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The impact of corporate governance on the financial reporting quality in Saudi banks

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Abstract: This research aims to define the association between improving the quality of financial reporting process and achieving positive changes in operating income and comprehensive income by means of applying corporate governance requirements in the banks of the KSA. The research showed a positive relationship and statistically significant association between achieving corporate governance requirements in the Saudi banks (especially the existence of audit committee, board size, number of board committees) and improving the Saudi banks profitability, and consequently, refining the value of financial reporting process. The study recommends the importance of applying CG requirements in the KSA *properly* in order to improve the quality of financial reporting process more and more. This will lead to achieving positive changes in operating income and comprehensive income.

Keywords: *corporate governance; disclosure, quality; financial reporting, and Saudi listed companies.*

1. Introduction

Corporate governance (CG) is the set of policies, processes, rules, and organizations that affect the way a corporation is directed or managed. CG includes the relationships between many stakeholders involved and goals for which the firm is governed (see for example: Gregory, Simmelkjaer, 2002) as well. The principal stakeholders are the shareholders, operating management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the civil environment and the community as a whole.

CG is a multi-dimensional matter. A significant issue of CG is to confirm the accountability of particular individuals in an organization through ways that try to lessen or eradicate the agency problems (ASX Corporate Governance Council, 2003).

Boards of directors have the main responsibility for corporate governance. They are responsible for setting strategic objectives, providing leadership, supervising the operating management, reporting to shareholders on their stewardship. The board of directors are responsible, for appointing the internal auditors, and in turn the internal auditors are responsible for providing the board of directors with an internal and neutral check on all company aspects, either financial or non-financial. The shareholders are responsible for assigning the directors and the external auditors. So, they are responsible for satisfying themselves that a fitting governance structure is prepared. In addition, the external auditors are responsible for providing the shareholders with an external and impartial check on the financial statements which form the basis of that reporting system.

Thomsen (2006) stated that since the Cadbury Code was published in 1992, there has been a prompt global spread of CG codes containing suggestions on boards, executive pay, disclosure, investor relationships and others. However, there was little or almost no scientific evidence to corroborate the recommendations; hence it is questionable whether they could be attributed to market failures.

Since 2001, interest in the CG practices of modern corporations has been renewed, particularly due to the high-profile downfalls of a number of large U.S. firms, such as Enron Corporation and WorldCom. The US federal government, thus, passed the Sarbanes-Oxley Act in 2002, with the aim of restoring public confidence in CG. Bre-X is a Canadian company in mining collapsed in 2002. Parmalat is an Italian company in food collapsed in 2003. MG Rover Group is a British company in Automobiles collapsed in 2005.

Under the Saudi market crisis during the last decade, the Saudi Capital Market organization required listed companies establish internal auditing departments in order to manage risk and activate the requirements of CG

(Capital Market Authority, 2006). This required meeting the characteristics of the quality of financial reports according to FASB, 2010, CON 8, PP. 1-42.

1.1. Research Problem:

To attain optimal use of available resources and realize targets in Saudi Banks, it is necessary to assess the effectiveness and quality of financial reporting process within these banks according to the requirements of Saudi Capital Market and CG code. CG is a basic requirement for any listing Saudi company (including banks), and the quality of compulsory disclosure of financial reports is a basic requirement to achieve the requirements of CG.

Hence, the problem of this research is how to assess the quality of financial reporting process as a result to achieve the requirements of CG in Saudi banks. In other words, this research is trying to determine the effects, either positive or negative, of achieving CG requirements on the value financial reporting process, and consequently on the quality of compulsory disclosure of financial reports in Saudi banks. We will use changes in operating income and changes in comprehensive income during a specific period (2011 – 2015G) to differentiate between the good quality disclosure and the bad quality disclosure.

1.2. Research Hypotheses:

In the terms of the research problem, this research is based on the following hypothesis:

"There is a positive relationship between achieving CG requirements and developing and improving the quality of financial reporting process".

This hypothesis can be tested via testing the following hypotheses:

H1: "There is a significance relationship between developing and improving the quality of financial reporting process and achieving positive changes in operating income during a specific period as a result to applying CG requirements in Saudi banks".

H2: "There is a significance relationship between developing and improving the quality of financial reporting process and achieving positive changes in comprehensive income during a specific period as a result to applying CG requirements in Saudi banks".

1.3. Research Questions:

To test the research hypotheses, this research includes the following questions:

A. How to achieve the main requirements of CG in Saudi banks?

B. What are the chief characteristics of the quality of financial reporting process?

C. What is the relationship between developing and refining the quality of financial reporting process and reaching positive changes in operating income and positive changes in comprehensive income during a specific period as a result to applying CG requirements in Saudi banks?

1. 4. Research Objectives and Importance:

To explain how the four research questions related to the research hypotheses, this research seeks to realize two key objectives as follows:

- **The first objective** is concerned with summarizes the features of CG requirements and the quality of financial reports disclosure.
- **The second objective** is concerned with:

A. Determining the relationship between developing and improving the quality of financial reporting process and achieving positive changes in operating income during a specific period as a result to applying CG requirements in Saudi banks;

B. Determining the relationship between developing and refining the value of financial reporting disclosure and achieving positive changes in comprehensive income during a specific period as a result to applying CG requirements in Saudi banks;

The significance of this research lies, therefore, in the need to improve the quality of the disclosure of financial reports and to rationalize the decision-making process and, consequently, to achieve the optimum exploitation of the resources available to Saudi banks and the achievement of their objectives.

