THE USEFULNESS OF CORPORATE ANNUAL REPORTS TO INVESTMENT ANALYSTS IN SAUDI ARABIA

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Abstract

In a developing country such as Saudi Arabia where alternative sources of company information tend to be more limited in a quantity and quality, the role of corporate annual reports for investment activities assumes a much more dominant and prominent role than in the more advanced and economically developed countries. This study was undertaken to examine empirically the usefulness of corporate annual reports to investment analysts in Saudi Arabia and their role in the investment activities.

Before undertaking the empirical investigation it was essential to provide a background of the economic and accounting environment under which the Saudi companies operate and investment activities being carried out. Three chapters are designed to fulfil this objective, these are Chapter 2, 3 and 4. Chapter 5 is focused in reviewing the literature related to usefulness of financial information. This review is believed to be an important step in providing a framework for the empirical investigation.

To achieve the main objective of this research which is to evaluate the importance of corporate annual reports to the investment analysts in Saudi Arabia, a questionnaire survey was carried out to obtain the investment analysts views of the annual reports, the importance they attached to them and the uses of these reports in their investment activities.

The results of the survey are presented and discussed in chapters seven and eight. The statistical tests results show that Saudi Arabian investment analysts, despite the differences in their background characteristics, still regard corporate annual reports as the most important source of information for their investment activities. A summary of the main conclusions of the study, as well as a number of recommendations, are reported in the final chapter.

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Chapter One
Introduction

1.1. Background

Several authorities have accepted the position that the main objective of financial reporting is to provide information that is useful to the users of these reports in making decisions. According to the Financial Accounting Standard Board, the objective of financial reporting is that,

> "Financial reporting should provide information that is useful to present and potential investors, creditors, and other users in making rational investment, credit, and similar decisions." (FASB,1978, Para.34, p.8).

The Institute of Chartered Accountants' view of the aim of financial reports, as expressed in 1975 in the Corporate Report, is that,

> "The fundamental objective of corporate reports is to communicate economic measurements of an information about the resources and performance of the reporting entity useful to those having reasonable rights to such information." (A.S.S.C. 1975, p. 28).

In 1973, the AICPA in the Trueblood Report stated that, "The provision of information useful for the of economic decisions is the basic objective of financial statements." (p. 13). In 1980, the Canadian Institute of Chartered Accountants (CICA) indicated that "An objective of financial reporting is the provision of useful information to all of the potential users of such information in a form and time frame that is relevant to their various needs" (p. 32). The Accounting Standard Board in its statement issued 1991 stated that

> " the objective of financial statements is to provide information about the financial position, performance and financial adaptability of an enterprise that is useful to a wide range of users in making economic decisions." (Para. 12).

On the other hand, other groups have been arguing that financial statements have not been useful. Benston in 1974 wrote that ;

> "the study that relates published accounting statement data with stock prices leads to the conclusion that the data either are not useful or have been fully impounded into stock prices before they are published. Since these studies use relatively simple decision models; evidence of the professional analysts' ability to use financial data for stock choices was reviewed. This evidence also supports the conclusion that the accounting statements are not useful; or timely; or both" (p.35).

However, it is difficult to draw a conclusion regarding the usefulness of financial statements in general. For the stewardship function and for the evaluation of the performance of the stewards, financial statements may have been useful. Financial statements also might have been useful for some users in particular circumstances, but it might not be in the ideal status that financial statements should be in. To improve financial reporting towards the ideal status, we have to study and understand the needs of each user group and make the necessary changes to financial reports so that these needs can be satisfied. Indeed, to fulfil the objective of financial statements which is providing useful information to the users, we have to know what information is considered to be useful for them.

The users of financial information or those who have reasonable rights to such information can be divided into two main categories: internal users and external users. The internal users are those responsible for the management of the company. Company managers are responsible for making all internally controlled decisions which affect the future performance and strategy of the company.

The external users of financial information whose needs should be recognised were identified by CICA in Corporate Reporting, Its Future Evaluation in 1980 as follows:

1. Shareholders, present and potential.
2. Long term creditors: present and potential.
3. Short term creditors: present and potential.
4. Analysts and advisors serving shareholders and creditors.
5. Employees: present, past and potential[1].
6. Non-executive directors: present and potential.
7. Customers: present, past and potential.
8. Suppliers: present and potential.
9. Industry groups.
10. Labour unions.
11. Government Department and Ministers.
12. Public- Political parties:

[1] Some writers classify employees as internal users of corporate reporting. See for example Ba-Owaidan (1994).

-Public affairs groups.

-Consumer groups.

-Environmental groups.

13. Regulatory agencies.

14. Other companies (domestic and foreign).

15. Standard setters, academic researchers.

Each group of these users needs financial information for many uses and this information might differ from one group to another in terms of the level of information, amount of information, and in terms of items of information. The corporate reporting should be improved to satisfy these various users as much as possible.

Proper and adequate corporate financial reporting plays a significant role in national economic growth through the allocation of resources to different sectors of the economy. Many of the various groups of corporate reporting users share a common concern, that is making decisions about the allocation of scarce resources between competing ends. The importance of corporate reporting is to reach the best allocation by enabling information users to make rational decisions and evaluate various alternatives. In the case of capital, the resource allocation procedure will pass through several stages with the final step being the selection of an investment opportunity (Dyckman, 1964, Glautier and Underdown, 1993).

Among the various and different user groups of corporate financial reporting, which group is the primary user of this information and to whom financial reports should be aimed. Interested parties, however, often disagree as to what groups should be given priority. In concepts statements (1978) FASB emphasise investors, creditors, and their advisors as the groups to be given priority for financial reporting. Even public accounting firms emphasise investors and creditors as the principal users of general purpose financial statements (Arthur Anderson &Co., 1984). Day in 1986 wrote that " it is generally agreed that investors form the largest and the most important groups of potential users" (p.295). The Ministry of Commerce in the objectives of financial accounting in 1986 stated that " The primary external users of general purpose financial statements are current and prospective equity investors, current and prospective lenders; and current and prospective suppliers." (Para. 53, p. 12). Experts in Saudi Arabia (our focus in this study) were asked to indicate their opinion as to who are the main users of corporate annual reports and their responses showed that investors came second after the Department of Zaket and Income Tax, the only tax authority in the country (Al-Amari, 1989). Regardless of whether investors are the primary user group of corporate financial reports or not, they are a major group and they should be given more consideration regarding their needs of financial information.

The importance of investors comes also from the significant influence they have on the capital market. For capital markets to operate efficiently and effectively we should satisfy the needs of the dominant providers of the capital in each market. Without accounting information these markets could not operate. Potential investors would refuse to trade if they could not assess the value of an investment, i.e. they do not know what price to buy or sell at - or if they considered themselves to be in an inferior position vis a vis other market participants they thought were better informed. Therefore, information has to be made available and it must be available to all.

The providers of capital vary from one country to another. In the UK, the major provider of capital is institutional investors , pension funds, insurance companies and building societies. In the USA the major provider of the capital is the private investors (Wallace, 1987). In both these countries there is clearly a demand for accounting information being made available externally by the firm. However, the case is different in a country like Germany where the banks provide or control the bulk of equity finance in the capital market, and furthermore they are regarded as insiders to companies having access to internal information.

Having identified the investor group a question arises as to whether this group is homogeneous. Typically the literature has divided the group into two distant classes. The sophisticated investors and the unsophisticated investors. The unsophisticated investor is the typical private or individual investor who has little understanding of the complexities of accounting and has little use for available accounting information and that because the lack of education and experience required to comprehend the complex, sophisticated accounting conventions and resulting financial reports, so they may ignore or misinterpret the annual reports' content.

On the other hand, the sophisticated investor such as institutional investors, investment trusts and investment analysts are believed to be knowledgeable readers of financial information who not only fully understand financial statements as they are now prepared but also desire even more such information for their professional purposes (Chang and Most, 1980, p. 8 and Parker, 1986). So the annual reports should be aimed at which one of these types of investors? Some writers have argued that the objective of financial statements is to serve primarily the private or the individual investors (AICPA, The

Trueblood Report, 1973). However, other writers have supported the idea that financial statements should be aimed at the sophisticated investors (Buzby, 1974a Beaver, 1978). In the UK a solution to this problem has been seen in terms of two types of financial statement; the complete and full statements and a simplified set of statements.

1.2. Statement of the Problem

This study is an attempt to examine the usefulness of accounting information provided in the companies' annual reports to investment analysts in planning and controlling investment decisions in Saudi Arabia. For any researcher to reach accurate results in assessing the usefulness of the financial information to investors he should differentiate between sophisticated and unsophisticated investors, failing to do so may lead to imprecise results and that is because of the differences that exist between the two types of investors in education, experience, and the amount of information they need. These differences between sophisticated and unsophisticated investors lead to differences in their evaluation and their uses of financial information that will, however, affect their decision regarding buying, selling, or holding shares.

In this study we are focusing on corporate annual reports because it has been believed that the annual reports are the primary source for investors in making their decision. When investors in three countries (United States, United Kingdom, and New Zealand) were asked about their information sources they placed high importance on the corporate annual reports as source of information for investment decisions (Chang and Most, 1980, p. 40).

In Saudi Arabia individual investors were given six sources of information and asked which of them they considered to be valuable and useful in making investment decisions. Their responses indicated that the annual reports were the main source of information which they would look at (Ba-Owaidan, 1994).

On the other hand, investment analysts in Saudi Arabia were chosen to be our focus in this study for several reasons. First of all, financial analysts as sophisticated investors are working for organisations such as institutional investors (unit trusts, companies, pension funds and insurance companies), merchant banks and stockbrokers which have an important and significant influence in the investment sector and they are growing rapidly in Saudi Arabia. Although the individual investors are the largest in number, the investment analysts control the largest portion in terms of the value of shares (Ba-Owaidan, 1994). Therefore, useful information to be provided to investment analysts will help them in making rational investment decisions in the Saudi stock market (and elsewhere) which is considered to be the largest in the Middle East in terms of market capitalisation. At the end of 1992, a total of 56 companies were quoted with a market capitalisation of $62,430 million (MEED, 26th November, 1993). These rational investment decisions made by investment analysts will be a major step toward the best allocation of resources.

The second reason for choosing investment analysts in Saudi Arabia to be our focus in this study is that no study has been conducted yet in Saudi Arabia concerning the usefulness of financial information to these analysts in particular. Abdelsalam (1990) studied the use of corporate financial reports by investors in general in Saudi Arabia. The investors surveyed in his study indicated that investors rely on the corporate financial reports when making decisions related to buying, selling and holding shares. The survey also indicated that investors feel that the financial reports present information useful to investment decisions. In another study by the same writer (Abdelsalam, 1991) the results did not support the conclusion in his first study in 1990. The conclusion in his second study (1991) was that the release of corporate annual financial reports does not significantly affect trade volume in Saudi Arabia. In other words, investors in Saudi Arabia feel that corporate annual reports contain useful information and they rely on them and yet these information has no effect on their decisions. These contradictory results support the idea that dealing with investors as one homogenous group without differentiating between sophisticated and unsophisticated investors would lead to such results.

Another study was carried out by Ba-Owaidan (1994) to investigate the contribution of accounting information to the decisions made by one type of investors which is the small or private investors in Saudi Arabia. His conclusion was that the majority of individual investors believed that financial statements gave them useful information for investment decisions. Therefore, studying the usefulness of the financial information provided in corporate annual reports for the investment analysts will be a great contribution for both accounting reporting and investment environment in Saudi Arabia.

1.3. Objective of the Study

The main objective of the study is to examine the importance of Saudi Arabian companies' annual reports to investment analysts and how they understand, evaluate and use the financial information provided in them. In particular, this study is an attempt to provide answers to the following questions:

- What is the importance of the various sources of information for investment analysts?
- How investment analysts rank the importance of corporate annual reports among all other sources of information for their investment analysis?
- Do investment analysts' background characteristics affect their perception and evaluation of the importance of corporate annual reports?
- What are the most important uses of corporate annual reports in the process of investment analysis?
- What are the most important sections of the corporate report to investment analysts?
- Do investment analysts adjust the items appear in the corporate annual report and if so what are the reasons for such adjustments?
- Do investment analysts' background characteristics affect the level of adjustments made to these items?
- Do investment analysts fully understand the information provided in the corporate annual report and do they find such information relevant to their investment activities?
- Do investment analysts feel confident when they are using the information contained in the corporate annual report?
- What is the investment analysts attitude towards various aspects related to the corporate annual report?
- Do investment analysts need more information to be disclosed in the corporate annual report?

Furthermore, this study will give some insight into three areas which considered to be an important background in fulfilling the main aim of this study. Firstly, the economic condition as well as the financial system of Saudi Arabia will be discussed and presented in this study. Secondly, the structure and development of the stock market, its major characteristics and its efficiency will also be included. Thirdly, a review of the process of developing accounting reporting, practices and standards will be carried out.

In the Saudi Arabian context, this topic is of a great importance to various groups of preparers and users of financial reports, such as the accounting profession, corporate management, investment and credit community and the government agencies and institutions. Finally, this study is an attempt to develop additional evidence concerning the relationship between financial information and investment analysis in developing countries.

1.4. Outline and Methodology of the Study

In order to achieve the above objectives, the study will be divided into three parts. The first is the background or framework part which consists of three chapters. The first chapter will deal with the economic and financial system in Saudi Arabia. This chapter will discuss the development of the economy by presenting the five-year development plans and the role of the private sector. The major components of the financial system will also be presented in this chapter. The next chapter will be devoted to the development of the Saudi Arabian stock market and its major characteristics. Shares trading activities and the efficiency of the stock market will be discussed too. The last chapter of this part will deal with the accounting environment. The topics that will be discussed include the professional accounting bodies, laws and acts related to accounting reporting, and the development the accounting standards.

The second part of this study consist of two chapters. The first chapter is a review of the related literature. Some of the topics that will be discussed in this chapter are as follows:

- The development of financial reporting.
- The objectives of financial reporting.
- The characteristics of financial information.
- The users and uses of corporate annual reports.
- Prior studies involving the usefulness of corporate annual reports for investment analysts in general.
- Prior studies involving the usefulness of financial information for investors in Saudi Arabia.

The second chapter in the second part is the methodology chapter. The advantages and disadvantages of the methods that were considered to be used in carrying out this research will be discussed in this chapter. Then , a detailed description of the method that was chosen to be used as well as the reasons for such choice will be given.

The third part of this study is the results and discussion of the investment analysts' survey. A questionnaire survey was conducted with investment analysts in Saudi Arabia regarding the importance and usefulness of corporate annual reports for their investment activities. The statistical tools that used in analysing the results as well as the interpretation of the results will be presented in this part too. Finally, based on the findings of this study recommendations and suggestions will be given.

Chapter Two

Economic Development and the Financial System in Saudi Arabia

2.1. Introduction

The Kingdom of Saudi Arabia was founded on September 23, 1932 by King Abdul Aziz Al-Saud, who united the whole of Arabia under his leadership. The Kingdom of Saudi Arabia is an Arabic Islamic monarchy with a political system lodged in Islamic traditions. Its rules and regulations ought to be governed by The Holy Quoran and teachings and sayings of The Prophet Mohammed (Sunnah) which call for peace, justice equality, consolation and respect for the right of the individual. Saudi Arabia covers most of the Arabian peninsula. It is a large country: its 2,186,000 square kilometres is roughly two-thirds the size of India or one-quarter that of the USA. The major west coast port of Jeddah is 1,500 kilometres from its east coast counterpart, Dammam. In the north-south direction, the northern border town of Tariff is about 3,500 kilometres by road from the southern border in Jizan (Johany, Bome and Mixon, 1986). It is divided into five regions with an estimated population of 16.9 million (The Economic Intelligence Unit, 1997).

This chapter has two aims to achieve. Firstly, to give a background of economic development of Saudi Arabia. Secondly, to give an overview of the major components of the Saudi Arabian financial system. In doing so this chapter is divided into two parts. The first part discusses the nature of Saudi Arabian economy and the stages that the economy had to go through. The objectives and achievements of each five-year development plan will be presented. The role of the private sector in the development process of the economy will also be discussed. The second part of this chapter is concerned with the financial structure of Saudi Arabia. The three major components, Saudi Arabia Monetary Agency, Commercial Banks, and the Government Specialised Credit Institutions, will be presented.

2.2. The Economic Development and Planning

Saudi Arabia's economic system is based on free and private enterprise. The commitment of Saudi Arabia to a free economy derives from the teachings of the nation's religious code and its social traditions. Economic and social changes cannot be imposed by the government alone, but must come about through increasing participation of all elements of society in both the process of development and its benefits. To pursue this understanding Saudi citizens have the opportunity to initiate and participate in economic activities and reap the rewards of their enterprise and hard work.

Saudi Arabia possesses a quarter of the worlds proven oil reserves and is the largest exporter of oil in the world, producing currently about 8.1 million barrels of oil a day which represent about 12% of the total world production with price currently (September, 1995) around $17 a barrel (Daghistani, 1994 and SAMA, 1994).

