 77.95% 77.95% 78.89% 79.00% 78.95% 131
78.25%
Bahrain 76.60% 77.00% 77.60% 77.80% 78.20% 78.20% 79.80% 35 77.88% Total 77.54%
77.51% 78.06% 78.05% 78.65% 78.62% 78.98% 396 78.21%

Mean of compliance by country

Figure 3.2 Compliance Level by Country

Compliance over years and by country

100.00%
90.00%
80.00%
70.00% 60.00%
Based on these findings, the hypothesis of the study cannot be accepted. According to legitimacy theory, society and individuals assume that there is a fair amount of compliance by different institutions (banks in this study), or a rise in compliance levels over the years in order to ensure the sustainability and survival of these banks. This may be inapplicable in cases of low compliance levels over the years or significant fluctuations in that compliance. In addition, even if there is stability in the compliance level over time, even a slight increase may somewhat weaken the argument and hypothesis of this study.

Finally, a more detailed explanation about the relationship between individuals and stakeholders and the degree of compliance will be provided in the fifth chapter of this thesis. The results of that particular study (which measures the impact of compliance on the cost of equity capital) confirm the existence of a negative relationship between the degree of compliance and the cost of equity capital.

### 3.6 Conclusion

Throughout this study, the level of compliance in GCC banks is measured from 2011 to 2017. The measurement tool (index) is prepared based on the steps detailed in Chapter Two of this thesis (Compliance with IFRS 7 by Financial Institutions: Evidence from GCC). This thesis, therefore,
provides some distinct results that reflect realistic compliance with IFRS 7, which is related to the disclosure requirements of financial instruments. Furthermore, the results of this study show that the level of compliance with IFRS 7 does not significantly change from 2011 to 2017 and has a tendency to be fairly stable. This stable trend can be attributed to the weakness of the control authorities (enforcement) in these countries and their lack of follow-up, as well as the lack of knowledge among practitioners of the proper application of IFRS 7. These findings may partially reinforce the study’s hypothesis that the relative stability in compliance (with minor increases) may be consistent with the community’s aspirations and requirements, provided that the degree of compliance does not decrease over time. However, this result cannot be fully supported. Additionally, the degree of compliance is somewhat convergent among the GCC countries. The highest compliance level is in Qatar, with a mean of 89%, while the lowest level is seen for Kuwait, with a mean of 66%. These minor differences, as mentioned before, can point to the similar cultural and regulation bases between the GCC countries and may help in looking for factors or determinants that might affect their compliance processes. Consequently, this trend is one of the objectives that the current thesis seeks to achieve: to conduct a study that considers the possible determinants that are related to the attributes of banks and corporate governance factors, which is covered in the next part (Chapter Four) of this thesis.

Finally, one of the limitations of this chapter is that it focuses only on GCC countries and the banking sector. Future researchers may therefore extend the scope of this research to involve all financial sectors, or even other sectors. They may also increase the number of countries to include both developing and developed countries and present the differences between their cultures and regulations. Moreover, employing theories other than legitimacy theory may add new value that could enhance the interpretation of the compliance phenomenon.
Chapter Four: The Impact of Corporate Governance on the IFRS 7
Compliance in GCC Listed Banks

4.1 Introduction

More than 140 countries have formally adopted International Financial Reporting Standards (IFRS), and the factors/causes of adopting IFRS actually differ from one country to another. Countries generally seek to achieve one goal: harmonising accounting systems, practices and business financial information. IFRS have been modified over years (Adhana, 2020; Carmona & Trombetta, 2008; Chand & White, 2007; Gastón, García, Jarne, & Laínez Gadea, 2010) to meet the requirements of countries, taking into account differences between them. In turn, issuing IFRS has provided accounting authorities with the relevant information that aids in establishing trade pacts and alliances based on the specific countries’ needs on the one hand, and on the other gives the ability to determine and analyse the countries’ economic status in general (Hope et al., 2006).

A number of goals have been set when issuing IFRS, including reducing the accounting differences between countries; that is, unifying the preparation of financial statements, as the standardisation of such outputs across all countries will certainly contribute to removing global barriers. One of the tools that can be used to achieve this convergence is the application of IFRS in a similar manner. Therefore, some studies have discussed the IFRS adoption decision and factors leading to that adoption (Clements, Neill, & Scott Stovall, 2010; Paknejad, 2017; Ramanna & Sletten, 2009), while other studies have focused on the issue of compliance and application of IFRS (Al-Shammari et al., 2008; Alsaeed, 2006; Appiah et al., 2016; Ebrahim & Abdelfattah, 2015; Halbouni & Yasin, 2016; Mbir, Agyemang, & Gackie, 2020; Mnif & Znazen, 2020; Tawiah & Boolaky, 2020).

In view of the wide array of financial instruments as well as their complexity, preparers and users of financial statements call for the importance of enhancing financial reporting and specifically the information related to financial instruments. They stress the inclusion of information that will increase the reliability of financial instruments and their usages by organisations (Pucci, 2017; Ryan, 2012). Moreover, the causes of the financial crisis in 2008 varied between incorrect investment decisions made by banks (André, Cazavan-Jeny, Dick, Richard, & Walton, 2009), accounting regulations followed (Laux, 2012), or financial instruments and the use of fair value,
especially the banking sector (Duh et al., 2012). Therefore, there has been a clear effort by the IASB to focus on financial instruments, their measurements, and disclosure. A number of standards emerged concentrating on financial instruments, and the latest update of these standards is IFRS 9 which deals with measurement requirements, and IFRS 7 which deals with disclosure requirements – the latter of which is the main focus of the current study (Deloitte, 2017d).

Previous studies (Alfaraih, 2009; Al Mutawaa & Hewaidy, 2010; Al-Shammari, 2011; Alanezi & Albuloushi, 2011; Tsalavoutas, 2011; Al-Jabri & Hussain, 2012; Bova & Pereira, 2012; Santos et al., 2013) attribute the low level of compliance with IFRS to the absence of adequate enforcement regulations. Therefore, in addition to investigating corporate attributes, studies discuss the role and effects of corporate governance (CG) as significant enforcement mechanisms in IFRS implementation (Al-Akra et al., 2010; Abdul Rahman & Hamdan, 2017; Al-Sartawi et al., 2016; Ebrahim & Abdelfattah, 2015; Juhman, 2017). Obviously, the literature emphasises the need to link corporate governance to the adoption and application of IFRS. Corporate governance is also important to interpret the relationships between a firm’s management, owners, investors and stakeholders. Effective corporate governance contributes towards enhancing the financial reporting system, which in turn enhances global financial market performance to be able to face any future financial crisis (Hla et al., 2013).

Considering that GCC countries are the sample of the current study, the six countries share a number of attributes, such as strategic locations, adopting Sharia (Islamic) law in the judiciary system, the economic climate, and the distinctive cultural basis of the countries’ communities (Pillai & Al-Malkawi, 2018). From another side, many studies emphasise the important role of corporate governance in promoting transparency of the business environment, maintaining the health of financial markets and protecting investment behaviour (Abdallah & Hassan, 2013; Elamer, Ntim, Abdou, Zalata, & Elmagrhi, 2019; Tessema, 2019). Consequently, GCC countries are keenly concerned with this aspect by issuing and developing codes of governance, although the issuing date varies from one country to another (Shehata, 2016). Moreover, with the economic and technological developments taking place around the world, it is necessary to instil sound and strong corporate governance principles that help keep pace with growth and financial progress appropriately and safely. One of the most important aspects of governance is the follow-up of the proper application of local regulations and financial standards (Swedan & Ahmed, 2019).