In order to reach the research targets, this research is divided into the following parts:

Part 1: Introduction

Part 2: Theoretical framework and Literature review

Part 3: Empirical Analysis and Discussion of Result

Part 4: Conclusion and Recommendations

2. Theoretical Framework and Literature Review

In this part we will talk about the features of CG and the quality of financial reports disclosure generally and in KSA particularly, as follows:

First: General Framework about Corporate Governance:

First of all, corporate governance (CG) can be described in a various respects. International Financial Corporation (IFC) has described CG as the "Structures and Processes for the Management and Control of Companies" of the International Financial Corporation (IFC, 2010, p. 50). CG is the regime by which businesses are managed and managed. It affects how business goals are set and accomplished, how risk is controlled and evaluated, and how performance is calibrated (ASX Corporate Governance Council, 2003, p.3). Thus, CG is a significant framework instrument for successful businesses. It is commonly a structural organisation and executive procedure used to guide and handle the business in order to attain the goals of the company and to guarantee its economic stability.

Since 2001, interest in the CG procedures of modern corporations has been renewed, especially as a result of the high-profile collapses of a number of big U.S. companies, such as Enron Corporation and WorldCom. In 2002, the US federal government enacted the Sarbanes-Oxley Act to restore public trust in CG.

To attain ideal use of available resources and reach targets in several fields in the Kingdom of Saudi Arabia (KSA), it is necessary to apply the requirements of CG properly. The main requirements of CG include internal auditing, external auditing, audit committee and board of directors.

Internal auditing is currently at a crucial stage in its development. It plays a vital role in the field of CG. It is an effective tool for CG (see for example: Karagiorgos et al, 2010).

External auditors can impact the risk taking an incentive of management through an appropriate application of accounting policies. They can help in resolving agency problems. They play a key role in achieving the aims of CG (see for example: Ojo, 2009).

Audit committee plays a pivotal role in activating the requirements of CG, especially in the field of earnings management.

Xiea, Davidson & Dadaltb (2003) found in their research that the activities of the Board and the Audit Committee and the economic sophistication of their employees may be significant considerations in limiting the proclivity of executives to participate in income management.

Second: The Quality of Financial Reporting Process:

The final product of AISs in companies, accounting information, should have certain principal characteristics in order to be useful in achieving the AIS's objectives properly.

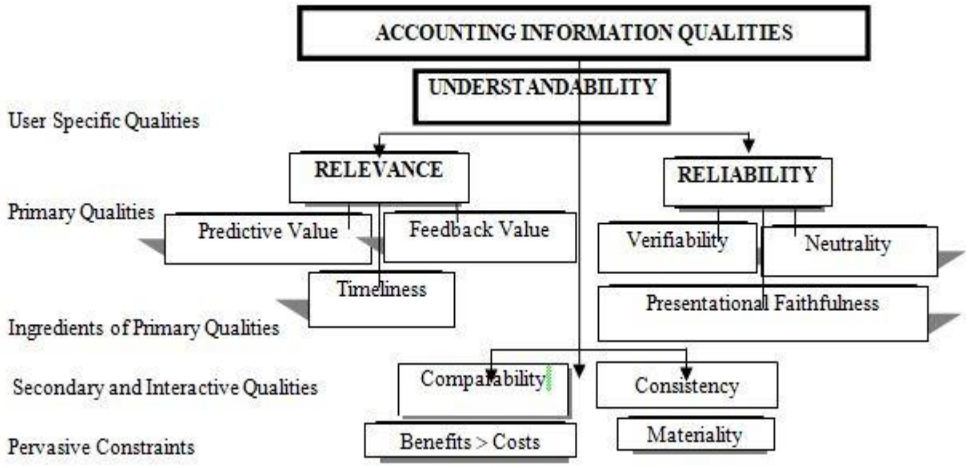
Relevance and reliability are the two principal qualities that make accounting data in businesses helpful for planning, controlling, measuring efficiency and decision-making. Subject to the limitations imposed by feasibility and materiality, enhanced significance and reliability are the qualities that make data a more appealing asset-that is, one that is helpful in decision making. If either of these features is totally lacking, the data will not be helpful. Although, ideally, the choice of an accounting alternative should generate information that is both more reliable and pertinent, it may be necessary to sacrifice one quality for profit in another (FASB, 2010, CON 8, PP. 1-42).

To be germane, accounting information must be well-timed and it must have predictive value and/or feedback value. So, to be relevant, accounting information must be capable of helping decision-makers in companies to form predictions about their decisions and to confirm and/or correct their expectations in the relevant time. The accounting information has the quality of relevance when it influences the process of decision-making process by helping the users of this information evaluate past and present, and to predict future events or to help them in approving, or correcting their past evaluations in the relevant time in order to rationalise their decisions.

To be reliable, accounting information must have representational faithfulness and it must be verifiable and impartial. Decision-makers in companies must be able to depend on this information to make their decisions. They should be able to have a degree of confidence in the accounting information presented to them and the degree of reliability must be recognised. The accounting information has the quality of reliability when it is free from material error and bias and is represented faithfully.

Accounting information should be understandable, because information cannot be useful to a decision-maker who cannot comprehend it. On the other hand, the decision-maker needs to expand his knowledge, his skills and his qualifications in order to be able to understand accounting information, because information may be relevant to a situation but the decision-maker may not be able to understand it.

Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to cater to the worth of information. In addition, accounting information must meet a test of materiality, and its benefits should be more than its costs. When the costs of obtaining information are higher than the benefits of using it, it is illogical to seek that information. Generally, to be of value, accounting information must cause a better decision to be made than would be made without the aid of that information. A hierarchy of accounting information qualities is shown in Figure 1 (FASB, 2010, CON 8, PP. 1-42):



Figure(1): Accounting Information Qualities
Source: FASB, 2010, CON 8, PP. 1-42

To provide decision-makers with useful information, an understanding of decision-makers' characteristics and their needs, the environment in which they operate and changes in this environment are needed for appropriate financial reporting.

Third: Corporate Governance in the Saudi Banks:

First of all, the Board of Directors of the Banks plays a crucial role in supervising the creation of a detailed bank policy and in tracking the choices taken by senior management to achieve the objectives. This demands required abilities and competencies to achieve the goals set by the Board. Additionally, the Board should set out clear rules on the independence of all departments within the bank and guarantee that they comply with defined policies and processes. Special committees of the Board, such as the Audit Committee, the Compliance Committee, the Compensation Committee and other special committees, can therefore play highly significant roles in this regard.

Senior banking leadership should set out an extensive business strategy; monitor day-to-day choices that support the long-term goals set by the Board. In order to guarantee economic stability, strict inner supervisory controls and efficient risk management must support the execution of the bank's general goals.

An efficient internal control system is essential to provide adequate certainty and timely data to the bank, which would assist detecting and correcting errors at the suitable moment. Such a scheme will also enhance the bank's operational efficiency and guarantee compliance with management policies, legislation, regulations and other authorized processes.

Effective risk management is based on sound CG and strict inner controls. Identifying risks in all operations is a key function of any bank. At the same moment, the bank must have the required technical systems and management procedures in place to assess, monitor and regulate hazards efficiently. An efficient risk management and control structure must be backed by a bank culture that guarantees that authorized policies and processes are effectively put into practice. The culture of the bank is determined by the philosophy and behavior of its board of managers and its senior management. In specific, the activities of senior leadership and the consistency of their choices and behavior with the values and principles that they articulate are significant in influencing the culture of the bank. It is essential that senior executives emphasize their dedication to ethical behavior, efficient risk management and challenging controls, and that these principles be implemented on an ongoing basis at all levels of bank management. (See for example: Basel Committee on Banking Supervision, 2015).

The other significant factor that promotes economic stability is efficient market discipline, which also adds considerably to excellent CG. When business members acquire timely, precise, realistic and up-to-date data on the results of the bank, their investment and loan choices can provide incentives for executives and boards of directors to manage their risks safely. No less important, the same market participants may penalize banks that fail to handle their risks peacefully. (See for example: Basel Committee on Banking Supervision, 2015).

Market discipline must therefore be endorsed by appropriate government disclosure and compliance with sound accounting standards. Knowing the Bank's desire for danger and its approach and risk management methodologies is crucial for evaluating the future of the Bank. However, the disclosure region needs improved accounting standards to guarantee correct valuation and reflect innovations, both in terms of fresh products and contemporary risk management methods. Accounting systems serve a range of purposes, the most noticeable of which is to help creditors and investors make strict and informed choices as to which firms meet market requirements in terms of effectiveness, competitiveness and profitability. Sound accounting systems also allow investors to assess the true economic value of companies. Systems also help attract funds, both foreign and domestic.

However, a significant challenge for managers and executives is to discover managers who are adequately autonomous but still knowledgeable about the bank's company. Independence represents the quality of objectivity, experience, knowledge and strength of personality. The need for managers to acquire this mix of technical expertise plus independence is crucial, considering the increasing complexity of most banking operations and the fast pace of change in financial markets and procedures.

Since its establishment in the KSA, as the Central Bank and the Banking Supervisory Authority, the Saudi Arabian Monetary Agency (SAMA) has played a leading role in the promotion of CG in the banking sector in Saudi Arabia. SAMA released a report entitled "Powers and Responsibilities of the Board of Directors of Commercial Banks in Saudi Arabia" in 1981. This document, in a comprehensive manner, guided the members of the Board in compliance with the Banking Control and Company Laws, required the implementation of an accounting and internal control system and assigned the Board responsibility for monitoring the assets, liabilities, investments and profitability of the bank. This was accompanied by a guidance document on the role of the Board's Audit Committee in 1996. This paper supplied the Saudi banks with detailed guidance on the structure, mandate, role and duties of their audit committees. In 2004, SAMA released another significant circular affecting bank directors and senior managers entitled ' App qualifications and requirements ' (Al-Sayari, Hamad, 2007).

In addition, over the last decades, SAMA has issued additional governance related regulations and guidance to banks in the KSA. These include Internal Control Circulars; Know Your Customer's Rules, Anti-Money Laundering and Anti-Terrorism Financing and Fraud Prevention Circulars. There are also specific rules on the position of external auditors and on the internal audit function. SAMA also needs the Board of Directors to create a specific compliance function to monitor the Bank's compliance with regulations and standards and to provide a reporting line to the Board of Directors or one of its committees. (Al-Sayari, Hamad, 2007).

In addition, SAMA needs all banks in the KSA to apply the International Financial Reporting Standards (IFRS) and two internal auditor companies to perform an annual audit. Moreover, SAMA needed banks in Saudi Arabia to comply with the CG guidelines issued by the Basel Committee on Banking Supervision and, more lately, the Islamic Financial Services Board. (Al-Sayari, Hamad, 2007). In 2014, SAMA issued Principles of CG, these principles include (Saudi Arabian Monetary Agency, 2014):

Principle 1: Board Members Qualifications:

The members of the Board should be eligible to carry out the duties entrusted to them. They should have a clear knowledge of their position and be able to practice sound and rational judgement on all bank matters. "Collectively" they should have a combination of professional, practical and managerial abilities, economic experience, strong reputation and expertise, honesty and the capacity to supervise, monitor and direct the bank to attain its strategic objectives.