In 1938, oil was discovered in Saudi Arabia and the Arabian-American Oil Company (ARAMCO) began production in the same year, with a total output of only 3.1 million barrels. Oil production was interrupted by World War II but from 1944 to 1945 output rose almost three-fold from 7.8 million barrels to 21.3 million barrels, and it reached 89.9 million barrels by 1947. The next significant increase in output took place in 1948, when crude oil output rose by nearly 60 per cent over the previous year.

In 1950 Saudi Arabia produced an average of 976,000 barrels a day which represented approximately five percent of total world output in that time with a price of $1.7 a barrel. During the 1960s Saudi output rose continuously and by 1970 represented 8% of world production. In 1973 the oil price jumped significantly from $3 a barrel to $11.65 by the end of that year and that was due to the Arab-Israeli war which broke out in October 1973, with the Egyptian and Syrian governments, stated aims of regaining their territories which had been under the Israeli occupation since 1967. In support of the Arab cause the six Gulf countries decided to use the 'oil weapon' and to cut their countries' overall crude oil production by 5 percent and to impose a complete oil embargo on United States and Netherlands (Ghanen, 1986).

Rapid expansion of oil production has provided the Kingdom with both government revenues and US $ to finance development. However, economic growth in Saudi Arabia has been primarily a product of this one sector rather than the substantial development of agriculture, mining and manufacturing sectors. Hence more dependence on oil has led to a convincingness for further development of the economy; a situation that must gradually be developed by diversifying production, exports and sources of government revenue.

2.2.1. Saudi Arabia's Five-year Development Plans

Planning for economic development has been the most popular activity of the governments of underdeveloped countries since World War II. The Kingdom of Saudi Arabia has accommodated the system of development planning since 1970 when the oil revenues provided the means for the government to improve the economic and social conditions in the country. The Saudi government looks to the development plans as a mechanism through which a more efficient allocation of the country's financial resources could be made. Thus, the Saudi government hoped that a five-year development plan would provide the necessary conditions that could help in reducing waste, diversifying the economy, and ensuring internal consistencies in government finances and in the overall development process of the Kingdom.

Planning has played an important role in guiding the economic and social development of Saudi Arabia during the past twenty-five years, and will become even more essential in the future, as conditions and needs become more complex and the country moves into a new phase of development. The special feature of the Saudi Arabian planning is integrating the government development action with the dynamism of the private sector in a free market economy.

Encouraging the private sector to be less dependent on government expenditure and to identify and develop new opportunities is the key role in the diversification and expansion of the economy. However, there are signs that the linkage between government expenditure and the growth in the private sector has begun to weaken over the past few years. Even though annual rates of growth in the government sector dropped from an average of 19.5% in 1990-1991 to 3.8% in 1992, 1.8% in 1993 and-2% in 1994, the growth in the private sector continued at around 6% in 1992, 5.1% in 1993 and 4% in 1994 (Al-Iktissad Wal-Aumal, January 1995). In support of this major role, the government has to create a favourable environment for private sector investment and growth, provide necessary incentives and develop institutional support systems.

The plan documents reflect the long term vision and provides the conceptual framework for restructuring the country's productive resources, expanding its industrial sector, and introducing modern technologies throughout the economy. The preparation of a plan requires the specification of objectives for each dimension of development : economic, social and institutional, and designing the most effective measures to achieve them. Each plan has identified the strategy to be achieved and allocated the tasks of implementing the strategy to the government or to the private sector as appropriate.

The basic principle underlying the Kingdoms' development has been the sustenance of religious value and the provision of national security. Under these two basic principles, several broad goals guided the Saudi development plans. These goals are stated as follows: (Ministry of Planning, 1990)

- Diversifying the economy and reducing dependence on oil
- Raising living standards and improving the quality of life
- Maintaining economic and social stability
- Regional development
- Strengthening the role of the private sector
- Broadening the linkages between the Kingdom and other nations
- Developing and completing the physical infrastructure
- Developing human resources

Under these broad long term goals each specific plan has represented a special consideration, all of which lead to structural changes in the economy and more effective control over the development process.

2.2.1.1. The First Five-Year Development Plan (1970-75)

The first five-year development plan prepared by the Central Planning Organisation was approved by the Council of Ministers in August 1970 and covered the years 1970-75. In the early 1970s the economy of Saudi Arabia was dominated by its dependence on oil, its commitment to a free economy, shortages of manpower, and rapid progress in all sectors over the previous decade.

The general aims of the first development plan were to increase the production capacity of the economy and to raise the standard of living and the wealth and welfare of the people of Saudi Arabia. At the same time, the plan intended to provide for national security and to maintain economic and social stability along the path of development (Central Planning Organisation, 1970). The specific objectives were:

- Raising Gross Domestic Product (GPD) by 10 per cent each year.
- Developing human resources so that the Saudis would be able to replace foreign skilled manpower and contribute more effectively to the growth of the economy and participate more in the process of development.
- Diversifying sources of income and reducing the country's dependence on oil by increasing the contribution of the productive sectors in the growth of the country (Central Planning Organisation, 1970).

To accomplish the above objectives, the plan projected an outlay of SR 41.3 billion in the public sector for five years. Total projects outlay was estimated to be SR 18,382.5 million (44.5 percent), and total recurrent expenditure amounted to SR 22,931 million (55.5 percent).

Table 2.1 shows each sector's share of the total outlay in the development plan. As shown, defence received the largest share of the total outlay, while trade and services received the lowest share. Defence accounted for a total outlay of SR 9,555 million (or 23 percent), while 58 percent of this (SR 5,575 million) was allocated for project outlay, and the remaining 42 percent (SR 3,980 million) was allocated for current expenditures.

Administrative allocation amounted to SR 7,717.4 million (18.6 percent), where SR 6,794.6 million was allocated for expenditures and SR 922.8 million was allocated for projects. The average annual increase is projected to be 5 percent. Transportation and communication come in third place with a total allocation of SR 7,476.5 million (or 18 percent), where SR 5,709.2 million was allocated for project outlay. Urban development and public utilities total allocation was SR 4,572.3 or 11.1 percent, while SR 3,325.4 million was allocated for project outlay, and the remaining SR 1,246.9 million for current expenditure. Health and social affairs' total allocation was SR 1,921.1 million or 4.78 percent.

Table 2–1

Financial Allocations for 1970-75

(SR Million)

Sector	Expenditure	Project	Total	Percent
Defence	3,980.0	5,575.0	9,555.0	23.1
Administration	6,980.0	922.8	7,717.4	18.6
Transport and communications	1,767.3	5,709.2	7,476.5	18.1
Education, Vocational Training and Cultural Affairs	6,150.2	1,227.5	7,377.7	17.8
Public Utilities and Urban Development	1,246.9	3,325.4	4,572.3	11.1
Health and Social Affairs	1,612.9	308.2	1,921.1	4.7
Agriculture	973.8	493.9	1,467.7	3.6
Industry	321.8	776.6	1,098.5	2.7
Trade and Services	83.5	43.8	122.3	.3
Total	**22,931.0**	**18,382.0**	**41,313.5**	**100.0**

Source: Central Planning Organisation, <u>The First Development Plan, 1970-75</u>, Riyadh, 1970.

In order to diversify the economy and to reduce its dependence on oil the plan aimed at increasing the contribution of other productive sectors, specifically agriculture and industry, to the national product. However, the amount allocated to these sectors was relatively very small, accounting for only 6.3 percent of the total planned outlay.

El Mallakh in 1982 described this situation as follows:

> "It seems that with regard to the development of agriculture and industry, the plan relied heavily upon the private sector. Given the crucial importance of these sectors and the objective of diversifying the economy, and the fact that the development of traditional sectors in developing countries is a most difficult task, it would appear the government put too much faith in the private sector's ability to contribute to investment and in this sector's overall participation in the economy." (p. 147).

In terms of plan performance it is difficult to make a final judgement regarding the plan's achievement because the plan did not set specific goals or targets that can be measured rather than giving direction and guidelines for the various sectors of the economy to follow. However, government officials and some economists argued, because the actual government's revenues and expenditures exceeded the plan projection and the state of growth of GDP of 13.5 percent exceeded the projected growth of 10 percent, that the plan condition in general is a success (El Mallakh, 1982, p.147).

In general, the management and implementation of the first five-year development plan has provided the Saudi government and the Planning Authority with invaluable experience that proved useful in the Kingdom's second five-year development plan.

2.2.1.2. The Second Five-Year Development Plan (1975-1980)

The second five-year development plan covered the period 1975-1980 and its objectives were to: (Ministry of Planning, 1975)

- Maintain the religious and moral values of Islam.
- Assure the defence and internal security of the Kingdom.
- Maintain a high rate of economic growth by developing economic resources, maximising earnings from oil over the long term, and conserving depletable resources.
- Reduce economic dependence on export of crude oil.
- Develop human resources by education, training, and raising standards of health.
- Increase the well-being of all groups within the society and foster social stability under circumstances of rapid social change.
- Develop physical infrastructure to support achievement of the above goals.

In order to accomplish the above objectives, the plan projected an outlay of SR 498.2 billion. Total projects outlay was estimated to be SR 331.6 billion, and total recurrent expenditure amounted to SR 166.6 billion. In terms of financial allocations for the second plan, Table 2.2 shows each sector's share of the total outlay in the development plan. As shown, the development of physical infrastructure received the largest share , 23 percent of the total outlay followed by the development of economic resources which received 18 percent of the total outlay. Social development received the lowest share (6.5 percent) of the total outlay.

Table 2–2

Financial Allocations for 1975 - 1980

(SR Million)

Categories	Expenditure	Project	Total	Percent
Economic Resources Development	4,518.5	87,616.5	92,135.0	18.0
Human Resources Development	43,907.3	36,216.6	80,123.9	16.0
Social Development	18,148.8	15,064.0	33,212.8	6.5
Physical Infrastructure Development	12,530.8	100,413.8	112,944.6	23.0
Administration	18,010.6	20,168.6	38,179.2	8.0
Defence	14,652.8	63,503.7	78,156.5	15.5
External Assistance Emergency Funds	54,857.9	8,620.3	65,478.2	13.0
Total	**166,626.7**	**331,603.5**	**498,230.2**	**100.0**

Source: Ministry of Planning, The Second Five-Year Development Plan, Riyadh, 1975.

To meet the target of reducing economic dependence on crude oil, the private sector was meant to become increasingly more active in the economic development of the Kingdom of Saudi Arabia. To ensure the implementation of the role of the private sector in the second plan, the government placed a great emphasis in accelerating investments in the physical infrastructure. This encouragement of the private sector and diversification of the non-oil sector was stimulated through four main policies: a) acceptance of the foreign labour force to assist in the economic development programmes during the second plan period; b) supporting internal migration from rural areas to urban areas where more industrial employment opportunities are available; c) all possible government assistance and financial stimulation to the development of productive sectors; and d) technological advancement through prudent utilisation of international co-operation agreements.

Overall, during the second plan period the Saudi economy registered considerable progress. The average annual growth rate of GDP was 9.2 per cent. The plan also was successful in attaining a higher rate of growth in the non-oil sector (14.8 percent) and participating in improving the infrastructure of the economy of Saudi Arabia.

2.2.1.3. The Third Five-Year Development Plan (`1980 - 1985)

The third five-year plan was approved by the Council of Ministers in May 1979 to cover the period from 1980 to 1985. Where the focus of the second plan was on infrastructure, the third plan concentrated on industrial and human resource development, consolidation, of the various sectors of the economy rather than continued expansion and the maintenance of Islamic values in Saudi society. The three fundamental objectives of the third plan were: (Ministry of Planning, 1980)

1. To promote structural change in the economy through emphasis on resource development and growth in the producing sectors.
2. To increase participation in the development process, thereby raising the overall level of social welfare.
3. To increase economic and administrative efficiency.

The third plan calls for an expenditure of SR 782.7 billion. The breakdown of these expenditures by development sectors is shown in Table 2.3. As shown, the development of economic resource received the largest share amounting to SR 261.8 billion.

Table 2–3

Financial Allocation for the Third Plan

(1980 - 1985)

(SR Million)

Development Sectors	Recurrent Expenditure	Project	Total
Economic Resource Development	30.4	230.7	261.1
Human Resources Development	80.5	49.5	130.0
Social Development	44.5	25.5	70.0
Physical Infrastructure	46.5	200.8	247.3
Administration	NA	NA	24.7
Emergency Reserve, subsidies	NA	NA	46.9
Total			**780.0**

Source: Adapted from, Ministry of Planning, <u>The Third Development Plan</u>, Riyadh, 1980.
NA : Not available

The period of the third plan saw the first downturn in revenue for the Kingdom and the first negative rate of growth in the GDP. That was the result of the decline of the oil market price which had great impact on the Kingdom's economic growth. For the first three years of the plan period the average annual growth for the Gross Domestic Product was 8.5 percent, but has declined to less that 1 percent in the last two years. However, the overall growth rate of the non-oil economy was 5.1 percent. This growth rate in the non-oil economy began to reflect designed structural changes. The sectoral growth rate in the utilities sector had the highest growth rate of 24 percent, while construction had the lowest growth rate. Agriculture had a growth rate of 8.7 percent and the mining sector growth rate was 5.7 percent.

At the end of the third plan period the manufacturing and agriculture sectors had reached significant size. Employment in manufacturing, which accounted for 5.6 percent of the workforce in 1980, grew at an average annual rate of 19.3 percent and represented 9.3 percent of the total employment in 1985. The contribution of the non-oil private sector generated during the third five-year plan period, was in 1984 36% of GDP. This reflected the considerable progress in the diversification of the economy (SAMA, 1994).

2.2.1.4. The Fourth Five-Year Development Plan (1985- 1990)

The fourth plan was approved to be implemented during the period 1985- 1990. It came at a period of great change in the financial circumstances of the Kingdom. Because of the conditions of the crude oil market at the time of the fourth plan the government revenue was at a level substantially less than during the third plan. The government decided to expand its oil-related industries (oil refining and petro-chemicals) and to put more emphasis on the importance of the private sector. The objectives of the fourth five-year development plan were formulated to ensure continuity with the strategy of the third plan. However, the fourth plan has focused more on the area of human resources development and on construction, transport, and communication. The major objectives of this plan were to: (Ministry of Planning, 1985)

- Continue structural change in the economy to diversify the economic base and reduce dependence on crude oil as the main source of national income.
- Encourage the rapid development of the private sector as the principal mechanism for achieving economic diversification.
- Improve the economic efficiency of the government sectors.
- Complete the infrastructure projects necessary to achieve long term economic and social development goals.
- Further develop the Kingdom's human resources.

In order to accomplish these objectives the government approved a total of SR 1,000 billion. However, because of the further weakening of world oil markets in the early years of the plan the government expenditures were reduced to SR 687.5 billion. Table 2.4 shows the allocation of the expenditures for the various sectors of the economy.

Table 2–4

Government (Civilian) Expenditures in the Fourth Plan

Category	SR Billion	Percent
Development Agencies of which:		
Economic Resources Development	130.7	
Human Resources Development	135.3	
Health and Social Development	89.7	
Transport and Communications	76.9	
Municipalities and Housing	67.4	
Sub-total	**500.0**	**72.7**
Transfer Payments and Reserves of which:		
Credit Institutions (net domestic lending)	60.1	
Subsidies and Budget Reserves	57.2	
Sub-total	**117.3**	**17.1**
Administration Expenses of which:		
Religious and Judicial	18.5	
Non-Financial Administration	7.0	
Non-Portfolio Offices	9.9	
Financial Administration	34.8	
Sub-total	**70.2**	**10.2**
Total Civilian Expenditures	**687.5**	**100.0**

Source: Ministry of Planning, The Fourth Five-Year Plan, Riyadh, 1985.

As shown in Table 2.4 human resources development had the largest of the development expenditures, followed by economic resources development.

The shortfall in the government expenditure during the fourth plan period ruled out the plan's growth targets from being achieved. However, the non-oil sector performance in general was considered to be respectable particularly in agriculture and the petrochemical industry. In general, the decline in government expenditure over the fourth plan period was proportionally less that the overall budget cuts, when the budget deficit for the second year of the fourth plan reached SR 69 billion.

2.2.1.5. The Fifth Five-Year Development Plan (1990-1995)

On August 1989 the fifth plan was approved to cover the period from 1990 to 1995. Its focus was enhancing efficiency and raising the output of local labour instead of increasing expenditure. The fifth plan came to take the economy forward to a better stage in which the private sector will assume a leading role and more participation of the areas of industry, agriculture and foreign trade. The major objectives of the fifth development plan were to: (Ministry of Planning, 1990)

- Develop human resources, thus ensuring a constant supply of manpower, upgrading its quality and improving its efficiency to meet the requirements of the national economy.
- Reduce dependence on the production and export of crude oil as the main source of national economy.
- Continue with real structural changes in the Kingdom's economy so as to establish a diversified economic base with due emphasis on industry and agriculture.

- Complete the infrastructure projects necessary to achieve overall development.
- Further encourage private sector participation in socio-economic development.
- Achieve balanced growth throughout all regions of the Kingdom.

To achieve these objectives the fifth plan calls for an expenditure of SR 357.7 billion. Table 2.5 shows the breakdown of these expenditures by development sectors.

