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CORPORATE FINANCIAL REPORTING IN THE UNITED ARAB EMIRATES

Key Words

Financial Reporting; Corporate Attributes; Annual Reports; Disclosure.

Abstract

This study empirically assesses the extent of financial reporting by a sample of shareholding companies and the impact of selected corporate attributes: firm size, age, profitability, industry type and multinational company influence, on the degree of financial reporting compliance in a developing country such as the United Arab Emirates. The study has arrived to four important conclusions. The first is that the overall degree of compliance was low, since none of the sampled companies complied with statutes nor disclosed mandatory information. The second is that although the extent of financial reporting is low, there remains some scope for development and improvement in the current practices. The third is that larger firms are likely to disclose more information compared to smaller ones. The fourth is that companies in the banking and insurance sectors were found to disclose more information than other industry types.

Introduction

The United Arab Emirates (U.A.E hereafter) unregulated Stock Market witnessed dramatic share price fluctuations during the months of July and August 1998 where the market capitalization rose to $50.1 billions and within a month it declined to $41.8 billions (Al-Shayeb, 1999). This phenomenon has become known as the "black summer". Such collapse of the stock prices leads to question the extent of financial reporting requirements and practices of companies in the UAE.

The U.A.E is a small country that has its own distinct disclosure reporting practices which differ from other countries due to a variety of legal, economic,

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political and cultural factors (e.g. Mueller *et al.*, 1987; Perera, 1989; and Nose and Parker, 1991a). Moreover, there are ample research studies in developed countries, which deal with regulation and disclosure practices. However, little is known about the level of corporate disclosure compliance and the influence of corporate characteristics on the extent of financial reporting in developing countries (e.g. Wallace, 1988; Abu-Nassar, 1993; Ahmed and Nicolls, 1994; Al-Mulhem, 1997; Zezhong, 1999).

The purpose of this study is to examine the factors that influence the general level of information disclosed by companies in the UAE. The extent of financial reporting is assessed with regard to five firm specific characteristics, namely: firm size, age, profitability, industry type and multinational company influence.

The Environment of Corporate Reporting in the United Arab Emirates

Two forces have shaped financial reporting requirements and practices in the UAE: the Ministry of Economy and the Central Bank of the UAE. The UAE Companies Act no. 8/1984 and its amendments no. 13/1988 represent the departure point in regulating disclosure practices of companies in the country. The Act requires firms to maintain records of their operation and to provide audited financial statements to the federal and state authorities. Investors, however, have not benefited from such umbrella due to the absence of an independent supervisory body able to regulate the accounting and auditing profession and also due to the absence of an official stock market.

Financial institutions, banks, finance and investment firms are, also, governed by another regulatory disclosure framework, which has helped, to some extent, in tightening financial reporting requirements and practices, through the Central Bank of the UAE. Decree no. 10/1980 authorizes the Central Bank to organize, regulate and develop the financial profession and the monitoring of the financial system. Accordingly, the Central Bank financial reporting requirements started with provision no. 445/1988 requiring financial institutions to prepare audited annual reports in accordance with the format prepared by the Central Bank, in addition to detailed information about assets and liabilities. The provision also instructed auditors to verify consistency of the annual report with facts and to provide the Central Bank with a report in this regard.

The wide use of the International Accounting Standards (IAS) in regards to accounts of banks and other financial institutions forced the Central Bank to issue Circular 20/1999 concerning the adoption of the IAS. It is believed that the financial reporting under these standards has become understandable and more acceptable world-wide, therefore its implementation would enhance the position of banks operating in the UAE. It is expected that the adoption of the IAS will fill the gap between the need for acceptable standards and the deficiencies in the current disclosure requirements and practices. Moreover, the formation of the UAE Securities and Commodities Authority and the launching of the Dubai and Abu Dhabi stock exchanges will improve the adoption of the IAS and enhance the current disclosure requirements and practices.