Principle 2: Board Composition and Appointment:

The Board should establish and guarantee clear lines of responsibility and accountability at all levels of the bank. There must be a thorough separation of duties at the stage of the bank's senior leadership. The members of the Board of Directors shall appoint a non-executive director as Chairman of the Board of Directors, who shall guarantee true reflection of autonomous and non-independent directors, depending on the size of the bank and its operations.

Principle 3: Board Responsibilities:

The Board shall supervise the activities of the bank, including the approval and supervision of the execution of the strategic goals of the bank and the approval of the risk plan, the regulations of the CG and the values of professional behavior. The Board shall also be accountable for the oversight of senior leadership. The members of the Board shall carry out the tasks and responsibilities entrusted to them by ensuring that appropriate policies and procedures are in place for the supervision and control of the performance of the bank.

Principle 4: Board's Committees:

The Board of Directors shall set up a suitable amount of committees, depending on the size of the bank and its operations, to allow the Board to conduct its responsibilities effectively and to receive guidance and guidance from experts in those committees.

Principle 5: Rights of Shareholders:

The following CG principles should safeguard and promote the exercise of the freedoms of shareholders, contribute to the provision of efficient channels of communication with shareholders and guarantee fair treatment of all shareholders, including minority holdings, promote higher involvement by shareholders in the sessions of the Ordinary General Assembly, and make proposals concerning the bank's performance.

Principle 6: Disclosure and Transparency:

The principle of disclosure and transparency shall apply to all operations and activities of the bank. The Board shall publish all economic and non-financial data concerning depositors, shareholders, investors, business dealers; such data shall be made available to legislative and supervisory authorities and other parties involved.

According to the charter of the Saudi Arabian Monetary Agency published by Royal Decree No. 23 of 23-05-1377h and the Banking Control Act published by Royal Decree No. m/5 of 22-02-1386h, SAMA issues laws, rules and guidelines that banks are needed to conform to. In this regard, SAMA has lately released a range of guidelines and regulations directly or indirectly linked to CG principles, which the Board members and senior management should be conscious of and guarantee that the Bank complies with all orders and guidelines published by SAMA and other associated local or international organizations.

Fourth: Corporate Governance and Quality of Financial Reporting Process

The Sarbane-Oxley Act 2002 (SOX) was adopted to enhance the CG in order to enhance the quality of the financial reporting process. Accordingly, the SOX Act described the interaction between the members of the audit committee, the external auditors, the internal auditors, the board members and the management as essential to effective governance and the disclosure of high-quality financial reports. Cooper, Leung and Wong (2006) argue that the SOX Act has added the dimension of the domestic financial reporting certainty anticipated from internal auditors and audit committees. Effective CG guarantees reliable accounting and high-quality disclosure of financial reports, ensuring transparency of data that allows consumers of accounting data, in particular shareholders and investors, to make the correct choices.

Numerous nations, including KSA, have published CG codes and proposals that symbolize ' excellent ' CG, which certainly contribute to enhanced transparency and disclosure. Yuan and Yuan (2007) indicate that CG has a higher effect on enhancing business efficiency and, as a result, on enhancing quality financial reporting. They stress that, instead of enhancing the internal control system, enhancing CG is a more effective way to avoid fraud and enhance business value.

Cohen et al. (2004) indicate that CG can be a significant function in maintaining the quality of disclosure of financial reports. However, the concept of "quality disclosure of economic reports" remains vague. Existing literature reviews show that, despite offering a clear definition of what constitutes "quality financial reporting disclosure," scientists have concentrated on variables that can obviously prevent the achievement of high-quality financial reporting (Cohen et al., 2004). According to them, elements such as earnings management, economic remediation and fraud have been used as proof of a failure to produce high-quality financial reporting. It was discovered that businesses with financial reporting issues are less probable to have an audit committee dominated by outside managers, and few meet more than three times a year (see, for instance, Beasley et al., 2000). For instance, Beasley et al. (2000) discovered that the proportion of the audit committee consisted completely of outside managers was smaller for fraud related companies. They also discovered that the audit committee for fraud firms met less often (usually once a year) than those for fraud-free businesses (usually two or three times a year).

There are many studies which are linked to corporate governance (CG), including Klijnsmit, Patrick's Study (2001) mentioned that in recent years CG has been in the spotlight in many countries all over the globe. One of the most progressive CG discussions has taken place in the United Kingdom. This discussion has led in a number of suggestions for improving the existing CG schemes, as well as some of the guidelines and regulations for reporting on CG. However, a great deal of discretion as to CG disclosures is left to the business. This paper deals with the reporting of CG in the United Kingdom, and more in the research, with the manner in which businesses exercise their discretion in disclosure. Some hypotheses clarifying the distinct levels of disclosure are created and empirically tested.

According to Gregory, Simmelkjaer (2002), the CG codes originate from countries with varied cultures, funding traditions, ownership structures and legal origins. Given their separate roots, the codes are exceptional in their similarities, in particular with regard to the attitudes they convey regarding the main positions and duties of the supervisory body and the suggestions they make with regard to its structure and procedures.

In addition, the biggest distinctions between CG procedures in EU Member States appear to be the consequence of variations in law and not of variations in suggestions stemming from the kinds of codes analyzed in this research. Although a substantial degree of standardization of company law has been attained across the European Union, some commentators indicate that the remaining legal distinctions are the most deeply rooted in domestic attitudes and therefore the hardest to alter. While there may be distinct points of emphasis in substance and some Member States may include more governance standards in law than others, the end outcome is that it is acknowledged in all Member States that good governance practices are useful to companies listed and the markets themselves, as well as to shareholders and other stakeholders. It should also be observed that, in each Member State, the legal framework gives companies a degree of flexibility to experiment with the improvement of CG procedures.