Table 2–5

Government (Civilian) Expenditure in the Fifth Plan

Category	SR Billion	Percent
Development Agencies		
Economic Resources	56.5	
Human Resources	139.9	
Health and Social Services	63.9	
Transport and Communications	52.6	
Municipalities and Housing	44.8	
Sub-total	**357.7**	**71.9**
Other Government Agencies		
Religious and Judicial	13.4	
Other Agencies	17.7	
Sub-total	**31.1**	**6.3**
Other Expenditures		
General Items	88.4	
Subsidies	20.4	
Sub-total	**108.8**	**21.8**
Total Civilian Expenditure	**497.6**	**100.0**

Source: Ministry of Planning, The Fifth Five-Year Plan, Riyadh, 1990.

As shown in Table 2.5 the development of human resources has received the largest share of the total expenditure (39 percent) and that reflects the fifth plan focus on the development of the human resources by ensuring a constant supply of manpower, upgrading its quality and improving its efficiency to meet the requirements of the national economy.

In summary, economic planning in Saudi Arabia, by the end of the fifth development plan, has made important progress towards its general goals. A large-scale modern infrastructure is complete with such refineries, petro-chemical complexes, hospitals, de-salination plants and universities. Economic planning towards the private sector has been indirectly due to the government subsidies. Government subsidies have encouraged the progress of private sectors, particularly agriculture and manufacturing sectors.

2.2.1.6. The Current Development Plan (1995- 2000)

The sixth development plan was originally expected to be announced on January 1995, but was delayed. In the beginning of July of the same year the plan was approved by the Council of Ministers to cover the period from 1995 to 2000. According to the Economist Intelligence Unit (1997) the delay was due to disagreements about the postulated price of oil and the extent of privatisation. In the event, no numerical projections of government expenditure and revenues accompanied this plan.

Many of the long-standing goals of the previous plans were reaffirmed, including (Ministry of Commerce, 1995):

- Supporting and enhancing the ongoing development of the Kingdom's defence capability.
- Rationalising government expenditure and making it more dependent on private sector activities.
- Addressing the constraints which impede the development and employment of Saudi human resources.
- Adopting appropriate means to achieve steady expansion in infrastructure.

In general the plan emphasises three main themes. These are economic efficiency, strengthening the role of the private sector in the economy and developing and utilising Saudi human resources. Increasing the role of the private sector in the national economy is a particularly important. The plan mentions the sale of government assets as a mean of rationalising government expenditure, but fails to provide a specific privatisation programme with revenue targets and a time table for state sales. Finally, where the fifth plan was aimed to keep the level of expenditure in line with government revenue, the sixth plan calls for more specific goals and that is a balance between government revenue and expenditure and to increase revenue and reduce expenditure.

2.2.1.7. Overall Assessment of The Development Plans

The main role of economic planning in Saudi Arabia is to provide an appropriate conceptual and organisational framework for the process of development. The main tasks of planning are to determine the objectives for each of the three dimensions of development, the economic, the social and the institutional; and to design the most effective methods to achieve them.

The first five-year plan which started in 1970 was very modest in size and its objectives were fairly basic focusing mainly on developing basic infrastructure and on improving government resources. During the second plan the government expenditure had increased almost nine-fold over the first plan and that was due to the large increase in the oil revenue during that period. The third plan put into effect with more emphasis on the developing of the manufacturing sector and more attention to social needs. In general the three development plans have shared common objectives. In seeking a higher rate of growth in GDP emphasis has been placed upon the development of human resources and the development of basic infrastructure. Diversification of the economy has also been strongly encouraged. However, due to the change in world oil market during the third plan period, which caused a decline in the government revenue that drove the government to shift its focus for the fourth and fifth plan.

The government emphasised the role of the private sector in the economic development of the Kingdom. It sought for more participation of the private sector in the various sectors of the economy to take the leading role in the development process. Moreover, during the last five-year plan more attention had been given to the Saudi-azation policy of the manpower.

By the end of the fifth plan Saudi Arabia completed 25 years of development planning. In spite of the benefits achieved through planned development, key issues remain unresolved. Making final judgement regarding the achievement of each plan has been difficult because in most cases the plans did not set specific measurable goals to be achieved rather than given guidelines and directions for the economy to follow.

In some cases the plan accompanied the financial allocation for two sectors under one category, in another case the plan split one sector into two categories and in other cases the sector just disappears like in the case of the defence sector which was shown in the first and second plan only. The other plans concentrated on the civilian expenditure without mentioning the financial allocation for the defence sector. Therefore, it is difficult to show consistency in strategy.

Even though the government has emphasised the role of the private sector, the role of the public sector continues to be dominant in the Kingdom's economy. Government ownership of the major source of revenue has meant that the government bears the responsibility for planning and executing development in all sectors which is in turn overshadowing the role of the private sector. As far as the development of the human resource is concerned, almost all plans have emphasised the manpower development and the government still face two main problems. First, the disparity in the cost of local versus foreign manpower will continue encouraging the hiring of foreign labour which limits the replacement of foreign workers. Second, regarding the education of manpower, education should be linked to the needs of industry. A great number of secondary school graduates should be redirected away from the University system towards technical and vocational training.

2.2.2. The Role of Private Sector

The Saudi government intention is to diversify and expand the economy and build a more broadly based, stronger, efficient, and competitive private sector for the future. The government has introduced and placed a great emphasis on the role of the private sector. In support of this major role, the government has established a broad set of policies, providing more incentives to the producing sectors of industry, agriculture and mining, trying to create a favourable environment for the private sector investment and growth.

Those incentives were to include:

- Interest free loans offered by the various development funds.
- Custom free import for the raw materials and machinery of manufacturing enterprises.
- Purchase obligator by the government in a very profitable price for wheat products.
- Priority in purchasing by government bodies, industrial and agricultural facilities including sites and lands.

Traditionally from an early stage the private sector activities were centred on commerce. As a result of government encouragement, this had been changing for a wider range of activities. The number of private sector factories stands in 1994 at 2,239 factories with a total investment of SR151 billion. The value of private sector factory production in 1993 was SR67.7 billion (Daghistani, 1994).

In 1970 the private sector contributed by 17% of the Gross Domestic Product (GDP) compared to 83% contributed by the public sector. In 1994 the portion of the private sector of the GDP has increased to reach 38.1% compared to 61.9 contributed by the public sector - (SAMA Annual Report, 1992, Al-Iktissad Wal-Aumal, 1995).

According to the Companies Act the registered companies in Saudi Arabia are classified into the following categories (Ministry of Commerce, 1985):

- Joint stock companies:

The capital of a joint stock company shall be divided into negotiable shares of equal value. The numbers thereof shall be responsible only to the extent of the value of their shares, and their number shall not be less than five (Article 48).

- Limited liability partnerships:

A limited partnership consists of two categories of partners, one including at least one general partner who is responsible to the extent of his entire fortune for the partnerships debts, and the other including at least one limited partner who is responsible for the partnerships to the extent of his interest in the capital (Article 36).

- Joint liability partnerships:

A general partnership is an association of two or more persons who assume joint liability, to the extent of their entire fortune, for the partnerships debts (Article 16).

- Mixed liability partnerships:

A mixed liability partnership consisting of two or more partners who are responsible for the debts of the partnership to the extent of their interests in the capital, and in which the number of partners not exceed fifty (Article 157).

- Mixed liability partnerships by shares:

Mixed liability by share is a partnership consisting of two categories (of partners), one including at least one general partner who is responsible to the extent of his entire fortune for the debts of the partnership, and the other including at least four shareholders who are responsible for the debts of the partnership only to the extent of their shares in the capital (Article 149).

Each category is sub-classified into Saudi, non Saudi and joint ventures. Table 2-6 shows the number of companies registered in Saudi Arabia for the various categories and their capital invested. In 1994, the total number of companies registered in Saudi Arabia had reached 7,815, and their total capital was SR 141,855.4 million.

In order to enhance the role of the private sector in the economy and in the development of the Kingdom the government has announced its intention to implement a privatisation policy. The policy, whereby the private sector will require to assume a more leading role in future economic development. Whereas in the past, the initial leadership in economic development was provided by the government, and the primary role of the private sector has always been to look for and manage profitable enterprises. Under the privatisation policy it is expected that the 6th Development Plan will concentrate on rationalisation of government expenditure, giving a go-ahead signal to the private sector to participate in most of the economic activities, including what used to be under government control, such as Airline, Rail Roads, Ports, and Water Desalination Plants (Daghistani, 1994).

Table 2–6

Number of Companies Operating in Saudi Arabia

Nature of Companies	Number		Capital (SR Million)	
Joint stock companies		**101**		**84,766.8**
Limited liability partnerships				
Saudi	3,490		32,492.9	
non-Saudi	19		101.7	
joint venture	1,114		18,318.9	
Sub-Total		**4,623**		**50,913.5**
Joint liability partnerships				
Saudi	2,182		4,180.4	
non-Saudi	4		12.1	
joint venture	29		30.7	
Sub-Total		**2,215**		**4,223.2**
Mixed liability partnerships				
Saudi	826		1,908.8	
non-Saudi	3		18.9	
joint venture	10		23.7	
Sub-Total		**875**		**1,951.4**
Mixed liability partnerships by share		**1**		**.5**
Total		**7,815**		**141,855.4**

Source: The Saudi Arabian Monetary Agency (SAMA), Annual Report, Riyadh, 1996.

The private sector will not be able to strengthen it's competitiveness in the producing sectors and have positive influence on its pattern of growth without further efforts, initiatives, and more CO-ordination between the private sector and the public sectors.

2.3. The Financial System in Saudi Arabia

The financial sector is of great importance in Saudi Arabia. With the government focus on the private sector to carry out most of the development activities in the Kingdom. The financial sector is expected to play the paramount role in the financing of investment requirements. The Saudi financial system consists of three major components. Most important is the Saudi Arabian Monetary Agency (SAMA) which is the country's central bank. Then there are the commercial banks. The third component of the financial system is the government's specialised credit institutions (SCIs).

2.3.1. The Saudi Arabian Monetary Agency (SAMA)

The increase in oil revenues in the early 1950s provided opportunity from the Saudi government to accelerate economic growth and development. The major step toward the achievement of this goal was the establishment of the Saudi Arabian Monetary Agency in 1952. The original objectives of SAMA in the 1950s were in conjunction with maintaining a balance between oil revenues and expenditure. In the 1960's the responsibilities and powers of SAMA were expanded to cover most of the rules traditionally associated with those of central banks (Abdeen and Shook, 1984).

It's activities could be classified into the following categories (El Mallakh, 1982):

1. Regulation of the money supply.

2. Stabilisation of the external value of the Riyal.

3. Supervision of banking activities and financial system.

4. Serving as a government banker.

5. Management of foreign resources.

6. Promotion of economic development.

7. Undertaking financial and economic research.

SAMA's role for regulating and stabilising the money supplies are to maintain the external and internal value of the currency, hold and operate any monetary reserves funds as separate funds earmarked for monetary purposes only, buy and sell for government account gold and silver billion, and to advise the government about new coinage and handle the manufacture, shipment and issue of all coins.

Due to other major functions of SAMA, supervising banking activities and financial systems, all commercial banks were required to register with SAMA and to submit monthly reports. SAMA also has the authority to control bank resources and credit availability within the commercial banks by requiring them to place a statutory deposit of 15 to 20 percent of capital and reserves (Abdeen and Shook, 1984). Serving as government banker, SAMA has the authority to pay for government purchases and to invest the resources of the Kingdom. It sells and buys Saudi currency in the name of the government, and it has the role to control the exchange of the Riyal in the international money market through open market operations to maintain the stability of the Saudi Riyal. Having an adequate financial system which enables all sectors to continue their way toward production is a long-term objective for SAMA to promote the economic development in the Kingdom. For carrying out its financial and economic research function SAMA has established a Research Department to collect and analyse data needed to aid the government and the agency in formulating and carrying out financial and economic policies (El Mallakh, 1982). SAMA also has a role to qualify Saudi personnel by establishing the banking training centre to provide courses in banking, accounting, economic and other subjects. In acting as a legislative body that regulates general and operational rules regarding share trade transactions, SAMA established in 1985 a new department called "Share Control Administration Department" within the Bank's Control Division to be responsible for day to day control of share activities (See Chapter 3).

2.3.2. Commercial Banks

The development of commercial banking in Saudi Arabia goes back to 1927 with the opening of the first branch of the Netherlands Trading Society, today this bank is called Al-Bank Al-Saudi Al-Hollandi, concentrating on import and export finance through the port city of Jeddah. The establishment of the first local private bank, the National Commercial Bank was in Jeddah in 1951. This was followed by the establishment of Riyadh Bank in the form of Saudi Joint Stock Banking Company in 1957. Subsequently, other foreign banks opened offices in the Kingdom. In 1975 there were ten international commercial banks in the Kingdom, with a total of twenty three branches. In 1976, because the foreign banks in the Kingdom were functioning according to policies drawn up by their foreign parent banks, which were not always in harmony with Saudi Arabia development plans, the Council of Ministers introduced the Saudiisation of the foreign owned banks operating in the Kingdom. These were to be reformed into Joint Stock Companies with 60 percent of their ownership being transferred to Saudi Nationals

(Abdeen and Shook, 1984). By 1988, there were twelve commercial banks operating in Saudi Arabia (Table 2.7).

Table 2–7

The Commercial Banks Operating in Saudi Arabia

Banks		Year Founded	Nature of Company
1	National Commercial Bank	1951	Private
2	Riyadh Bank	1957	100% Saudi joint stock company
3	Saudi American Bank	1980	60% Saudi public, 40% Citibank NA
4	Saudi Franch Bank	1977	60% Saudi public, 40% Banque Indosuez
5	Arab National Bank	1975	60% Saudi public, 40% Arab Bank
6	Saudi Hollandi Bank	1974	60% Saudi public, 40% Algemene Limited, Netherlands
7	Saudi Cairo Bank	1978	60% Saudi public, 40% Banque du Cairo
8	Saudi British Bank	1976	60% Saudi public, 40% British Bank of Middle East
9	Bank Al-Jazira	1974	65% Saudi public, 35% National Bank of Pakistan
10	Saudi Investment	1978	36% Saudi public, 8% Gosi, 56% other banks
11	United Saudi Commercial Bank	1983	60% Saudi public, 40% other banks
12	Al-Rajhi Banking and Investment Corporation	1988	NA

Source: Arab News, 9 February,1988 and SAMA, Annual Report, 1990.

The best evidence of the growth of banking activities in the Kingdom, and as a result of the saudiisation program, is the increase in the number of branches (Table 2.8). In 1967 there were only 51 branches in the entire country. These branches were mostly concentrated in a few cities around the Holy Places in the Western province and the oil cities in the Eastern province. In 1985 the number of branches jumped to 617. By the end of the year 1995 the number of branches reached 1,192 situated all over the country. Al-dukheil (1995) argued that one major challenge facing the expansion in banks' branches is that to formulate effective strategies to mobilise the enormous reserves of savings that continue to remain untapped in Saudi society.

All of these banks have been involved in traditional banking activities such as accepting deposits, dealing in foreign exchange, and facilitating the country's import trade. Among the various services offered to businesses there is a heavier emphasis on short-term credit. About one-third of Saudi Arabia imports are financed by commercial banks. Another important activity for the commercial bank is providing bonds and guarantees that contractors must provide upon winning contracts. The banks have developed the expertise to cope with the risky activity which is becoming increasingly complex as the economy moves away from the relatively simple infrastructure related contracts (Johany, Bome and Mixon, 1986, p. 157 and Presley and Wilson, 1991, p. 26).

Table 2–8

Regional Distribution of Bank Branches

(as at the end of fiscal years)

Year	Western & Southern Provinces	Northern & Central Provinces	Eastern Province	Total
1981	142	120	90	**352**
1982	182	153	101	**436**
1983	226	184	114	**524**
1984	247	200	123	**570**
1985	267	222	128	**617**
1986	273	232	132	**637**
1987	293	246	135	**674**
1988	379	375	172	**926**
1989	409	397	179	**985**
1990	425	421	186	**1,032**
1991	440	443	197	**1,080**
1992	458	473	208	**1,139**
1993	464	481	215	**1,160**
1994	478	510	226	**1,214**
1995	468	503	221	**1,192**

Source: SAMA, Annual Report, 1992,93 and 96.

Table 2–9

Consolidated Balance Sheet of Commercial Banks

(at the end of fiscal years)

(SR Million)

Assets	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Cash Balance	13,918	18,594	10,689	11,751	11,636	12,678	10,653	11,531	11,648	11,178
Foreign Assets	86,672	102,198	114,741	118,844	123,467	118,951	106,372	111,007	97,144	96,790
Loans & Investment	59,264	58,804	70,523	73,281	65,295	73,616	87,161	102,740	113,693	121,622
Unclassified Assets	10,805	11,463	20,286	29,709	31,657	53,085	71,007	78,438	90,308	92,042
Total Assets & Liability	**170,659**	**191,059**	**216,239**	**233,585**	**232,055**	**258,330**	**275,192**	**303,716**	**312,793**	**321,632**
Liability										
Total Deposits	121,927	129,305	142,473	146,304	143,662	171,223	177,408	183,350	187,665	196,368
Foreign Liability	14,288	24,485	28,727	34,603	30,172	27,936	32,509	37,283	39,150	39,678
Capital and Reserves	13,148	13,542	14,954	15,719	17,359	18,783	24,457	30,193	33,313	34,725
Unclassified Liability	21,296	23,727	30,085	36,959	40,862	40,389	40,818	52,890	52,665	50,859

Source: SAMA, Annual Reports. 1992, 93 and 1996.