Factors Affecting Disclosure

Firm Size

In developed countries there seems to be a positive correlation between the firm's size and the extent of disclosure where larger firms tend to disclose more information voluntarily than smaller ones (e.g. Cerf, 1961; Singhvi and Desai, 1971; Stanga, 1976; Chow and Wong-Boren, 1987; Cooke 1989, 1991, 1994). However, studies in developing countries showed inconsistent evidence (e.g. Abdulsalam, 1985; Ahmed and Nicholls, 1994; Al-Mulhem, 1997).

Firm size can be measured in a number of different ways and there is no theoretical reason to select one measure over the other. However, one size variable may be applicable to a particular country but may not be relevant to another (Cooke, 1994: 176). It is for this reason that two distinct size variables are used in this study, namely total asset and net annual sale. As multicollinearity may exist between these variables two models are used with one size variable in each model.

Age

Firm age is based on the assumption that older firms tend to disclose more information than younger companies. Various reasons may justify more disclosure by older firms such as the availability of past operating history to report which may help to predict future performance, marketability of their securities and financing opportunities.

Profitability

Profitability can be measured in a number of different ways; including earning margin and rates of return. The use of profitability variable is built on indirect argument stating that profitable companies are more likely to disclose more information in their annual report to shareholders and other interested parties to justify management's compensation and position (e.g. Cerf, 1961 and Singhavi and Desai, 1971). Conflicting evidence ranging from positive to negative correlation has been suggested in the literature (e.g. Cerf; 1961; Singhavi and Desai; 1971; Mc Nally et. al., 1982; Cheung *et al.*, 1991; Al-Mulhem, 1997). For the purpose of this study, return on equity is used to measure the profitability variable.

Multinational Companies Influence (MCI)

It is expected that a subsidiary of multinational companies, relative to local companies, will disclose more information and comply with statutes in developing countries due to the influence of the parent company. However, the fear of political cost, in the form of political pressure and exploitation (Korbin, 1978), may lead them to disclose less information through manipulating reported profit. (Rahman and Scapens, 1988)

Type of Business

Firms in different sectors of the economy are not expected to be identical concerning the extent of disclosure. Several studies have found a significant correlation between the type of business and the extent of disclosure (Stanga, 1976; Cooke, 1989, 1991, 1994). For instance, Cooke (1989), in a study on voluntary disclosure by Swedish companies, found companies with significant trading disclosed less information than companies of conglomerate, manufacturing and services business types. On the other hand, in a study of voluntary disclosure by Japanese companies, Cooke (1991) found manufacturing companies likely to disclose more information than other business types.

Research Methodology

Survey of annual reports

The survey covers 54 companies that published their annual reports during the year ending on 31 December 2000. The companies are classified into three categories. First, the banking group, second the insurance group, and a third categorized as the service group. The industrial sector was excluded due to availability of few joint-stock companies in this sector. In order to obtain the annual reports, 100 companies were contacted in writing. The overall response rate was 54% .

Developing a Disclosure Index

Different approaches to developing a scoring procedure have been suggested in the literature. Copeland and Frederick (1968) developed a weighted approach to a scoring mechanism. The approach relies on the presentation of information by counting the number of words used to describe an item disclosed. Such an approach results in a scale of disclosure which varies between zero and one. The other approach that is commonly used, and the one adopted in this study, is a dichotomous procedure in which an item scores one if it is disclosed and zero if it is not disclosed. This approach has been adopted in many previous studies (e.g. Cerf, 1961; Sighvi and Desai, 1971; Wallace, 1988; Cooke, 1989; 1994; Ahmed and Nicholls, 1994; Al-Mulhem, 1997).

In the disclosure model employed in the current study, the total disclosure index (TDI) for a company is considered additive as follows:

$$TDI = \sum_{j=1}^{m} dj \qquad (1)$$

Where, $dj = 1$ if the item dj is disclosed,

0 if the dj item is not disclosed, and $m \leq n = 72$ (discussed below)

The additive model employed allows solving the problem of non-applicable items. If a particular item was not mentioned in the annual report, it would be treated as not applicable. For example, if no mention was made in respect of fixed asset leased, it was assumed that the item was not applicable for the company in that year. However, if it was disclosed without mentioning the amount, then the score would be zero. Moreover, the entire annual report should be read first before deciding whether a particular item was applicable. This approach was used in the current study. The whole annual report was read first and other relevant materials, such as the Financial Position of the Commercial Banks in the U.A.E and the National Bank of Abu Dhabi National directories. Thus, the risk of penalizing a company for not disclosing an item which was not applicable or relevant, was reduced greatly.