In addition, trends towards convergence of CG methods in EU Member States appear to be both more numerous and more potent than any trends towards differentiation. Codes — together with market pressures — may serve as a convergence force, concentrating attention and debate on governance problems, expressing best practice suggestions and urging businesses to embrace them.

However, Leuz, Nanda & Wysocki (2003) explores systematic variations in income leadership across 31 nations. This research offers an explanation of these distinctions on the basis of the concept that insiders use earnings management to hide company performance from outsiders in an effort to safeguard their private control advantages. As a result, earnings management is anticipated to reduce investor protection because powerful protection limits insiders ' capacity to gain private control advantages, which decreases their incentive to mask corporate performance. The results are compatible with this forecast and indicate an endogenous connection between CG and the quality of reported income.

Another research focuses on how capital structure, dividend policy and GC differ across nations as the focus of latest research, but the way funds are reallocated in reaction to bad results has not gained as much attention. The research discusses that the market for corporate control and official bankruptcy / liquidation procedures of a nation are two main mechanisms through which corporate assets are reallocated. Ideally, an economy would only allow the finest consumers of financial resources to maintain the right to use those assets, and sub-optimal use would result in either a takeover by a more competent proprietor or a sale of property. The research provides a preliminary indication that capital market delisting occurs more frequently in nations with powerful shareholder rights. In addition, both powerful creditors and shareholder rights improve the use of bankruptcy in relation to purchases as a mechanism to resolve financial distress. This research also provides preliminary evidence that these processes are not as efficient in Japan (Klapper & Dahiya, 2007).

Doidge, Karolyi & Stulz (2007) is developing and testing a model of how the features of a country, such as legal protection for small investors and the level of economic and monetary growth, impact the expenses and advantages that companies face in adopting measures to enhance their own governance and accountability. The model sheds light on an entrepreneur who needs to raise funds to finance the investment opportunities of the firm and who decides whether or not to invest in better governance mechanisms to cut the costs of the agency. The research demonstrates that, for a specified level of country investor protection, incentives to embrace stronger governance processes at country level boost the financial and economic development of a nation. When economic and financial growth is poor, incentives to enhance firm-level governance are weak because access to capital is too costly and the implementation of better governance instruments is costlier. Using firm-level information on global CG and transparency ratings for a large sample of companies from around the globe, the research discovered proof consistent with this forecast. Specifically, the research demonstrates that (1) almost all variations in governance ratings across businesses in less developed countries are attributable to country features rather than company features, (2) firm features explain more of the variation in governance scores in more developed countries, and (3) access to worldwide capital markets sharpens incentives for better governance and diminishes the importance of country characteristics in explaining a firm's governance rating.

Another study investigates the effect of CG on the management of income. They use firm-level governance information from Credit Lyonnais Security Asia (CLSA) of nine Asian nations, in relation to the country-level governance information used in previous research. The findings are as follows. First, businesses with excellent CG tend to perform lower earnings management procedures. Second, there is a size impact for a smoothing of income, that is, big companies are susceptible to a smoothing of income, but excellent CG can ease the impact on average. Third, there is a turning point for leverage, i.e. when the governance index is big, leverage exists, otherwise there is a reverse leverage effect, which demonstrates that a heavily leveraged company with poor governance is likely to be carefully scrutinized, making it difficult to fool the market by managing profits. Fourth, companies with greater development (reduced earnings yield) are likely to participate in smoothing income and aggressive profits, but excellent CG can ease the impact. At the end of the day, companies in stronger anti-director rights nations tend to show greater income smoothing. This counter-intuitive outcome differs from that of Leuz, Nanda & Wysocki (2003) & (Shen & Chih's Study, 2007).

Muhamad et al (2009) explores the disclosure of the quality of governance issues in the annual reports of Malaysian PLCs. In the latest years, the problem of CG has gained more attention than it would normally have as the product of a sequence of corporate debacles. Corporate collapses such as Enron Corporation (US), Barings Empire (UK) and in Malaysia cases such as Perwaja and Pan Electric Inc. are all rooted in the absence of an adequate governance system. As a consequence, the CG Finance Committee was created in 1998 to conduct a review of the legal and regulatory infrastructure, specifically to evaluate its efficiency in encouraging sound CG norms in Malaysia. Following this growth, a number of CG rules have been published, in particular discussing values and best practices such as the Malaysian CG Code, the Capital Market Master Plan and the Master Financial Sector Plan. The primary aim of these rules is to strengthen CG standards and practices in Malaysia by concentrating on the role and duties of the multiple CG members, in particular the management, board of directors, audit committee, external and internal auditors. In this research, secondary data is used. The Disclosure

Index is created following the rules of the Bursa Malaysia Governance Model, the Code Guidelines and the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The aim of this research is also to analyze factors that may have an impact on the quality and amount of disclosure. In particular, this research found that Malaysian businesses had complied with the standards criteria. Only three factors under review, namely leverage, size and type of business, have been discovered to be related to the quality of disclosure related to governance problems.