Table 2.9 shows the consolidated balance sheet of commercial banks. In 1986 6% of the total assets were unclassified assets, while 8% were in cash, 51% in foreign assets and 35% were loans and investments. Beginning in 1988, the growth of unclassified assets began to accelerate to reach 26% of total assets in 1993, justifying the action by Saudi banks for the first time to buy large amounts of government securities as a way of covering sacrament budget deficits. On the liability side, Table 2.9 shows that in 1993 60% of the total liability were deposits, 12% foreign liability, 10% capital and reserves, and 18% unclassified liability.

Finally, it is worth noting that the commercial banks in recent years are facing the problem of the increasing in government indebtedness to them. According to Wilson and Graham (1994) the government debt to the Saudi's commercial banks rose more than threefold during 1989-1993 and shows no sign of slackening. Moreover, most government debt held by the banks is long-term, while most of their deposits are short-term. Such a situation could result in serious liquidity problems for the Saudi financial system.

2.3.3. Specialised Credit Institutions (SCIs)

The government realised the need to promote agricultural, industrial, and housing development with long term loans and because of the inability of the commercial banks to carry out this task the Saudi government established six specialised lending institutions.

The primary aim of these institutions is to provide development loans at relatively low cost, interest-free credit, except for an administrative cost of 2.5% of the value of the loan, with complete government finance. The duration of the loans is different from one institution to another. Real Estate Development Fund loans last for 25 years, while Industrial loans extend between 5 to 15 years.

These institutions are:

- The Public Investment Fund (PIF): This fund was established in 1971 to promote the diversification of the economy by establishing corporations and then re-selling them to the public such as the Saudi Basic Industries Corporation (SABIC).
- The Saudi Arabian Agricultural Bank (SAAB): To encourage investment in the Agriculture sector in 1962 the government established this institution to provide short, medium and long-term loans to be used for a wide range of purposes such as the purchasing of seed, fertilisers, animal stock and construction.
- The Real Estate Development Fund (REDF): It was created in 1974 to provide loans for private residential house construction and for the construction of residential compounds. To encourage the prompt payment of outstanding loans the government introduced in 1980 a repayment incentive scheme. A discount of 20% was allowed on timely payment with an additional 10% discount if repayment was made in one lump sum.
- The Saudi Industrial Development Fund (SIDF): This Institution was established in 1974 to provide medium and long-term free-interest loans to the private sector so they can invest and involve more in the industrialisation of the Kingdom. Moreover, the Industrial Development Fund provides the private sector with technical, financial, and marketing advice.

- The Specialist Finance Programmes (SFP): This fund was founded in 1974 to provide loans to Saudi contractors to finance direct purchases of basic materials so they could implement government contracts for roads, buildings and digging works.
- The Saudi Credit Bank (SCB): This was established in 1971 to provide medium and long-term loans to businesses for financing potential new projects and to low income Saudi families for a number of purposes, such as marriage and home improvements (El Mallakh, 1982).

2.4. Summary

This chapter was aimed at highlighting the economic development and the major components of Saudi Arabian Financial System. In the first section the process of the economic development was discussed by presenting the major elements of each plan in the series of five-year development plans which commenced in 1970.

Each plan has identified guidelines for the various sectors of the economy to follow. Because of its control of the oil revenue the government has played the major role in the process of development of Saudi Arabia. However, in order to meet the need for economic diversification the focus of planning has shifted towards placing a higher priority on the role of the private sector, with government incentives and encouragement, to participate in the process of development. The second section of this chapter has sought to provide a background of the three major components of Saudi Arabian Financial System. The most important functions of Saudi Arabia Monetary Agency (SAMA) was presented.

Twelve commercial banks and a network of about 1192 branches co-ordinated and regulated by SAMA have been developed. Complementing the commercial banks are six specialist credit institutions established by the government to channel development funds to specific activities.

Chapter Three

The Stock Market in Saudi Arabia

3.1. Introduction

The stock market in Saudi Arabia is a recent development compared to the industrialised countries. It was officially regulated in 1984. The importance and the need for a stock market came from its role in the formation and transfer of debt and equity capital in freemarket economies. The most important functions of the stock market are (Attia, 1993, p. 2):

1. To encourage the individuals to save by offering them shares that bring forth cash revenues at regular stated times, and at the same time, make liquidity available when needed as these shares are transferable. This in itself is an incentive for the individuals to consume sensibly so as to increase their savings.
2. Stimulation of the savings by directing them to investment instead of accumulation. The cash revenues achieved through investment compensate the investors for any loss in the real value of the money that may be caused by the effect of inflation on the accumulated wealth.
3. To finance investment in big projects that are beyond the affordability of individuals or small group investors. There is no doubt that investing in big projects assists in the transfer of modern technology which usually accompanies these projects.
4. To increase the efficiency of the utilisation of the invested capitals. Under normal circumstances the individuals are inclined to buy the shares of the most successful

and lucrative companies and avoid the shares of the losing and inefficient companies.

5. The stock market fulfils the need of the local investors who wish to invest their wealth inside the country. By doing so the stock market stops the flow of a large portion of the wealth outside the country and at the same time speeds up the development of the society.

This chapter provides an overview of the structure of the Saudi stock market. The development of the primary and secondary markets will be discussed. The shares trading activity in the Saudi stock market will be presented in this chapter as well as the major characteristics of the Saudi stock market.

3.2. The Primary Market

The primary market is a market where new issues of shares, whether for newly formed companies which have never had their shares traded or for companies which have already sold part of their shares to the public at an earlier date, are sold to the primary holders.

In 1934 the Arabian Automobile Company was established which was to be the first joint stock company in the Kingdom. That was the start of the primary market in Saudi Arabia. By 1965 this had increased to 17 joint stock companies . Up to that time all companies operated under the commercial law which remained unchanged from 1931. However, the commercial law had not covered all matters related to the companies whether during the conduct of their business or upon their incorporation, dissolution, and liquidation. The government realised the need for a new adequate and comprehensive law to regulate all matters related to the companies. So, in July 1965, for the first time in the Kingdom, the Companies Act was issued which consisted of 234 articles. The Companies Act includes regulations that control the board of directors, the annual general meetings, the company's final accounts and the obligations and benefits of the shareholders. Two types of shares were specified to be issued by the joint stock companies - ordinary shares and preferred shares. According to the company law, when a Saudi company wishes to issue shares to the public it has to advertise its share offer in a local newspaper for at least 5 days before the offer date and the offer prospectus should be distributed during the offer period containing the following information (Felemban, 1986):

1. The founders' names, residences, addresses, occupations and nationalities.
2. The company's name, objectives, activities and its Head Office.
3. The amount of authorised capital, issued capital and the amount to be paid up.
4. The type of shares to be issued, the value of each share and the number of shares reserved for the founding members.
5. Any special privileges granted to the founders.
6. Dividend distribution system.
7. The estimated cost of company formation.
8. The offer duration.
9. The allocation method that will be used in case of over subscription.
10. The date of issue and number of the Royal Decree authorising the formation of the company.
11. The minimum and maximum numbers of shares available for each applicant.

One or more local commercial banks have to be appointed by the joint stock company to carry out the shares subscriptions. Banks are responsible for all transactions related to shares subscriptions until the final share instalment payments have been made. Financial consultant offices also have to be appointed by the joint stock company, in case of over subscription, the office will undertake the share allocation on behalf of the company.

According to the Companies Act, Article 100, the company's founders are prohibited from selling their shares until the company is operating and the financial statements for two years have been published to the public. The reason behind this article might be to gain individuals' confidence in the stock market. The share offer lasts between 10 to 90 days and can be extended for up to a further 90 days in the case of the share subscription being below average. Before making any final decisions regarding share allocation, the financial consultant office has to submit three alternative share allocation equations to the Ministry of Commerce. According to the best public interest one of these alternatives will be approved.

The primary market witnessed the biggest jump in the number of publicly traded companies in the period 1976 - 1980 when 19 new companies were offered to the public (Felemban, 1989). The Saudi government has played an important role in activating the primary stock market by participating in the formation of many joint stock companies through its secondary investment agencies such as the Retirement Pensions Agency and General Organisation for Social Insurance. These two agencies were among the founder groups for several companies. The Public Investment Fund, one of the specialised credit institutions owned by the government, has a great portion of its capital invested in forming the joint stock companies. The second biggest jump witnessed in the primary stock market was in 1984 when the Saudi government decided to privatise 30% of the capital of the Saudi Basic Industries Corporations (SABIC) with a value of SR3 billion.

The essential factor in the basic development of the primary stock market in Saudi Arabia has been the government support and participation in forming joint stock companies.

3.3. The Secondary Market

Most of the activity, buying and selling, which takes place in the stock market is in old issues and essentially involves changes in ownership, and that is the secondary stock market. The development and the history of Saudi Arabian secondary stock market can be divided into two major stages that the secondary market went through. The first stage started from the beginning of the second five-year development plan in 1975 until 1985, and the second stage started from 1985 until now.

3.3.1. The Development of the Secondary Stock Market from 1975 - 1985

Before 1975 share investment in Saudi Arabia was unpopular and share investment activity was relatively very few. The reasons for this situation are; first, the Saudi investors were heavily involved in real estate investment which was a very popular and profitable investment activity in that time. The second reason being that the shares offered to the public were few because of the few numbers of joint stock companies in that time, and also because the share holders of those companies seemed to be long-term investors. This situation started to change with the beginning of the second five-year development plan in 1975. Since that time the Saudi Arabian secondary stock market has become more active in terms of transactions and marketability. The reasons for such changes can be stated as follows (Felemban, 1989):

1. In 1976 the government implemented a new policy under which 60% of the foreign banks' capital had to be owned by Saudi nationals. Such policy forced these banks to offer their shares in the stock market which helped in activating it (See Chapter 2).

2. Due to the increase in oil prices during the second five-year development plan (1975 - 1985) the government was able to finance many long development projects which were carried out by joint stock companies which resulted in high performance by these companies. These then distributed good dividends and issued more shares for capital expansion. This came as an encouragement for the individuals for investing in the stock market.

3. To diversify the economy, the government supported the formation of many new companies during the second five-year plan in various activities which attracted a wide range of new investors according to their interest. This increased the investing basis of the market and activated the secondary market as well as the primary market.

4. The over subscription of issued shares by new joint stock companies were often between 5 to 10 times, which led to the new shareholders trading these newly acquired shares in the secondary market in order to gain a quick and profitable return.

During the period 1975 - 1985 the share trading in the secondary market was based on the direct negotiation system. Under this system the seller and the buyer exchanged the shares against the payment in front of the company concerned. Since this system is not practical because of the difficulties for the seller to find a buyer or for the buyer to find a seller, a brokerage system had began to develop to get the buyer and seller in touch.

However, most of these brokerages had no experience in share investments. The only experience they had wasin the real estate investment and because of the shifting in the investment activities during that period they became more involved in the shares investment. Moreover, these brokers were informally putting buyers and sellers in touch and had no licence, capital or credential requirements.

The secondary stock market suffered from a number of problems during that period of time. The first problem was that there were three sources of official directives from the government for the stock market. These sources were the Ministry of Finance and National Economy, Saudi Arabia Momentary Agency (SAMA) and the Ministry of Commerce. Such a situation created confusion for trading and related activities, and discouraged those who might be interested in participating in the stock market. The second problem was that, because there was no official policy to regulate stock exchange activities, a number of non-specialist offices had emerged to deal with shares. The unofficial brokers effectively fixed the prices and were involved in unhealthy share ownership control. The third problem was the ownership of large percentages of the shares by members of the board of directors and the founders. The number of shares owned by this group, compared to that owned by the general public, effectively allowed the directors and the founders to set the market price, depending only on what the market demand would bear at any given point in time (Abdeen and Shook, 1984, p. 145).

Overall, the secondary stock market in Saudi Arabia was unorganised and unregulated at that time and was suffering from many problems. The collapse of the stock market in Kuwait in 1982 came as a sign of hazard for the government in Saudi Arabia to take steps toward regulating the stock market in the Kingdom and to avoid such problems which were the reason for that collapse, especially the speculation which was considered to be the largest activity in the Saudi market in that time and was carried out by unofficial and inexperienced brokers. In 1983, a Royal Decree approved the formation of a joint ministerial committee to study and review the stock market and to take whatever steps were necessary to regulate the stock market. The committee members were delegates from the Ministry of Commerce, Ministry of Finance and National Economy and Saudi Arabia Momentary Agency (SAMA). The committee's deliberations were the beginning of a new stage for Saudi Arabia secondary stock market.

3.3.2. The Development of the Secondary Stock Market After 1985

In 1984, the Ministerial Committee issued new rules and regulations to monitor and control the share trading activities effective from 1 January 1985. At that time there were 38 joint stock companies having a total capital of SR 14.7 billion - $4.03 billion - (Azzam, 1988, p. 80). These regulations were to include the following (Royal Decree No.1320 / 8, 1984) :

- The establishment of a share negotiation system (SNS) through commercial banks.
- The establishment of a supervisory body for all securities trading.
- The establishment of a share control administration department under the jurisdiction of SAMA.
- The formation of a securities trading company by the 12 banks in Saudi Arabia.

3.3.2.1. The Share Negotiation System Through Commercial Banks

According to the 1985 regulations negotiations and dealing operations for Saudi joint stock companies' shares were to be made only through Saudi commercial banks. The commercial banks act as intermediary in share sale / purchase transactions on behalf of its clients and it is not allowed for the commercial banks to buy or sell shares for their own interest (SAMA, 1985). Each commercial bank is required by these rules to organise a Central Trading Unit (CTU) in the Kingdom Capital (Riyadh) to receive share sale / purchase orders from its branches, which also have to organise their own Trading Units, and affect negotiations accordingly with other banks through their CTU in Riyadh. In carrying out these transactions the commercial banks get a commission based on the transaction value at a maximum of one percent to be paid by both the seller and the buyer on an equal basis (SAMA, 1985). In terms of order type, the system has two types of orders; the first type is a limited order in which the client determines a specific price for any share he wishes to buy or sell. The bank in this case must not change the price without the client's permission. The second type is a market order whereby the client authorises the bank to buy at the lowest price demanded or to sell at the best price available. Moreover, the system states the following restricted rules in order to protect the market from any misbehaviour:

- The employees in the Banks' CTU are not allowed to negotiate shares for their own account or for their next-of-kin or relatives.
- Buying or selling instructions by telephone are not accepted.
- Payment of transaction values is to be made in a form of immediate and full settlement such as cash, by certified cheque or by authorisation to debit an account. Deferred cheques, promissory notes or bills are not acceptable.

3.3.2.2. The Securities Supervisory Committee

The Securities Supervisory Committee comprises of senior representatives of the Ministry of Finance and National Economy, Ministry of Commerce, and Saudi Arabia Monetary Agency (SAMA). This committee was established to fulfil the following functions (SAMA, 1985).

- Supervise transactions and monitor complaints with the relevant instructions and rules issued by the Ministerial Committee.
- Revise rules and directives regulating trading transactions to ensure the development and increased effectiveness of the market. It has the right to request all financial information from the commercial banks and companies which are required to provide the committee with such information.
- Stop the trading or provide a ceiling to the share trade of a certain company, in the public interest.

3.3.2.3. The Shares Control Department

According to the 1985 regulations, SAMA was required to establish a share Control Department to handle day-to-day operation control. This department's duties were stated as follows (SAMA, 1985):

- Determines and monitors the working hours for share trading in the Central Trading Units in the Commercial Banks.
- Analyse daily trading transactions received from CTUs.
- Supervise the appointment of personnel working at the Bank's CTUs.

- Create records, settle and take legal action in connection with share holders complaints.
- Reports the share price list and the daily and weekly trading summary to the local media.
- Conveys the ministerial committees and supervisory committee's instructions to the commercial banks and the companies.
- Issues briefing publications and brochures for public interest.

3.3.2.4. Saudi Share Registration Company

In 1985 the commercial banks in Saudi Arabia jointly formed the Saudi Share Registration Company (SSRC) with a total capital of SR11 million shared equally between them. This was supposed to act as a clearing house after trades were executed. The main function of the company is to provide share registration and transfer services to all joint stock companies. However, the company's articles of association in 1985 specified the following function as well (SSRC, 1985):

- Receiving, recording and dealing with probates, succession certificates, powers of attorney, dividend receiving mandates, powers vested, certificates of death, and other documents affecting title to shares.
- Monitoring issue of shares and signing share certificates upon issue.
- Maintenance of shareholders' files and provision of information on status of shareholders' account.
- Handling and classification of proxies.
- Compilation of data and analysis of shareholding.

Because of the joint stock companies reluctance to hand over their confidential papers, the Saudi Share Registration company faces problems carrying out the above functions and were merely acting as messengers between SAMA and the joint stock companies.