The additive model employed in the current study is unweighted where each item of disclosure is equally important because the current study does not focus on one specific group, but rather on the different user of annual reports. As different user groups benefit from the annual report, a scoring sheet of possible items was constructed based on the following:

1. Items required by the Central Bank of the U.A.E Provisions and Circulars;
2. Items required by the Companies Act 1984 and its amendment no. 13/88;
3. Items included in previous studies (Singhvi and Desai, 1971; Buzby, 1974; Barrett, 1976; Wallace, 1988; Cooke, 1989; Abu-Nassar, 1993; Ahmed and Nicholls,1994; Al-Mulhem, 1997).

The disclosure index, then, was created to measure the level of disclosure among companies in the UAE. The index is a ratio of the actual scores awarded to the scores which the firm is expected to earn. Therefore, the maximum score a firm can receive is:

$$M = \sum_{j=1}^{m} dj \qquad (2)$$

dj = expected items to be disclosed?

n = the number of items the firm is expected to disclose, i.e. $n \leq 72$

Corporations in the UAE have considerable discretion over the content of the annual report due to few reporting requirements: the Companies Act 1984 and its Amendments 1988 and the Central Bank Provisions and Circulars with respect to financial institutions and banks. Therefore, most of the disclosed information in the annual corporate reports, except few items of information, fall into voluntary reporting category.

Items of Information

The preliminary selection of items resulted in a disclosure index consisting of 102 items. To ensure the applicability of the selected items, it was pilot-tested on a sample of 20 annual reports for the year 2000. The final index list consisted of 72 items of information and these formed the basis for the aggregate index (see Appendix 1 for more details). This list consists of both mandatory and voluntary items. The aggregate index is divided into four major parts as shown in table 1. These items reflected different types of information in the annual reports of corporation in the U.A.E and aimed to examine the impact of a number of explanatory variables on the extent of financial reporting. These types of information were related to balance sheet, income statement, other statements (e.g. funds and retained statements) supplementary information,and projections and budgetary information.

Table 1
Distribution of Items in the Scoring Sheet

	mandatory	voluntary	Total	%
Balance sheet items	13	22	35	48.61
Income statement items	9	10	19	26.39
Other statements and supplementary information items	3	6	9	12.5
Projections and budgetary items	0	9	9	12.5
Total	25	47	72	100

The Results

Univariate Analysis

An analysis of the disclosure index for each of the 54 companies revealed that only ten companies (18 percent) scored more than 60 percent; the highest was 68.49 percent. The index for 21 companies (41.4 percent) was between 50-59 percent, whereas twenty-one companies (37.8 percent) disclosed between 10-49 percent. Furthermore, it is interesting to note that none of the firms disclosed all items. This suggests that the level of financial reporting of companies in the UAE is not at optimum level. These results are consistent with studies in other countries, such as Nigeria (Wallace, 1988) and Bangladesh (Ahmed and Nicholls, 1994), which revealed a low level of reporting compliance. However, there is a scope for development and improvement in the current practices of firms in the UAE due to the establishment of the UAE Commodities and Securities Authority, which is responsible for supervising reporting compliance, and the beginning operation of two official stock exchanges in the States of Dubai and Abu Dhabi.