In 2011, Klai & Omri's (2011) explores the sensitivity of governance processes to the quality of economic data in the evolving framework of the Tunisian industry. It focuses mainly on the characteristics of the board of directors and the ownership structure in order to identify the main governance mechanisms in Tunisian companies. Using a multivariate assessment of variance for a sample of 22 companies listed on the Tunis Stock Exchange, the research found that accounting quality had an impact on the implementation of governance processes in Tunisian companies. Primarily, the lack of financial reporting improves the power of foreigners, relatives and blockholders and decreases the existence of the State and financial institutions in Tunisian companies. The results reflect the governance position of accounting data on the Tunisian market.

Additionally, Al-Moataz & Hussainey's (2012) seeks to assess the relationship between certain CG processes and the level of disclosure of CG data in the listed firms of Saudi Arabia. It seeks to further our understanding of the primary drivers of CG reporting in one of the developing countries. This paper used a sample of 97 financial reports and accounts of the Saudi Arabian listed companies in 2006 and 2007, using the content analysis approach to examine the content of these reports. In this regression model, the CG disclosure score is the dependent variable, while the stable features (firm profitability, liquidity, debt ratio and size) and the CG processes (board independence, audit committee size) are the independent variables. This document disclosed that the independence of the board, the size of the audit committee, profitability, liquidity and gearing are key determinants of CG disclosure in the KSA. No statistically significant connection was found between the size of the company and the disclosure of CG.

Whilst, Al-Janadi, Abdul Rahman & Omar (2013) examined the effect of inner and external CG processes on voluntary disclosure in the KSA. The sample is made up of 87 firms from the Saudi Stock Market. The information is gathered from the annual reports for the financial years available, 2006 and 2007. CG mechanisms have been discovered to play a main role in delivering quality reporting. Most CG mechanisms, in particular non-executive directors, board size, CEO duality, audit quality and public ownership, make a significant contribution to offering quality voluntary disclosure. The results of this research provide proof of the efficacy of CG as a system for controlling the authority to provide appropriate and sufficient data to consumers. The results of this research have significant consequences for regulatory authorities, policy makers, shareholders and other consumers of reports who are interested in CG's best practices.

Whereas, Almoneef (2015) investigates current CG practices and other characteristics which may affect whether companies discharge hierarchical responsibility in three countries of the Arabian Gulf namely: the Kingdom of Saudi Arabia, the Sultanate of Oman, and the Kingdom of Bahrain. For this purpose, this empirical work uses a CG disclosure index to examine whether any of the three countries discharge more hierarchical accountability than the others, and also scrutinizes the effect of certain features on companies' CG disclosure representing hierarchical accountability. The main findings indicate Bahraini companies discharge more hierarchical accountability by disclosing more CG items in their annual reports compared to Saudi and Omani companies. Furthermore, companies with larger board and working in the Banking sector discharge more hierarchical accountability.

Finally, Ahmed's study (2019) aims to show the role of governance in reducing creative accounting practices, which are one of the most important causes of financial collapse, and the impact on the quality of accounting information, which is the main tool for making rational decisions. To achieve the goal of the study, a questionnaire is used. An inductive approach was used next to the descriptive and analytical approach. The study's main findings conclude that the weakness of religious authority is one of the reasons for creative accounting practices, and that governance plays a big role in reducing creative accounting practices, which reflects positively on the quality of accounting information. The study recommends the need to strengthen the ethical framework of the accounting profession and to adhere to the firm use of accounting principles in order to reduce creative accounting practices.

Based on the above mentioned studies, CG has an influence on the quality of financial reports disclosure. Each study covered one or more aspect or issue of the research topic in several environments. However, the current study tries to measure the impact of CG on the quality of financial reports disclosure in the KSA.

3. Empirical Analysis and Discussion of Results

This study aims to define the influence of achieving the requirements of CG (Independent Board Directors and Independent Audit Committee) in Saudi banks on changes in operating income and comprehensive income during the period 2011 – 2015G in order to differentiate between the good quality disclosure and the bad quality disclosure of some Saudi banks by using simple regression model. The researcher used operating income and comprehensive income because they are the most important figures in the financial statements for the majority of their users.

In what follows, the researcher discusses the models equations, the study sample, the study variables, and the statistical results.

In the first step, we measure the financial information quality using two models. The models equations are as follows:

Model One: Operating Income Model

$$\mathbf{OIncome_{it} = a + CGR_{it}\, b + \varepsilon}$$

Model Two: Comprehensive Income Model

$$\mathbf{CIncome_{it} = a + CGR_{it}\, b + \varepsilon}$$

IF:

$OIncome_{it}$ = Change in Operating Income in a Bank i in Year t

$CIncome_{it}$ = Change in Comprehensive Income in a Bank i in Year t

CGR_{it} = CG Requirements in a Bank i in Year t including: Independent Board Directors (X1), Independent Audit Committee Independent (X2) and Independent External Auditors (X3)

a, b = Consonants

ε: Random Error (Regression residuals)

First: The Study Sample:

The study sample includes ten banks of twelve main Saudi banks in Saudi Arabia, or 83%. The National Bank was excluded because its shares are not registered in the local stock market, and also excluded Al Rajhi Bank because it hadn't practiced any activities that lead to other comprehensive income items. The Saudi banking sector was chosen because it is a sector that has applied international accounting standards long ago. In addition, it applies Basil I, II & III. Furthermore, it is a vital sector in the Saudi economy. It has been chosen during the period from 2011-2015 because it is the period before and after issuing the updated Principles of CG in 2014 in the KSA. A list of banks surveyed is shown in the following table:

Table(1): List of banks surveyed

No.	Item	Year	Board Size	Independent Board of Director	Board committees	Audit committee Size	Independent Audit committee	External Auditors
1	Saudi Investment Bank	2011	9	8	4	3	3	2
		2012	8	8	4	3	3	2
		2013	8	8	5	3	3	2
		2014	9	3	5	4	3	2
		2015	9	4	5	5	3	2
2	Al-inma Bank	2011	9	5	6	3	3	2
		2012	9	5	4	3	3	2
		2013	9	5	6	3	3	2
		2014	9	5	5	4	3	2
		2015	9	5	5	4	3	2
3	Riyadh Bank	2011	10	7	9	5	3	2
		2012	10	6	8	5	3	2
		2013	10	6	9	5	3	2
		2014	10	6	7	5	3	2
		2015	10	6	9	5	3	2
4	Al-Bilad Bank	2011	11	6	5	5	4	2
		2012	11	7	5	5	4	2
		2013	11	7	5	5	5	2
		2014	11	7	6	5	4	2
		2015	11	4	8	5	4	2
5	Arab National Bank	2011	10	5	4	3	4	2
		2012	10	5	5	3	4	2
		2013	10	5	4	3	4	2
		2014	10	5	4	3	4	2
		2015	10	5	4	3	4	2
6	Al Jazira Bank	2011	9	6	5	4	3	2
		2012	9	5	7	4	3	2
		2013	9	3	5	3	2	2
		2014	9	2	6	4	3	2

		2015	9	2	5	4	2	2
7	Samba	2011	10	7	5	3	3	2
		2012	10	7	3	3	3	2
		2013	10	5	4	3	3	2
		2014	10	5	4	3	3	2
		2015	10	5	4	3	3	2
8	The Saudi British Bank	2011	10	4	5	5	4	2
		2012	10	4	4	5	4	2
		2013	10	4	4	5	4	2
		2014	10	4	4	5	4	2
		2015	10	4	4	5	4	2
9	Saudi Fransi Banque	2011	10	3	4	4	4	2
		2012	10	4	4	4	4	2
		2013	10	4	5	5	5	2
		2014	10	4	4	5	5	2
		2015	10	4	4	5	5	2
10	Saudi Hollandi Bank	2011	10	4	4	3	3	2
		2012	10	4	4	3	3	2
		2013	10	4	4	3	3	2
		2014	10	4	4	3	3	2
		2015	10	4	4	3	3	2

Second: The Study Variables

Study variables include the following:

The **dependent** variables in the study are:

- The annual change in net profit (Income), and this change is measured by the change in net profit per year.
- The annual change in comprehensive income (CIncome), and this change is measured by the change in overall profit per year.

The **independent** variables in the study are:

- Board Size (X1)
- Independent Board Directors (X2)
- Number of Board Committees (X3)
- Audit Committee Size (X4)
- Independent Audit Committee (X5)

Third: The Statistical Results of the Study:

- **Net Income Model Findings:**

From Table 2 we can find that there is a correlation between Net Income (Y_1) and Number of Board Committees (X_3). However, there is no correlation between Net Income (Y_1) and other independent variables (X_1, X_2, X_4 & X_5).

Table(2): Correlations

		y1	x1	x2	x3	X4	X5
y1	Pearson Correlation	1	.177	-.202	.329*	.054	-.129
	Sig. (2-tailed)		.218	.160	**0.020**	.711	.371
	N	50	50	50	50	50	50
x1	Pearson Correlation	.177	1	.016	.123	-.016	.564**
	Sig. (2-tailed)	.218		.915	.395	.913	.000
	N	50	50	50	50	50	50
x2	Pearson Correlation	-.202	.016	1	-.480**	.140	.091
	Sig. (2-tailed)	.160	.915		0.000	.333	.530
	N	50	50	50	50	50	50
x3	Pearson Correlation	.329*	.123	-.480**	1	-.089	-.125
	Sig. (2-tailed)	**0.020**	.395	.000		.539	.388
	N	50	50	50	50	50	50
X4	Pearson Correlation	.054	-.016	.140	-.089	1	.338*
	Sig. (2-tailed)	.711	.913	.333	.539		0.016
	N	50	50	50	50	50	50
X5	Pearson Correlation	-.129	.564**	.091	-.125	.338*	1
	Sig. (2-tailed)	.371	0.000	.530	.388	0.016	
	N	50	50	50	50	50	50

*. Correlation is significant at the 0.05 level (2-tailed). **. Correlation is significant at the 0.01 level (2-tailed).

Y1 (Net Income) = -55929 + 9648 X_1 – 12937 X_2 + 4647 X_3 + 4647 X_4 + 4364 X_5, as mentioned in the following table:

Table(3): Coefficients a (Model 1)

	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std-Error	Beta		
Constant	-55929	3942728.571		-1.4	.163
Board Size	9648	452307.914	.370	2.1	**.039***
Independent Board Directors	-12937	190360.099	-.105	-.680	.500
Number of Board Committees	4647	356967.114	.206	1.3	.200
Audit Committee Size	4647	356967.114	.206	1.3	.200
Independent Audit Committee	4364	2944778.566	.220	1.48	.145

Note: *= p≤ 0.05 and **= p≤0.01; a. Dependent Variable: y1

The regression of Model 1 in Table 2 examines the relationship between Net Income and the independent variables. Table 2 indicates that board size only is statistically significant at the 5% level with Net Income; this means that larger boards (X_1) which indicates that the change in the dependent variable Y_1 is due to many factors including achieving CG requirements in Saudi banks especially board size.