3.3.3. The Development of the Saudi Stock Market Mechanism

Since the adoption of new regulations in 1985 and the implementation of the new system, share negotiations through commercial banks, the government through its agency, SAMA, and the other committees have been trying to improve and develop this system with these objectives in mind (SAMA, 1995):

- Encourage Saudi investors to invest in the domestic economy, so contributing to its growth.
- Provide Saudi companies with a ready and wide-based source of finance through issues of securities in the market.
- Concentrate equity trading into a single market in which sell and buy orders, (no matter where they originate in the Kingdom) are matched, so setting a fair price.
- Provide an efficient market for execution of all orders, supported by the latest electronic facilities.
- Provide efficient and accurate settlement and registration which ensures timely delivery and payment and investors trust.
- Protect investors and companies by the enforcement of effective equity market rules and procedures.

In order to fulfil these objectives SAMA observed the need for automation and floorless trading of the stock market. Automation offered operational efficiency, accuracy of trading and settlement processing, fast and efficient information dissemination and enhanced surveillance capabilities. Floorless trading offered fair access to the market, irrespective of geographical location. In 1988 SAMA introduced the Electronic Securities Information System (ESIS) and that was the beginning of the automation of the Saudi stock market. ESIS provides a floorless, continuous trading, order driven market with up to the minute price, volume and company information to be disseminated through the media. It concentrates all local share trading into one single market. ESIS processes buy and sell orders from entry to the final share registration. Using central computers in SAMA and terminal workstations in the Banks, a high speed telecommunications network links the system. The Central Trading Units (CTUs) of each bank enter orders and the client information into the system through terminals in the banks. The system automatically validates client information and availability of shares. From the terminals, the banks' authorised traders may, as trading strategy requires, move whole or part of each order into the market as bids and offers. Market bids and offers are firm and are automatically matched in the ESIS market within an opening collective auction and in continuous trading during the daily trading session, observing priorities of price and time. From matches, ESIS generates the trades, consolidating or splitting bids and offers (SAMA, 1995). In 1993 the ESIS was expanded with a new service which enabled banks to transmit sell / buy orders from bank branches to ESIS. Before 1993 the banks' branches were using telex and facsimile machines to send sell / buy orders to their Central Trading Units (CTUs) in Riyadh. The new service provides the banks' branches with all the information in the ESIS, but they can not execute any sell / buy orders which have to be executed through bank Central Trading Units (CTUs) only.

The implementation of the ESIS offers the Saudi stock market with the following:

- Transparency, with instantaneous dissemination of bids / offers, executed quantities and prices to all market participants.
- Fairness, by providing equal access to the market for all market participants, in addition to maintaining trade execution priorities.
- Narrow price spreads, most buy and sell orders are priced around market averages and previous results.
- Efficient and short trading cycle, provides a short elapse time between order entry, execution, settlement and transfer of ownership.

3.3.3.1. Trading Cycle

The Trading Cycle starts by investors placing orders and ending with customers receiving their shares and money (SAMA, January 1995).

Step 1

Buying and selling clients approach designated branches to place their buy and sell orders. These orders represent the agreement between the bank and their clients to execute a specific business transaction. The system automatically validates availability of the shares and client details. Real-time market information and company information (including company announcements) is disseminated to all designated branches.

Step 2

Such orders are electronically passed to the Central Trading Units' (CTU) dealing room at each bank.

Step 3

Orders received update the CTU electronic order book. The electronic order book provides CTUs with an effective way of managing and tracking their orders. Although these orders are stored at the central computer system, they are only accessible by the CTU who has entered the orders and SAMA Surveillance.

Step 4

Only CTU Traders working in the dealing room, have the ability to generate bids and offers from the orders. These bids and offers are then placed in the electronic market and displayed to all authorised users.

Step 5

Once placed in the electronic market, the computer system attempts to match the placed bid / offer with the best available bid / offer according to price and time priority. Unmatched bids and offers are kept in the electronic market until either matched by the system or taken out of the market by the CTU Traders on request of the client.

Step 6

From unmatched bids and offers trades are generated and reported electronically to the settlement system. The settlement system keeps track of all trades to be settled.

Step 7

Dematerialised based trades, where no physical delivery of certificates are required, are settled on trade date (80 - 90% of all trades) by book entry transfer. Certificate based trades are settled in two days. For certificate based trades, the transfer system generates transfer instructions in the form of reports for each security, listing the individual buyers and sellers. These reports are sent to company register. The registrar cancels the certificate and updates the corresponding number of shares in the Saudi Share Registration Company's nominee account.

Step 8

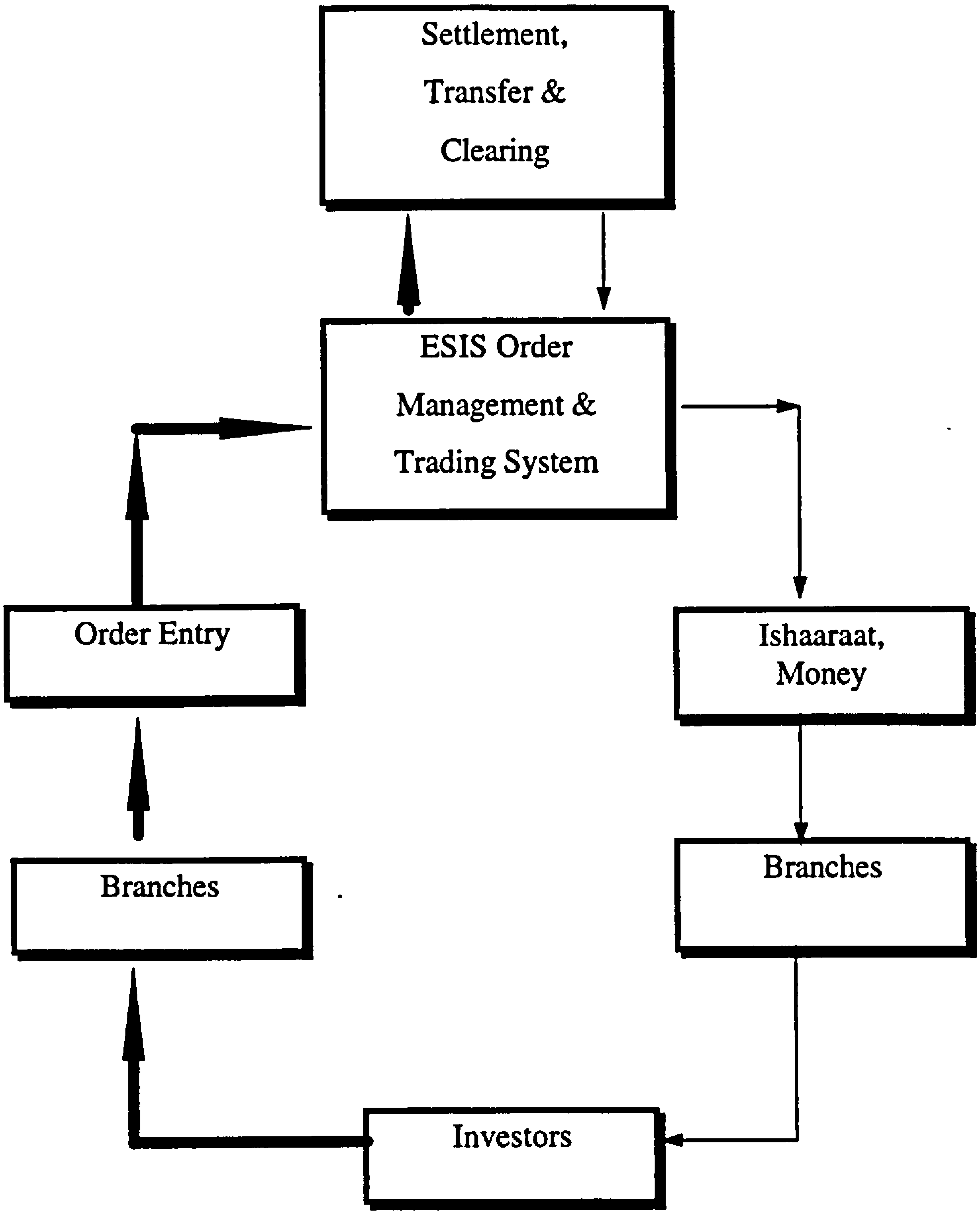
All banks are required to hold clearing accounts with SAMA. After settlement net money clearance takes place with net transfers between the Bank's accounts.

Step 9

Settlement, clearing reports and receipt of ownership (Ishaaraat) are electronically delivered back to the originating CTU or branch. Banks can integrate this information directly into their own systems thus allowing the delivery of the receipt of ownership to the buyer and the crediting of the seller account. The banks / branches either credit the client's bank account or pay the client directly.

Figure 3-1

Saudi Stock Market Trading Cycle



Source: Saudi Arabia Monetary Agency, Development of Saudi Arabia Equity Market, January, 1995.

3.4. Shares Trading Activity in Saudi Stock Market

The Saudi Stock Market trades the stock of all general joint stock companies capable of being circulated. In 1994 these were 67 joint stock companies trading with a total capital of SR 73,040 million. Table 3.1 shows the classification of these companies.

Table 3–1

The Classification of Joint Stock Companies

Sector	Number of Companies	Market Capitalisation
Banking Sector	11	13,700
Industrial Sector	15	14,342
Cement Sector	8	7,408
Services Sector	14	10,373
Electric Sector	10	25,039
Agricultural Sector	9	2,178
Total	**67**	**73,040**

Source: Riyadh Bank, Saudi Stock Trends, Equity Investment Department, Riyadh, April, 1995.

Table 3-2 shows the share trading activities from 1985 to 1996 in terms of numbers of transactions, volume of shares traded, and value of shares traded. In terms of transactions, the table shows that in 1985 these were 7,842 transactions. The number of transactions then increased annually until it reached 110,030 transactions in 1989. However, due to the second Gulf War and the unsettled political and economic situation the number of transactions declined in 1990 and increased only slightly in 1991. Bu the end of the war in 1992 the number of transactions increased by 200% compared to 1991 to reach 272,057 transactions. Then there was a large increase in 1993 followed by farther increase to 357,000 transactions in 1994. The year 1995 marked the beginning of the decline in number of transactions as a natural reaction to the big jump will occurred in 1992. As shown in table 3-2 the number of transactions declined in 1995 by 18% and by further 3% in 1996.

In term of the volume of shares in the Saudi stock market the number of shares traded in 1985 was approximately 3.9 million, that number increased to exceed to exceed 152 million in 1994. The biggest jump in the number of shares traded in the stock market happened in 1994 with an increase of 152% compared to 1993. However, this increase did not include the shares of all companies. The number of shares traded increased for 40 companies only, decreased for 20 companies and the shares for the remaining companies were not traded in 1993-1994. As in the case of number of transactions, the year 1995 also witnessed a declining in the value of share traded by 23% compared to 1994.

In terms of the value of shares traded table 3-2 shows that the total value of circulated stocks increased by 43% from SR 17,360 million in 1993 to SR 24,871 1n 1994. It is worth noting that during 1993-1994 the increase in the number of shares traded (152%) was highly more than the increase in the value of shares traded (43%) for the same period of time which indicates the declining of the general level of share prices. In 1994 the share prices fell down for 52 companies in some cases such fall reached 63% compare to 1993 (Attas,1994). For some companies the price fall was the result of distributing free stocks, that is, bonus shares. For others raising a new capital there was a fall in share price. This phenomenon is widely recognised on stock exchanges. However, for others the price fall was more to do with the economic prospects of the companies. If this was to continue, confidence in the market would be lost and negatively affect the development and growth of the Saudi stock market.

Table 3–2

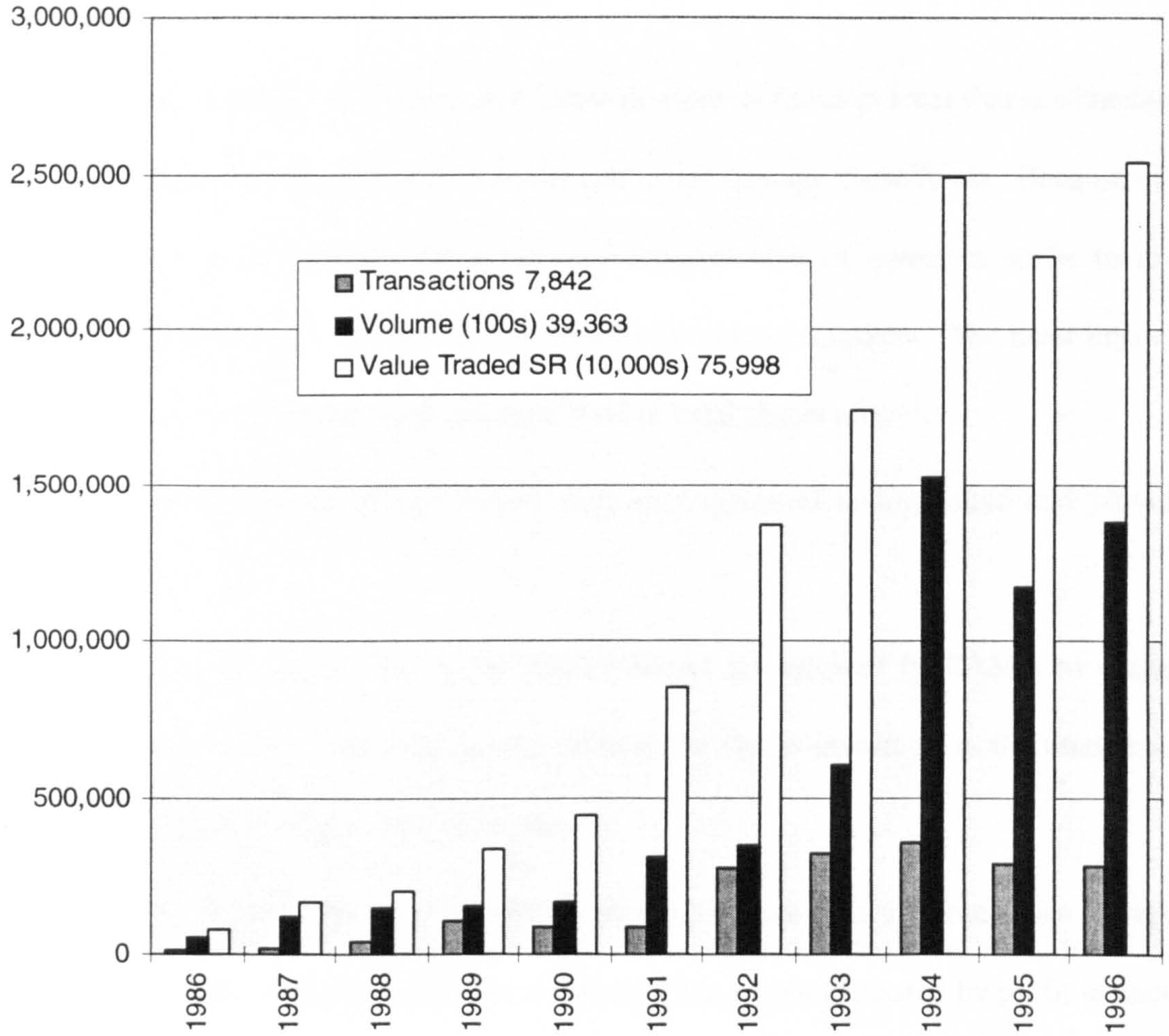
Stock Market Growth 1985 to 1996

Year	Transactions	% Change	Volume (100s)	% Change	Value Traded SR (10,000s)	% Change
1985	7,842	-	39,363	-	75,998	-
1986	10,833	38%	52,630	34%	83,075	9%
1987	23,267	115%	120,123	128%	168,552	103%
1988	41,951	80%	146,413	22%	203,679	21%
1989	110,030	162%	152,719	4%	335,369	65%
1990	85,298	-22%	169,384	11%	440,324	31%
1991	90,559	6%	307,581	82%	852,731	94%
1992	272,075	200%	351,999	14%	1,369,883	61%
1993	319,582	17%	603,076	71%	1,736,003	27%
1994	357,000	12%	1,521,000	152%	2,487,100	43%
1995	291,742	-18%	1,166,179	-23%	2,233,659	-7%
1996	283,759	-3%	1,378,326	18%	2,539,733	9%

Source: SAMA, 4th Qtr 1996, Money and Banking Statistics.