Popular and Rare Items of Information

Some items of information were disclosed in all sampled companies in the U.A.E; other items were absent. Table 2 provides a list of popular and

Table 2
Disclosure of Items

Panel A: Items disclosed by all sampled companies	
1. Asset order•	8. Net sales (revenue)•
2. Total value of current assets•	9. Amount of cost of goods sold*
3. The amount of receivables•	10. Gross profit•
4. Investments•	11. Amount of operating expenses•
5. Liabilities classification•	12. Net profit before tax•
7. Reserved amount•	13. Tax expenses•
Panel B: Items not disclosed by any of the sampled companies	
1. Secured and unsecured debts*	7. Plans for future capital expenditures*
2. Ageing schedule of debts*	8. Factors affecting company's future*
3. Research and development expense*	9. Quantitative forecasts of sales and profits*
4. Accounting method for research and development expense*	10. Qualitative forecasts of sales and profits*
5. Forecast assumptions*	11. Economic factors affecting future business*
6. Company plans for the following years*	12. Political factors affecting future business*
	13. Technological factors affecting future business*

Key: • = mandatory disclosure; * = voluntary disclosure.

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rare items in the corporate annual report of companies in the U.A.E.

The conclusions which can be drawn from table 2 are that: first; there is a moderate level of disclosure of balance sheet and income statement mandatory items. This moderate level of disclosure arises from the fact that the disclosed items represent the basic items which must be included in order to prepare each statement. A greater proportion of these items, also, is required by the Companies Act and Central Bank's Circulars to be published in annual financial statements of companies. Second, there is an apparent weakness in respect of financial reporting relating to other statements (e.g. funds flow and statement of retained earnings), supplementary information, and projections and budgetary items. This paucity of information stems from three facts. First, there are no legal requirements to disclose information relating to these categories. Second, there is no demand for such information from the concerned parties. Third, there is a fear of a negative reaction if such items are disclosed. Such reaction may come from government, stockholders, and competitors.

Descriptive statistics for the dependent and explanatory independent variables are presented in Table 3. Pearson product-moment correlation coefficients (r) were used to examine the correlation between the dependent and independent variable (firm size, firm age and profitability). The bivariate statistical results show that disclosure index is significantly correlated with firm size, measured by total assets and net annual sale ($p < 0.001$); and profitability, measured by return on equity ($p < 0.001$), with modest significant correlation with firm age ($p < 0.05$). This implies that large, profitable and old firms are likely to disclose more information compared to small, less profitable and young firms.

Table 3
Descriptive Statistics of the Dependent and Explanatory Variables

Variables	Mean	Median	Std. Deviation	Pearson correlation	Sig.
TDI	49.42	56.43	13.12	N/A	N/A
Age	20.50	22.50	9.25	0.361**	0.012
Asset (In)	7.052	6.995	1.493	0.324***	0.003
Sale (In)	4.352	4.231	1.170	0.349***	0.008
R. on Equity	14.33	13.86	11.10	0.421***	0.006

*** $p < 0.001$; ** $p < 0.05$, * $p < 0.10$, 1-tailed probability

الملخص

الإفصاح المالي في التقارير السنوية للشركات في دولة الإمارات العربية المتحدة

عبدالرحمن محمد الشايب
جامعة الإمارات العربية المتحدة

تهدف هذه الدراسة إلى قياس مستوى الإفصاح المالي في التقارير السنوية للشركات المساهمة العامة في دولة الإمارات العربية المتحدة. ومن أجل تحقيق هذا الغرض، قامت الدراسة بتوظيف خمسة متغيرات وهي: حجم الشركة، عمر الشركة، الربحية، نوع الصناعة، تأثير الشركات المتعددة الجنسيات. وقد توصلت الدراسة إلى أربع نتائج في غاية الأهمية وهي **أولاً**؛ أن مستوى الإفصاح المالي في دولة الإمارات منخفض، حيث لم تلتزم أي شركة بالإفصاح عن المعلومات المطلوبة من الجهات القانونية المعنية بالرقابة. **ثانياً**؛ إنه على الرغم من انخفاض مستوى الإفصاح المالي حالياً فإن إمكانية التطوير في الممارسات الحالية قائمة. **ثالثاً**؛ أن الشركات الكبيرة أكثر إفصاحاً عن المعلومات مقارنة بالشركات الصغيرة. **رابعاً**؛ أن شركات قطاعي المصارف والتأمين أكثر إفصاحاً للمعلومات مقارنة بغيرهما من القطاعات.

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