- **Net Income Model Findings**

The relationship between X1, X2, X3, X4 & X5 (Independent variables) and Y1 (Net Income) is significant, as shown in the following table:

Table(4): ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.379E13	5	6.758E12	2.414	**.05a**
	Residual	1.232E14	44	2.800E12		
	Total	1.570E14	49			

a. Predictors: (Constant), x1, x2, x3, x4, x5, b. Dependent Variable: y1

Moreover, we can find that around 22% of changing in Y1 (Net Income) is due to the change in X1, X2, X3, X4 & X5 (Independent variables), as showing in the following table:

Table(5): Model Summaryb

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.464a	.215	.126	1673227.48213	1.328

a. Predictors: (Constant), x1, x2, x3, x4, x5, x6

b. Dependent Variable: y1

- **Comprehensive Income Model 2 Results:**

From Table 2 we can find that there is a correlation between Comprehensive Income (Y2) and Board Size (X1). In addition, there is a correlation between Comprehensive Income (Y2) and Number of Board Committees (X3). However, there is no between Comprehensive Income (Y2) and other independent variables (X2, X4, & X5).

Table(6): Correlations

		y2	x1	x2	x3	X4	X5
y2	Pearson Correlation	1	.312*	-.027	.293*	.103	.075
	Sig. (2-tailed)		**0.028**	.852	**0.039**	.476	.603
	N	50	50	50	50	50	50
x1	Pearson Correlation	.312*	1	.016	.123	-.016	.564**
	Sig. (2-tailed)	**0.028**		.915	.395	.913	.000
	N	50	50	50	50	50	50
x2	Pearson Correlation	-.027	.016	1	-.480**	.140	.091
	Sig. (2-tailed)	.852	.915		.000	.333	.530
	N	50	50	50	50	50	50
x3	Pearson Correlation	.293*	.123	-.480**	1	-.089	-.125
	Sig. (2-tailed)	.039	.395	.000		.539	.388
	N	50	50	50	50	50	50
x4	Pearson Correlation	.293*	.123	-.480**	1.000**	-.089	-.125
	Sig. (2-tailed)	**0.039**	.395	.000	.000	.539	.388
	N	50	50	50	50	50	50
x5	Pearson Correlation	.103	-.016	.140	-.089	1	.338*
	Sig. (2-tailed)	.476	.913	.333	.539		.016

	N	50	50	50	50	50	50
x6	Pearson Correlation	.075	.564**	.091	-.125	.338*	1
	Sig. (2-tailed)	.603	.000	.530	.388	.016	
	N	50	50	50	50	50	50

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

Y2 (Comprehensive Income) = 8.744 + 0.717 X1 – 0.169 X2 + 0.178 X3 + 0.187 X4 + 0.125 X5, as mentioned in the following table:

Table(7): Coefficients [a] (Model 2)

	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std-Error	Beta		
Constant	8.744	2.213		3.951	.000
Board Size	.717	.254	.473	2.824	.007**
Independent Board Directors	-.169	.107	-.236	-1.586	.102
Number of Board Committees	.178	.200	.136	.890	.378
Audit Committee Size	.178	.200	.136	.890	.378
Independent Audit Committee	.125	.165	.108	.756	.454

Note: *= $p \leq 0.05$ and **= $p \leq 0.01$; a. Dependent Variable: y2

The regression of Model 2 in Table 6 examines the relationship between Comprehensive Income and the independent variables. Table 2 indicates that board size is statistically significant at the 5% level with Comprehensive Income; this means that larger boards (X_1), and Number of Board Committees (X_3) which indicates that the change in the dependent variable Y_2 is due to many factors including achieving CG requirements in Saudi banks especially board size and number of board committees.

- **Net Income Model Results Goodness**

The relationship between X_1, X_2, X_3, X_4, X_5, X_6 (Independent variables) and Y_2 (Comprehensive Income) is significant, as shown in the following table:

Table(8): ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.219E13	5	4.437E12	2.250	.039[a]
	Residual	8.678E13	44	1.972E12		
	Total	1.090E14	49			

a. Predictors: (Constant), x1, x2, x3, x4, x5,
b. Dependent Variable: y2

Moreover, we can find that around 20% of changing in Y_2 (Comprehensive Income) is due to the change in X_1, X_2, X_3, X_4 & X_5 (Independent variables), as showing in the following table:

Table(9): Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.451[a]	.204	.113	1404412.69571	.564

a. Predictors: (Constant), x1, x2, x3, x4, x5, b. Dependent Variable: y2

Accordingly, the Saudi banks' profits are improving during the period (2011 -2015) as a result of the end of financial crisis in the Saudi market and starting to apply CG requirements in Saudi banks. This will lead to improve the quality of financial reporting.

4. Conclusion and Recommendations

The core of this paper has involved an examination of the relationship between applying CG requirements in the Saudi banks and refining the quality of financial reporting process in the KSA. This research depends on regression analysis of Operating Income Model and Comprehensive Income Model to achieve the research objectives.

The main findings of this research are that Saudi banks' profits are improving during the period (2011 - 2015) by means of the end of financial crisis in the Saudi market and starting to apply CG requirements in the Saudi environment especially in the Saudi banks. Accordingly, there is a significant relationship between the existence of audit committee and achieving improvement in net income and comprehensive income. In addition, there is a correlation between Net Income and Number of Board Committees. Moreover, there is a correlation between Comprehensive Income and Board Size and Number of Board Committees. Therefore, there is a positive relationship between achieving CG requirements (especially the existence of audit committee, board size, and number of board committees) in the KSA and improving the Saudi banks' profitability, and consequently, enhancing the value of financial reporting process.

The study recommends the importance of applying CG requirements in the KSA **properly** in order to improve the quality of financial reporting **more and more**. This will lead to achieving positive changes in operating income and comprehensive income.

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