Figure 3-2

Stock Market Growth 1985 to 1996



3.5. The Characteristics of Saudi Stock Market

The stock market can be characterised by the following attributes:

- the possession of the shares is normally restricted to Saudi citizens and only under special cases the citizens of the Gulf Co-operation Council are allowed to posses a limited number of shares as in the case of the Saudi Company of Basic Industries. This restriction limits the span of activity of the market and can deprive the Saudi market from an expected large demand for the shares of the successful Saudi company.
- Many commercial banks have established investment funds in local shares whereby the Saudi Citizens and non Saudi Citizens can invest through these funds. Because of the privileges given by these funds, an increasing number of investors prefer to invest through these funds instead of dealing directly in stock markets. The most important privileges provided by the investment fund in local shares are:
- The funds are managed by experts who are capable of taking sound and provident decisions.
- Reduced investment charges per share (Banks are allowed by SAMA to charge a maximum of 1% of the total market value of the shares invested) as the total charges are spread over a large number of shares.
- Minimum degree of risk as the investment fund invests in many companies in various sectors of the economy and a loss in one area can be compensated by profit in another area.
- The small size of the base of transaction in the Saudi stock market in comparison with the total issued shares. In 1993 around 60 million shares were traded accounting for only 8% of the total shares (Agency France Press, May 5-1994). The stock of all companies are of circulation nature from jural point of view, however from actual

view, a large percentage of those stocks which are owned by the government or some foreign bodies are not provided for circulation. Among 755 million stocks issued in the Saudi stock market by the end of 1994 the government owns 296 million stocks (Table 3-3) which represent 39.3 percent of the issued stocks. Foreign bodies own 3.8 percent and the remaining 430 million stocks owned by individual and Saudi establishments which represent 56.9 percent. This number represents the actual size of the Saudi stock market. It is worth mentioning that the size of the Saudi stock market is expected to rise during the coming years because of the important declaration of King Fahad in May 1994 in which he stated the government intention of abandoning more productive and beneficial entities in order to give a chance for the national capital to take part therein that means some of the public establishments shall be converted to joint stock companies.

Table 3–3

Shares Holders

Sectors	# of shares issued (000s)	Government		Foreign bodies		Individuates	
		Number of shares (000s)	Value of shares (million)	Number of shares (000s)	Value of shares (million)	Number of shares (000s)	Value of shares (million)
Banking sector	137,000	14,460	1,446	25,771	2,577	96,769	9,677
Industrial sector	151,420	73,634	7,350	1,170	177	76,616	6,805
Cement sector	76,850	8,409	841	1,800	140	66,641	5,655
Service sector	115,482	19,371	1,731	0	0	96,111	7,755
Electric sector	250,660	179,090	17,029	0	0	71,570	6,458
Agricultural sector	23,567	1,364	116	0	0	22,203	1,787
Total	754,978	296,328	28,515	28,741	2,834	429,909	38,136

Source: Attas Stock Investment Group, The Annual Reports for 1994, Jeddah.

- Most of the portion owned by the individuals is concentrated in the hands of a few big investors and the remaining is distributed to a wide cross-section of small investors. The big contributors strive to keep their high contributions so they can control the market by keeping their shares and only buy when conditions are favourable. This kind of attitude, of course, has a negative effect on the performance of the market. The large number of small investors with small size savings cannot cope with the instability in prices and this may leave them with little choice in deciding whether or not to sell (Chamber of Commerce and Industry, 1994; Aljohani, No date).

- Seasonality of transaction is one of the prominent features of the Saudi stock market. Transactions do not follow a fixed pattern and are not of the same level all the year through. There are times and seasons when the market witnesses more activity and much transactions such as at the end of the fiscal year of the joint stock companies when dividends are distributed. On the other hand, there are times when transactions shrink to their lowest level such as during the summer season when many people go abroad for their holiday.

- There are no investment banks in the Saudi Market. If there was investment banks, they could facilitate the process of issuing new local shares and also provide financial advice to investors. The existence of investment banks is considered as one of the key elements to attract the national savings to invest in productive projects which creates a sound potentiality to expand in establishing more joint stock companies (Chamber of Commerce and Industry, 1994).

3.6. Saudi Stock Market Efficiency

The stock market is said to be efficient when share prices fully reflect all available information. In such a market share prices adjust quickly to information, and by giving full access to all information, the current share's price is the best estimate for future returns (Keane,1985, p. 36). Beaver (1981) described the efficient stock market by stating that " a securities market is said to be efficient with respect to an information system if and only if the prices act as if everyone observes the signals from that information system. In other words, prices act if there is universal knowledge of that information. If prices have this property, they fully reflect the information system" (p.142).

Keane (1985) defined three forms of efficiency in which the market can be tested. These are the following:

- The weak form efficiency which exists when the market share price fully reflects all past price changes. That means historical information on share prices can not be used to predict future prices and out perform the market, in other words an investor using past prices is not in a position to obtain abnormal profit from it in future.
- The semi-strong form efficiency which means that share market prices fully reflect all publicly available information about shares. Such information includes past prices statistics and non-price information publicly available.
- The strong form efficiency which to be achieved when prices reflect all publicly and privately available information about shares and companies.

With regard to the Saudi stock market efficiency a few studies have been conducted to measure such efficiency. Abdelsalam and Satin (1988) conducted a study to examine the share price reaction to published financial reports. They concluded that the release of earnings information has no notable effect on share prices. The same writers conducted another study in 1991 focusing on the effect published corporate financial reports on stock trading volume in the Saudi stock market. They found that the release of earnings information has little effect on the trading volume. The conclusion suggested by both studies was that the release of corporate financial reports do not effect either the trading volume nor the share prices which drive us to believe that the efficiency as defined above does not exist in such stock market.

Felemban (1989) using data of 28 listed companies (for the period from March 1985 to December 1988) examined the efficiency of the SSM. The weekly share prices were used and the efficiency of the SSM was tested in the weak form. Felemban concluded that "the Saudi Stock Market in general is more likely to be an inefficient market.". Moreover, Attia (1993) studied the economic and the development efficiency of the Saudi stock market. The results of his study suggested that the Saudi stock market is not efficient either from economic point of view nor from development point of view.

3.7. Summary

This chapter was designed to study the development of Saudi Arabian stock market. We have seen that the primary market in Saudi Arabia has existed with the establishment of the first joint stock company in 1934. With the gradually increasing number of the joint stock companies the Saudi Government has issued the Companies Act in 1965 to regulate the primary market. The development of the secondary stock market has been divided into two periods. The first period was from 1975 - 1985. During that period the share investment in Saudi Arabia was unpopular and few people were involved in such activity and the share trading in that period was based on the direct negotiation system. The second period of the development of the secondary market started in 1984 when the Government, due to many problems that were facing the stock market at that time, issued new rules and regulations to monitor and control the share trading activities. The development of the mechanism of the stock market and the share trading cycle were presented in the chapter. The growth of the shares trading activity since the adoption of the new rules and regulations in 1984 are also presented in this chapter. Finally, the major characteristics of Saudi Arabian stock market was discussed.

Chapter Four
Accounting Development in Saudi Arabia

4.1. Introduction

The previous two chapters dealt with a review of the overall economy and the development of the Stock Market in Saudi Arabia which both were considered to be the most important factors affecting the development of accounting practice. Abdeen and Yavas in 1985 stated the "A widely held belief is that if a country is to experience accelerated economic development and be able to deliver a higher standard of living to its citizens, a vitalisation of the accounting profession and a development of qualified accounting talent are necessary" (p. 156). However, in Saudi Arabia according to Shinawi (1971, p. 40) there was no accounting profession up to 1971 and accounting practices were imported from Britain, Egypt, Lebanon and Sudan. Ba-Eissa (1984) pointed out two main reasons explaining the non-existence of the accounting profession in the Kingdom. These reasons were:

- The lack of awareness among foreigners who dominated accounting practice in Saudi Arabia about the organisation of accounting in a country that is not theirs.
- Establishing a professional body is considered to be a political activity which is not encouraged under the present political system in the country.

The second reason may explain the major role that the government played and is still playing (as we will see in this chapter) in the process of accounting development. Even the organisation for public certified accountants which was established in 1992 is under the supervision of the Ministry of Commerce. However, the role of the government has been expressed in the Companies Act by stating that 'As a user and regulator, the Saudi government has an impact on accounting and reporting practices to safeguard the public interest, to protect the private funds put at their disposal, and to prescribe penalties for violations of such provisions' (Ministry of Commerce, 1985).

The development of an accounting profession and practice and the presentation of the most relevant regulations related to accounting are the main objectives of this chapter. The Companies Act, accountant regulations, the recent development and establishment of concepts and objectives of financial accounting and the general presentation and disclosure standard, and the establishment of the Saudi organisation for Certified Public Accountants will all be presented and discussed in this chapter.

4.2. The Companies Act

The Companies Act, which was introduced in 1965, was the first body of regulations to set rules for accounting and auditing in Saudi Arabia. Before the passage of the Saudi Companies Act corporations turned to neighbouring Arab countries, especially Egypt, copying certain expedient rules regulating corporations from their formation through their operation to their dissolution (Shinawi, 1971, p. 40). The Companies Act articles deal exclusively with the fundamental details of business formation such as, minimum capital required, number of directors, and other similar matters. In spite of that, the Companies Act provides little guidance for accounting and auditing rules and procedures. The Act is more specific in the case of auditing than it is on the subject of accounting. It has touched on relatively few subjects regarding accounting. According to Article 123, at the end of every financial year the Board of Directors shall make an inventory of the value of the company assets and liabilities as of that date and shall prepare a balance sheet of the company, a profit and loss statement, and a report on its operations and financial position for the expired financial year, setting out the proposed method for the allocation of net profits. The Board shall put the said documents at the disposal of the auditor at least fifty five days prior to the date set for the general meeting.

The Companies Act also provides a rule for the principle of consistency in preparing the financial statements and valuing the assets and liabilities. Article 124 states that in classifying the accounts in the balance sheet and the profit and loss statement in every financial year, the classification used in the previous years shall be observed, and the bases of evaluation of assets and liabilities shall remain unchanged, unless the general meeting resolves at the recommendation of the auditor to alter such classification or evaluation bases. Article 91 required an absolute majority vote of the shares represented in the regular general meeting before any resolutions can be adopted. The Board of Directors shall, every year, set aside 10% of the net profits to build up a reserve fund to be called The Statutory Reserve. The regular general meeting may resolve to stop such deduction when the said reserve amounts to one half of the capital (Article 125). The statutory reserve shall be used for meeting the company's losses or for increasing its capital. If the said reserve exceeds one half of the company's capital, the regular general meeting may resolve to distribute such excess (as dividends) among the stockholders in the years during which the company fails to realise sufficient net profits for distribution of the dividends prescribed in the company's by-laws (Article 126). The company's by-laws shall specify the percentage to be distributed among stockholders out of the net profits after deduction of the statutory reserve provided the percentage is not less than 5% of the capital (Article 127).

The directors must, within thirty days of the date of approval by the general meeting of the balance sheet, the profit and loss statement, the Board of Directors report, and the auditor's report, file copies of the said documents with the commercial Register Office and with the General Department of Companies (Article 128). These were some of the articles in the Saudi Companies Act related to Accounting. Although these articles require the preparation of balance sheet, profit and loss statement, directors' report, and other similar reports, no more detail was given as to the form of content of these reports and statements or even referred for any technical standards.

The Saudi Companies Act of 1965 was also the first body of regulations to recognise the accounting profession. It requires all corporations, partnerships limited by shares, and limited liability companies to appoint one or more auditors who are licensed to practise in Saudi Arabia. To keep the auditor from feeling obligated to the Directors and Officers and thus preserve his independence, the Companies Act required that the first Annual General Meeting of stockholders shall appoint the auditor and determine his remuneration. In pursuing the object of maintaining the auditor's independence, the Act prevents the auditor from combining his duties as such with that of promoter, incorporater, director, or employee, even in an advisory capacity, for the Company he is auditing. Furthermore, the auditor shall not be a partner, employee, or relative to the fourth degree of any of the Founders of Directors of the Company (Article 130). The Act gave the auditor the statutory right to have access at any time to the Company's books, records, and other documents. He shall be entitled to request such particulars and clarifications as he may deem it necessary to obtain, and to verify the assets and liabilities of the Company. The Act also required the Chairman of the Board of Directors to enable the auditor to perform his duty. If the auditor encounters any difficulty in this respect, he shall state that fact in a report to be submitted to the Board of Directors. If the Board fails to facilitate his task, the auditor must call a regular General Meeting to look into the matter (Article 131). Concerning the content of the auditing report, the Act required it to state:

(a) whether or not the auditor has obtained the information he required.

(b) any violations of the Companies Act.

(c) any violations of the articles of incorporation.

(d) The auditor's opinion as to the accuracy of the Company's accounts (Article 132).

The Act provides that the auditor shall not disclose to the stockholders outside the General Meeting or to third parties, such secrets of the Company as may have come to his knowledge by reason of the performance to his work; otherwise, he must be removed and shall be held liable for damages (Article 133).

The Saudi Companies Act, as can be seen from the above summary, set the basic rules for accounting and gave the auditor statutory rights, and imposed penalties on those who might impede his work. It established a standard of independence for the auditor to help in preserving his integrity. The Act also required the auditor to include certain information in his report and holds him responsible for his errors or negligence and misdoing. However, the Companies Act did not go far enough in satisfying the accounting and auditing requirements, other than being general. There were no specific prescribed accounting rules, or procedures, nor has there been any sufficient attempt to define the scope and objectives of accounting and reporting or the scope and duties of the audit or auditor.

4.3. Certified Public Accountants Regulations

The second Law in Saudi Arabia related to the accounting profession is the Accountants' Law which was first enacted in 1974. This Law was superseded by the Certified Public Accountants' Regulations in 1992 (SOCPA, 1994).

This Law sets the standards that should be applied to auditors. The Law started by stating that no person, natural or legal, shall be entitled to practice the audit profession unless his name is listed in the Register of Certified Public Accountants with the Ministry of Commerce (Article 1). Article two of the Law specified the conditions of enrolment in the Register i.e. an applicant shall be a Saudi national, holder of Bachelor's degree in accountancy or any other equivalent certificate as may be deemed acceptable by the competent authorities in charge of equivalency of degrees, and having practical experience in the field of accounting after graduation for a minimum period of three years, reducible to two years if the applicant is a holder of a Master's degree, and to one year if the applicant is a holder of Ph.D. in accountancy or any equivalent degree. Such experience can be obtained from either certified public account's offices approved by the Saudi Organisation for Certified Public Accountants or from Government bodies, companies or sole proprietorships. Article two also required an applicant to be a full member of the Saudi Organisation for Certified Public Accountants and to be fully dedicated to practice the profession.

Articles 3 through to 5 of the Accountants Law deal with the procedures for enrolment in the Register. Article 3 for example calls for formation of a committee to consider the applications for enrolment. This committee shall be chaired by a high ranking official from the Ministry of Commerce and with membership of both the Saudi legal adviser to be appointed by the Minister of Commerce and a Saudi certified public accountant to be nominated by Saudi Organisation for Certified Public Accounts (SOCPA).

The license granted by this committee is valid for a period of five years, renewable for equal terms (Article 5). Article 6 through to 18 defined certified public accountant obligations. For example, Article 10 stated that a certified public accountant shall comply with the professional code of ethics as well as with accountancy, audit and other technical standards issued by SOCPA. A certified public accountant, under all circumstances, shall maintain documents received from clients, audit working papers and copies of financial statements pertaining to his clients for a minimum period of 10 years from the date of issue of the audit report covering each financial year that is duly audited (Article 12). A certified public accountant shall be liable for damages sustained by clients or other parties as a result of professional errors in the performance of his work. Such liability shall be borne jointly by partners of the accounting firm concerned (Article 15). Article 19 through to 27 called for the establishment of Saudi organisation for Certified Public Accountants (SOCPA). The objectives, responsibilities and current activities of SOCPA will be presented later in this chapter.

Finally, Article 28 through to 38 deal with penalties and general and interim provisions. For example, Article 28 stated that persons who do not comply with the provisions of these regulations shall be subject to one of the following penalties:

- Reprimand, warning, or suspension from practising the profession for a period not to exceed six months.

- Removal of the name of the non-compliant from the Certified Public Accountant's register and publishing the resolution at his expense in one or more of the local newspapers.

These are some of the more important Articles of Certified Public Accountants Regulations regarding the accounting profession in Saudi Arabia (SOCPA, 1994). In conclusion, it can be seen after the examination of the above mentioned Laws, that they are designed to achieve specific legal purposes rather than reporting objectives. These laws contain very few specific measurement and communication standards. Having said that, this leads us to discuss the next section, the efforts and programmes towards accounting standardisation in Saudi Arabia.

4.4. Efforts and Programmes Towards Accounting Standardisation

The Kingdom of Saudi Arabia, with the adoption of the First Five Year Development Plan in 1970, has experienced a massive social and economic development during the 1970s. However, the role and significance of accounting and the accounting profession was not adequately realised. This situation seemed critical and certain deficiencies in the profession were having a more serious impact on the economic and financial activity in the Kingdom than was actually recognised. In response to this situation, the department of accounting at King Saud University organised a conference in 1981 on the theme of current accounting and auditing practices in Saudi Arabia (Al-Amari, 1989). The main objectives of the conference were to discuss the issues involved in current accounting and auditing practices and to make recommendations on the most appropriate alternatives for improvement. Some of the discussion papers presented at the conference in 1981 were as follows:

- The role of accounting in the economic development of the Kingdom.
- Auditing standards and the auditor's report.
- The accounting profession and auditing practices in Saudi Arabia.

At the end of the conference, the participants called for the development of accounting and auditing standards and for the establishment of series of annual accounting conferences. The second conference was in 1983 and the last one was the sixth conference, in December 1994.

On the other hand, the Ministry of Commerce in early 1980 appointed one of the leading public accountancy firms in the Kingdom, Al-Rashed Office, to study the current accounting problems and the areas for potential improvement, together with a proposal for the development of accounting and auditing standards, and an organisational structure for the development of the profession. The finding of the study was reviewed by the Ministry and was accepted as a suitable start for the development of the profession. By taking into consideration the experiences of other countries in this field, and the specific requirements of the Kingdom's environment, Al-Rashed Firm presented a Two Phase Plan comprising the preparation of accounting and auditing standards and an internal organisation of the profession (Ministry of Commerce, 1986 and Al-Rashed, 1983).

The first phase of the Plan regarded conducting a comparative study of the profession in three different countries. The purpose of the study was to obtain information about the development of the profession in these countries to benefit from their experience. Three countries were chosen for this comparative study. To make the selection, nine countries were identified and classified into three groups based on the extent of development of their profession, their economic environment and the ability to benefit from their experience in developing the profession in Saudi Arabia. These groups were as follows:

- The first group: USA, England and Canada.
- The second group: France, West Germany and Sweden.
- The third group: Tunisia, Venezuela, Brazil.

Then one country of each group was chosen to carry out the comparative study. These countries were USA, West Germany and Tunisia and because they represent three very different accounting development systems. This comparative study specifically comprised of (Ministry of Commerce, 1986):

A) Review of authoritative pronouncements, laws and regulations of the three countries which relate to:

- Accounting standards and financial reporting requirements.
- Auditing standards and other auditing requirements.
- Professional ethics.
- The internal organisation of the profession.

B) Interviews with officials representing the profession from the three countries to seek the help of experts from these countries.

C) Analysis of data gathered from step A and B.

D) The preparation of a comparative report setting forth the profession's status in the three countries, and should touch on the following:

- A comparison of the internal organisation of the profession, the standards of accounting and auditing, and the code of the professional ethics in the three countries.
- Tentative conclusions as to the implications of the study to the development of the profession in Saudi Arabia.

Phase One was clearly an information gathering exercise which followed by Phase Two of applying the results of the detailed comparative study to Saudi Arabia.

Phase Two of the Plan had three main tasks to carry out. The first task was to determine the objectives of financial accounting, select and define the most important concepts of financial accounting, and prepare standards of general presentation and disclosure. The second task related to the determination and development of auditing standards. The final task of this phase was to organise the internal structure of the profession. In order to accomplish these tasks, three teams were formed consisting of technical and academic experts from the selected countries and highly qualified Saudi professors and advisors. Each team was assigned to study one subject of the above and was requested to draft a proposal on its subject and circulate it to the other team members for discussion. After a number of meetings of the team members, a final proposal was presented to the Ministry of Commerce for approval.

In 1986, the Ministry of Commerce issued Decree No. 692 stating that the general presentation and disclosure standard is the official guide for all accounting practitioners in Saudi Arabia. After almost four years, the Ministry of Commerce, in 1990, issued another Decree No. 852 mandating all companies to comply with the standard when preparing their annual reports.

4.5. Objectives and Concepts of Financial Accounting and General Presentation and Disclosure Standard

The proposal that was approved by the Ministry of Commerce to be the official guide for all accounting practitioners consisted of three major parts. These are the objectives of financial accounting, concepts of financial accounting and general presentation and disclosure standard. The purpose of this section is to review these three parts.

4.5.1. Objectives of Financial Accounting

Para 51 of the statement of objectives of financial accounting stated that:

> "The objectives of financial accounting have been determined by way of the fundamental concepts dominating in Saudi Arabia and by way of defining the outputs of this financial accounting process. Therefore, in determining the objectives of financial accounting in this statement, the importance of financial statements has been emphasised because they represent the final product of financial accounting which is prepared for the information benefit of external parties who have an interest in the enterprise." (Ministry of Commerce, 1986).

According to para 53 of the statement, the primary external users of general purpose financial statements are current and prospective equity investors, current and prospective lenders, and current and prospective suppliers who enter into long term supply agreements with the business enterprise. Although governmental agencies, in particular, the Zakat[1] and Taxation Department and departments responsible for granting subsidies often use the information in financial statements for their purposes, they are excluded as primary external users because they can and do prescribe the form and content of the financial statement submitted to them for their specialised purposes. Accordingly, they do not need to rely on information provided to other external users. Management is also excluded as an external user of general purpose financial statements because managers including directors, can receive most of their financial information about the business enterprise they manage, in other reports which can be specially tailored for their needs. The making of business decisions is considered in this statement to be the common primary use of financial statements to all the primary external users (Ministry of Commerce, 1986).

The statement has identified the objectives of general purpose financial statements as follows (Ministry of Commerce, 1986):

- Presentation of information suitable for the needs of the primary users.
- Periodic measurement of the business enterprises ability to generate earnings.
- Presentation of information for the evaluation of the enterprises ability to generate cash flow.
- Presentation of information on the economic resources of the enterprise.
- Presentation of information on the sources and applications of funds.

[1] The Zakat is a religious tax charged in accordance with Islamic law.

Para 78 through to 82 of the statement of objectives of financial accounting identifies some limitations of general purpose financial statements. For example, para 79 stated the general purpose financial statements are not intended to provide information about the progress of the business enterprise toward achieving non-monetary objectives such as human resources development, nor do they intend to provide information that can be used directly to assess the social costs of the enterprise operations.

4.5.2. Concepts of Financial Accounting

The scope of this statement consists of three parts. First, this statement defines the basic elements of financial statements of business enterprises. Second, the concepts that should govern the measurement of those elements and finally, the criteria that should be used to evaluate the usefulness of the information to be disclosed in the financial statements.

The basic elements of financial statements that have been defined in the first part of the statement include assets, liabilities, owner's equity, revenues, expenses, gain and loss, net income (net loss) and investment by and distribution to owners (para 233 through to 257).

The concept of events, transactions and circumstances was also defined in this statement. Para 258 stated that changing the entity's assets, liabilities and owners equity are caused by events, transactions and circumstances affecting it. Measurement in financial accounting involves the recognition of events affecting the entity's assets and liabilities, determining the amount of changes in those assets and liabilities and expressing those amounts in monetary units. Events, transactions and circumstances that change the entity's assets, liabilities and owners' equity are the basis for the basic elements of the entity's results of operations - revenues, expenses, gains, losses and net income - and other changes in its financial position with which financial accounting is concerned.

The second part of the concepts of financial accounting statement deals with the measurement concepts. Measurement in financial accounting involves the determination of the amounts of the basic elements of financial statements of a particular business enterprise. The measurement concepts define certain assumptions underlying the measurement process and the basic characteristics of the measurement process itself. They include the entity concept, the going concern concept, the measurement unit concept, the periodic reporting concept, the recognition concept, the measurement basis concept, and the matching concept (para 266). Para 267 through to 309 of this statement identifies in detail each one of these concepts.

The last part of this statement is the quality of accounting concepts. The quality of information concepts define the characteristics or the criteria of useful accounting information. These characteristics or criteria should assist those responsible for establishing accounting standards, as well as, those responsible for the preparation of financial statements in evaluating financial information produced by alternative accounting methods and in differentiating between necessary and unnecessary disclosures. The usefulness of financial information must be evaluated in relation to the objectives of presenting financial statements which are focused on helping current and prospective equity investors, lenders, and others making decisions involving the entity (para 310).

The statement has specified eight characteristics that would make the information useful for decision making need to be discerned and defined. The definitions that were given to these characteristics are consistent with the standard definitions of such characteristics in the UK and USA. These characteristics are (Ministry of Commerce, 1986):

1) Relevance
2) Reliability
3) Neutrality
4) Comparability
5) Timeliness
6) Understandability
7) Materiality
8) Optimal disclosure

Para 313 through to 336 of this statement discussed in detail the definition and meaning of each one of these characteristics.

4.5.3. The General Presentation and Disclosure Standard

This standard sets forth the general presentation and disclosure requirement for financial statements including consolidated and development stage company financial statements. It also prescribes the accounting treatment for accounting changes and contingencies. Finally, it prescribes the requirements with respect to the disclosure of the identify of the reporting entity, nature of its business, identity of its financial statements, its accounting policies, commitments and subsequent events. The standard has been divided into four primary branches: The first one is devoted to the general presentations, the second one is concerned with the general disclosure, while the third branch is designed for the general presentation and disclosure requirements of consolidated financial statements and finally, the fourth one is concerned with the general presentation and disclosure requirements of development stage business enterprises (para 578 and 579). In this section, the most important branches of the standard which are the general presentation requirements and the general disclosure requirement will be presented.

4.5.3.1. The general presentation

The standard of general presentation has been divided into two parts. The first part sets out the general requirements. For example, para 583 specifies the complete set of financial statements which are composed of the following:

- statement of financial position.
- statement of income (loss).
- statement of changes in owner's equity or alternatively, a statement of retained earnings and disclosure of changes in other categories of owner's equity.
- statement of sources and application of funds[1].

These statements and related notes are the minimum required to present the financial position. This part also specifies some general principles for the presentation in the financial statements such as the requirement of the presentation of the financial statement in comparative form with those of the preceding comparable period(s) (para 590).

[1] This statement was cancelled by Decree No. 852 in 1990 which means that it has become voluntary.

The second part identifies the general presentation requirements of individual financial statements. Para 592 through to 609 sets out the presentation requirements of the statement of financial position and the following are some examples of these requirements:

- The statement of financial position should include and properly describe all assets, liabilities and classes of owner's equity. Assets and liabilities in the statements of financial position should not be offset unless a legal right of set off exists (para 592).
- Asset valuation allowances (e.g. accumulated depreciation) should be deducted from the assets to which they relate (para 601).
- The liabilities that are secured by a mortgage should be stated separately on the face of the statement of financial position or in the related notes and the assets used as a mortgage or security for these liabilities should be disclosed (para 608).

The standard has presented three illustrative statements of financial position for an enterprise to chose from (Table 4-1, 4-2 and 4-3) emphasising that the format used by the reporting entity should be selected with a view of presenting clearly the nature and amount of the entity's assets, liabilities and owners' equity.

Table 4–1 Vertical Comparative Classified Statement of Financial Position

Arabian Company
A Joint Stock Company
Statement of Financial Position
As at / / 14x2H.

14x1			14x2		
	SR		Notes	SR	SR
		CURRENT ASSETS			
	xx	Cash in hand and with banks	( )	xx	
	xx	Accounts receivable	( )	xx	
	xx	Inventories	( )	xx	
	xx	Prepaid expenses	( )	xx	
	xx		( )	xx	
	xx		( )	xx	
xxx		**Total Current Assets**			xxx
		CURRENT LIABILITIES			
	xx	Notes payable	( )	xx	
	xx	Accounts payable	( )	xx	
	xx	Accrued expenses	( )	xx	
	xx	Dividends payable	( )	xx	
	xx	Current maturates of long-term dept	( )	xx	
	xx	Zakat	( )	xx	
	xx		( )	xx	
	xx		( )	xx	
(xxx)		**Total Current Liabilities**			(xxx)
xxx		Working Capital			xxx
		FIXED ASSETS at cost (Note)			
	xx	Land	( )	xx	
	xx	Buildings	( )	xx	
	xx	Machinery and equipment	( )	xx	
	xx	Office furniture and equipment	( )	xx	
	(xx)	Less Accumulated depreciation	( )	(xx)	
	xx		( )	xx	
			( )	xx	
xxx		**Total Fixed Assets**			xxx
		INTANGIBLE ASSETS			
	xx	Patent	( )	xx	
	xx	Goodwill	( )	xx	
	xx		( )	xx	
	xx		( )	xx	
xxx		**Total Intangible Assets**			xxx
xxx					xxx
SR	SR		Notes	SR	SR
		NON-CURRENT LIABILITIES			
	xx	Long-term loans	( )	xx	
	xx	End of service indemnity	( )	xx	
	xx		( )	xx	
	xx				
(xxx)		**Total Non-Current Liabilities**			(xxx)
xxx		**Net Assets**			xxx
		SHAREHOLDERS' EQUITY			
		Authorised share capital ____ shares			
xx		par value SR ______ per share	( )	xx	
(xx)		(Less) Unissued share capital __ shares	( )	(xx)	
xx		Paid up share capital	( )	xx	
xx		Donated capital		xx	
xx		Reserves or appropriated retained earnings		xx	
xx				xx	
xx				xx	
xxx		**Total shareholders' equity**			xxx
xxx		Contingent Liabilities	( )		xxx
xxx					xxx

Table 4–2 Horizontal Comparative Unclassified Statement of Financial Position

Arabian Company

A Joint Stock Company

Statement of Financial Position

As at / / 14xx H.

		14x2		14x1				14x2		14x1	
	Notes	SR	SR	SR	SR		Notes	SR	SR	SR	SR
Cash in hand with banks	( )		xx		xx	Notes payable	( )	xx		xx	
Accounts receivable	( )		xx		xx	Accounts payable	( )	xx		xx	
Notes receivable	( )		xx		xx	Accrued expenses	( )	xx	xxx	xx	xxx
Prepaid expenses	( )		xx		xx						
						Shareholders' equity:					
						Authorised share capital ---- Shares	( )	xx		xx	
Land	( )	xx		xx		par value SR--- per share					
Buildings	( )	xx		xx		Less Unissued share capital--- share		(xx)		(xx)	
Office furniture	( )	xx		xx		Paid up share capital	( )	xx			
Less: Accumulated depreciation	( )	(xx)		(xx)		Donated capital		xx		xx	
			xxx		xxx	Reserves or appropriate retained earning	( )	xx		xx	
						Unappropriated retained earning	( )	xx		xx	
									xxx		xxx
Good will	( )	xx		xx		Contingent liabilities	( )		xxx		xxx
Patent	( )	xx		xx							
			xxx		xxx						
			xxx		xxx						

Source: Ministry of Commerce, Objectives and Concepts of Accounting, Riyadh, 1986.

Table 4–3 Horizontal Comparative Classified Statement of Financial Position

Arabian Company
A Joint Stock Company
Statement of Financial Position
As at / / 14xx H.

	Notes	14x2 SR	14x2 SR	14x1 SR	14x1 SR
CURRENT ASSETS					
Cash in hand with banks	( )	xx			xx
Accounts receivable	( )	xx			xx
Notes receivable	( )	xx			xx
Prepaid expenses	( )	xx			xx
________________	( )	xx			xx
Total Current Assets			xxx		xxx
FIXED ASSETS at cost (Note)					
Land	( )	xx		xx	
Buildings	( )	xx		xx	
Machinery and equipment	( )	xx		xx	
Office furniture & equipment	( )	xx		xx	
Less: Accumulated depreciation	( )	xx		xx	
Total Fixed Assets			xxx	xxx	
INTANGIBLE ASSETS					
Patent	( )	xx		xx	
Goodwill	( )	(xx)		(xx)	
Total Intangible Assets			xxx		xxx
TOTAL ASSETS			xxx		xxx

	Notes	14x2 SR	14x2 SR	14x1 SR	14x1 SR
CURRENT LIABILITIES					
Notes payable	( )	xx		xx	
Accounts payable	( )	xx		xx	
Accrued expenses	( )	xx		xx	
Dividends payable	( )	xx		xx	
Zakat provision	( )	xx		xx	
Total Current Liabilities			xxx		xxx
NON-CURRENT LIABILITIES					
Long-term loans	( )	xx		xx	
End of service indemnity	( )	xx		xx	
Total Non-Current Liabilities			xxx		xxx
Shareholders' equity:					
Authorised share capital ---- Shares par value SR--- per share	( )	xx		xx	
Less Unissued share capital--- share		(xx)		(xx)	
Paid up share capital	( )	xx			
Donated capital		xx		xx	
Reserves or appropriate retained earning	( )	xx		xx	
Unappropriated retained earning	( )	xx		xx	
Total Shareholders' Equity			xxx		xxx
Contingent liabilities	( )		xx		xx
TOTAL LIABILITIES & SHAREHOLDERS'EQUITUY			xxx		xxx

With regard to the statement of income the standard required the presentation of the results of operations of the reporting entity in a multi-step format showing appropriate intermediate component of net income, specifically, the following (para 611):

- The results of continuing operations
- The results of discontinued operations including any related gain or loss from the disposal of a segment of a business
- Extraordinary items, that is, gains or losses resulting from casualties and/or involuntary expiration of usage period of assets for reasons not related to operations.

Another important requirement by this standard is that any government operating subsidy should be displayed separately on the face of the statement of income following the presentation of the results of operations before the operating subsidy (para 614). Table 4-4 shows an illustrative statement of income as presented in this standard. Finally, the standard required that the statement of Retained Earnings should separately report the changes in appropriated (resourced) and Unappropriated retained earnings during the period. Moreover, the statement of Retained Earnings should separately display the beginning balances of appropriated and Unappropriated retained earnings before and after any prior adjustments (para 628).

Table 4–4

Statement of Income from Continuing operations, Discontinuing operations and Extraordinary Items

Arabian Company
A joint Stock Company

Statement of Income
for the year ended / / 14x2

14x1 H.				14x2 H.	
SR	**SR**		**Notes**	**SR**	**SR**
	xx	Net sales		xx	
	(xx)	Cost of goods sold		(xx)	
xxx		**Gross profit**			xxx
		Expense related to major operations			
	xx	Selling		xx	
	xx	General administration	( )	xx	
(xxx)					(xxx)
xxx		**Income from continuing major operations**			xxx
		Other operating income (loss):			
	xx	Rental income net	( )	xx	
	xx	Investment income	( )	xx	
	(xx)	Loss on sale of fixed assets		(xx)	
xxx		**Income from continuing operations**			xxx
		Discontinued operations:			
	xx	Income (loss) from discontinued operations of Division X		xx	
	(xx)	Loss on sale of discontinued operations assets		(xx)	
xxx		**Net income before extraordinary loss**			xxx
(xxx)		Extraordinary loss			(xxx)
xxx		**Net income**			xxx

4.5.3.2. The general disclosure

The second branch of the standard is the general disclosure which defines disclosure requirements in the financial statements with respect to the following (para 679):

- Nature of business.
- Significant accounting policies.
- Accounting changes and their treatment.
- Contingencies.
- Commitments.
- Subsequent events.

First of all, with regard to maturity of business, the standard requires a brief description of the maturity of an entity's business to be included in the notes to the financial statement (para 680). The standard consideres a clear and concise description of the significant accounting policies of an enterprise as an integral part of the financial statements (para 681). Any changes in these policies required that the new policy should be applied retroactively be restating the financial statements of all prior periods presented for comparative purposes (para 685). In dealing with the changes in accounting estimates, the standard requires the disclosure of the nature and effect on net income before extraordinary items and net income of the current period for a change in an accounting estimate that is rare or unusual or that may effect the results of both current and future periods, such as a change in the estimated service life of a fixed asset (para 693).

With regard to contingencies, the standard has set two conditions which have to be met for the amount of a contingent loss to be charged to income. These are (para 700):

- It is likely that a future event will confirm that an asset had been impaired or a liability incurred at the date of the financial statements.
- The amount of the loss can be reasonably estimated.

Finally, the standard requires the disclosure of unusual or large commitments of the reporting entity with a description of the commitment, the terms of the commitment and the amount of such commitment (para 708 and 709).

In conclusion, the aim of the above section was to given an idea and an overview of what is considered to be the major event in the development of accounting reporting in Saudi Arabia which is the issue of the objectives and concepts of financial accounting and the general presentation and disclosure standard. Major points and examples were presented to give an idea of the contents of the standard.

4.6. Saudi Organisation for Certified Public Accountants (SOCPA)

The Saudi Ministry of Commerce made a comprehensive study, the object of which was to develop the accounting and auditing profession in Saudi Arabia. This study ended with the issue of a conceptual framework which included the determination of the concepts and objectives of financial accounting, and taking this framework into consideration a general standard for presentation and disclosure, auditing standards, and an internal organisation structure for the profession were prepared.

Those efforts culminated in the issue of Royal Decree No. 12 in 1992 authorising the passage of the new CPA regulations which have been presented early in this Chapter. Article 19 of these regulations states that an organisation shall be established under the name of Saudi Organisation for Certified Public Accountants (SOCPA). It shall operate under the supervision of the Ministry of Commerce in order to promote the accounting and auditing profession and all matters that might lead to the development of the profession and raising its status (SOCPA, no date). The objectives, management and current activities of the SOCPA will be presented in the next sections.

4.6.1. Objectives

- Review, develop and approve accounting standards.
- Review, develop and approve auditing standards.
- Establish an appropriate quality review programmes in order to ensure that Certified Public Accounts implement professional standards, and comply with the provisions of CPA's regulations.
- Establish the necessary rules for fellowship certificate examination (CPA exam).
- Organise continuous education programmes.
- Conduct special research work and studies covering accounting, auditing and other related subjects.
- Participate in local and international committees and symposiums relating to the profession of accounting and auditing (SOCPA, 1994).

4.6.2. Management

SOCPA affairs are managed by a thirteen member Board composed of the Minister of Commerce as Chairman, with the following other members:

- The Deputy Minister of Commerce.
- The Deputy Minister of Finance and National Economy for Financial Affairs and Accounts.
- The Vice President of General Controller's Bureau.
- Two Saudi members of the teaching staff from the accounting faculty members from one or more of Saudi Universities.
- A representative of the Council of Chambers of Commerce and Industry.
- Six members from among Saudi licensed practising Certified Public Accountants to be selected by the Organisation's general meeting for a term of three years.

The Board of Directors practices the powers required for the realisation of its objectives. The Secretary General of SOCPA executes and follows up Board decisions and practices authorities of executive management.

SOCPA formed technical committees to carry out its objectives. (Table 4-5 shows the names and members of these committees.

Table 4–5

SOCPA Technical Committees

Name of Committee	Professional	Academic	Companies	Government	Total
Accounting Standards	2	3	2	2	**9**
Auditing Standards	2	4	1	2	**9**
Education and Training	4	2	1	1	**8**
Examinations	3	3	2	-	**8**
Professional Ethics	2	5	-	1	**8**
Quality Review	4	3	1	-	**8**

Source: SOCPA Objectives, Responsibilities and Current Activities, SOCPA, (No date)

4.6.3. SOCPA's Current Activities

1. Issuing and developing objective, definitive, and acceptable auditing standards to be binding for certified public accountants licensed to practise in the Kingdom and to be used as a measurement tool for evaluating the competence of auditors and the work they perform.
2. Issuing and developing accounting standards determining the proper methods of measurement, presentation and disclosure of financial statement's elements and the effect of transactions, events, and circumstances on the financial position and results of operations.
3. Developing a quality review program to monitor the performance of certified public accountants to ensure their compliance with professional standards and any other regulations issued by SOCPA or any other competent authority.

4. Developing the code of professional conduct which consists of the principles and rules. The principles provide the framework for the rules which govern the performance of professional services by members.
5. Preparing and managing SOCPA fellowship exam. The CPA Regulations made it a condition for enrolment in the register of Certified Public Accountants to be a full member of the organisation, and this cannot be accomplished except by passing SOCPA fellowship examination.
6. Organising training programs which ensure raising the professional level specifically the following projects:

- SOCPA fellowship examination.
- Special courses for practitioners licensed before the issue of the new regulations.
- Continuous education.
- Special courses for specific subjects or parties.

7. Establishing a specialised information Center using the latest technology, the Center includes a specialised library containing books, research papers, specialised bulletins in the field of the accounting and auditing and the standards and professional rules issued by professional bodies in different countries. The Center will also include a practitioners data base.
8. Issuing of a specialised professional bulletin dealing with matters of importance relating to accounting and auditing.
9. Organising a number of specialised seminars in the field of accounting to raise professional knowledge.

4.7. Summary

The aim of this Chapter was to present the accounting development and the development of rules and regulations of the accounting profession in the Kingdom of Saudi Arabia. In doing so, the first two sections discussed the essential features of the two authoritative legislative sources which were the most relevant to accounting development in Saudi Arabia. The first was the Companies Act which is considered to be the first body of regulations to set rules for accounting and auditing in Saudi Arabia. The second one was the Certified Public Accountants, Regulations which was first introduced in 1974 then superseded in 1992.

The third section of this Chapter discussed the efforts and programmes towards accounting standardisation in Saudi Arabia. The main reason for such efforts, which started in the 1980s, seemed to be the growth in the private sector economy and industrialisation which took place in Saudi Arabia at that time. Such growth needed the development of the accounting profession which forced some writers (Abdul-Khadir, 1981; Kurdi, 1983; Badran, 1983) to express their dissatisfaction with the accounting practises inability to meet the growing demands of the private sector at that time. Despite that, some writers argued about the lack of conclusive evidence as to the causality of relationships between the growth of the private sector and the development of accounting (Pound & Pollard, 1981; Lister, 1983; Chandler & Holzer, 1984). The case in Saudi Arabia appears to be different.

The major step in accounting development in Saudi Arabia was the issue of the Objectives and Concepts of Financial Accounting and General Presentation and Disclosure Standard in 1986.A review of the content of this standard, as well as some examples of its requirements was presented in this Chapter. Finally, this Chapter discussed the establishment, objectives and current activities of SOCPA, which was established in 1992.

Chapter Five

Literature Review

5.1. Introduction

A quiet revolution has taken place in accounting during the past two decades. Accounting researchers, by adopting scientific methods of inquiry, have established a substantial body of empirically based knowledge. That knowledge concerns, primarily, how decision makers perceive, evaluate, and eventually use financial information and what effects that information might have on their behaviour. Research examining an investment analysts' use of information and the aggregate of combined effects thereof has enabled accounting policy-makers and others who must select or evaluate accounting alternatives to understand more completely the nature of accounting and reporting by business enterprises in a market economy.

This chapter discusses the objectives of financial reporting, the characteristics of accounting information, and the previous studies which have dealt with financial reporting and its importance to shareholders and investors in general and investment analysts. This part of the chapter also reviews previous studies which have been focused on Saudi Arabia surveys.

5.2. Objective of Financial Reporting

Many attempts have been made to examine the objectives of financial reports. Some conclusions of the more authoritative are summarised below.

In his monograph entitled "Basic Postulates of Accounting" Moonitz (1961) defined the objective of company reporting as the provision of data to be used as a basis for choosing between available economic alternatives and for checking and evaluating progress and results. Similarly, the American Accounting Association (1966) postulated that "Financial reports are intended to provide information that is useful in making business and economic decisions".

The Accounting Principles Board of the AICPA (1970) statement No. 4, lists the following as general objectives of financial accounting and financial statements:

- To provide reliable financial information about economic resources and obligations of a business enterprise.
- To provide reliable information about changes in net resources (resources less obligations) of an enterprise that result from its profit directed activities.
- To provide financial information that assists in estimating the earning potential of the enterprise.
- To provide other needed information about changes in economic resources and obligations.
- To disclose, to the extent possible, other information related to the financial statements that is relevant to users' needs.

The objectives as expressed above appear to provide the structure of conventional financial reports. The first two points are the construction of a Balance Sheet and Profit and Loss account respectively. Therefore this statement assesses the structure of financial reports; they are not derived. The statement admitted that the particular objectives are stated in terms of accounting principles that are generally accepted of the time the financial statements are prepared. The general objectives fail to identify the informational needs of users. The statement implicitly recognises these limitations when it admitted that the objectives of financial accounting and financial statements are at least partially achieved at present. Wolk et al (1992) argued that the document is, to a large extent, justly accused of being all things to all people. However, in spite of these limitations, this statement was a step toward the development of financial accounting and has directly influenced both the Trueblood Report and the Corporate Report in their search for the objectives of financial statements.

The Trueblood Report (AICPA, 1973) reached a number of conclusions on the desirable goals of the financial accounting process:

- "The basic objective of financial statements is to provide information useful for making economic decisions.
- An objective of financial statements is to serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities.
- An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.
- An objective of financial statements is to provide users with information for predicting, comparing, and evaluating enterprise earning power.

- An objective of financial statements is to supply information useful to judging management's ability to utilise enterprise resources effectively in achieving the primary enterprise goal.
- An objective of financial statements is to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.
- An objective of financial statements is to report on those activities of enterprise affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment." (pp. 61-66).

As can be seen of the above that these objectives are mixture of disclosure standards, valuation methods, postulates concerning the production process, and behavioural assumptions.

The first objective is a vary broad statement of goal or direction for the standard-sitting process. In its second objective the report describes the primary users being served by financial statements. Identifying these users depend on the interpretation of the term "limited ability" used in this objective. Belkaoui (1992, p.184) argued that if we interpret the objective literally, the primary users of accounting information are those shareholders who depend on financial statements for information about a firm's financial position and performance. Other writers argued that although this objective may be interpreted to mean the financial statement should serve those with "limited ability" that was not the report's intention. Financial statements should not serve special or narrow needs of specific users put rather should serve the general needs of all users. If this is the case, "limited ability" then, may simply be code for full disclosure and broad, general-purpose financial statements (Sorter and Gans, 1974, and Wolk et al, 1992). A certain thing can be said about this objective and that is it is too vague.

The importance of cash flows and its characteristics of interest to investors and creditors is emphasised in objective No 3. However, there is no mention of how the valuation of potential cash flow in the presence of uncertainty might be done. Objective No 4. identifies earning power rather than accounting income as the information primarily needed by users. Earning power is perceived as the ability to bring in cash rather than as the ability to produce earnings. The emphasise in earning power, and consequently on cash flows, is a shift in emphasise from traditional accounting objectives (Belkaoui, 1992). Objective No 5. emphasises on management ability which implies that the accounting data may be used to evaluate the economic behaviour of the management which goes beyond a narrow definition of the stewardship function. Objective No 7. recognises the possible interactions between the private goals of the enterprise and its social goals. It seemed to call for reporting both sacrifices and benefits result from such interaction.

As can be seen from the above discussion the report's objectives were based largely on the general objectives of APB statement No 4. that were discussed earlier. The major criticism to these objectives was mentioned by Miller (1974). He argued that the objectives are obvious and do not specify operational objectives, such as valuation under uncertainty, that could be put into practice. Moreover, there is no mention made of the costs of disclosure as compared to the benefits.

In 1974 the Accounting Standards Committee of the Institute of Chartered Accountants in England and Wales decided to set up a working group to re-examine the scope and aims of published financial reports. In 1975, a discussion paper, "The Corporate Report" was published. The report defined the objectives of corporate financial reporting as, "to communicate the economic measurement of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.".

The Corporate Report defines users as those having a reasonable right to information and whose information needs should be recognised by financial reports. The users are identified as: the equity investor group, the loan creditor group, the employee group, the analyst-advisor group, the government, and the public. The main difference between the Corporate Report and the Trueblood Report is that the Corporate Report expresses a more pronounced concern for a statement useful for evaluating the social performance of an enterprise.

In November 1978, the Financial Accounting Standards Board (FASB) issued statement of financial accounting No. 1, "Objective of Financial Reporting By Business Enterprises". The financial reporting objectives according to the statement are as follows:

- Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions (paragraph 34)

- Financial reporting should provide information to help investors, creditors, and others assess the amount, timing, and uncertainty of prospective net cash inflows to the related enterprise (paragraph 37)
- Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change resources and claims to those resources (paragraph 40).
- Financial reporting should provide information about an enterprise's financial performance during a period (paragraph 42).
- Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment borrowing, about its capital transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency (paragraph 49).
- Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (paragraph 50).
- Financial reporting should provide information that is useful to managers and directors in making decisions in the interests of others (paragraph 52).

The FASB's objectives presented above are generally a boiled-down version of the Trueblood Report with some necessary value judgements as well as redundant statements. Although the statement singles out investors and creditors among external users, it maintains that financial statements must be general purpose in nature rather than geared toward specific needs of a particular user group. An apparent departure from the Trueblood Report statement assuming "limited ability" of users, the FASB statement takes the position that users of financial statements must be assumed to be knowledgeable about financial information and reporting.

Agrawal (1987) criticised the statement of being incomplete with respect to both the presentation of financial statements and other information to be in the financial reports. The reason for this criticism was that the statement gives no guidelines with regard to display of information in financial statements or disclosure of information in other parts of financial reports. However this criticism might not be reasonable since it is about how you achieve the objectives and not about the objectives themselves.

In 1980, the Canadian Institute of Chartered Accountants (CICA) commissioned Professor Edward Stamp to carry out a research study into the objectives of financial reporting. The resultant report postulated that the central objective was "To provide adequate information about the economic position and performance of an enterprise to all potential users who need such information to make decisions." (p. 32). The economic position that has been emphasised in this statement has to be distinguished from financial position that has been emphasised in other statements. Economic position is much wider and includes financial position. Economic position would consider the company' position versus its competitors, the nature of the industry it operates in and the nature of the distinctive assets the company has at its disposal. So basically a full description of economic position would include non-financial as well as financial information.

The objective was then extended to all types of users:

- An objective of financial reporting is the provision of useful information to all of the potential users of such information in a form and time frame that is relevant to their various needs.
- An objective of financial reporting is to provide such information in such a form as to minimise uncertainty about the validity of the information, and to enable the user to make an assessment of the risks associated with the enterprise.
- Financial reporting should have ample scope for innovation and improvements.
- An objective of financial reporting should be taken to be directed toward the needs of users who are capable of comprehending a complete set of financial statements or, alternatively, to the needs of experts who will be called on by sophisticated users to advise them.

The Accounting Standards Board in its statement issued 1991 identified the following to be the objectives of financial statements:

- To provide information about the financial position, performance, and financial adaptability of an enterprise that is useful to a wide range of users in making economic decisions.
- To show the result of the stewardship of management, that is, the accountability of management for the resources entrusted to it.

Moreover, the statement emphasises that since the financial statements portray the financial effects of past events and do not necessarily provide non-financial information, they do not provide all the information that users may need to make economic decisions.

This latest statement by ASB presents nothing new in terms of objectives of financial information since they are conventional in nature and based largely on the earlier FASB statements.

Finally, the attempts of developing a conceptual framework for financial reporting create a significant challenge to accounting standard-setters and practitioners. It is the accountants' responsibilities to ensure a reasonable adherence in reporting practice to the objectives and ideas produced by such framework. If these objectives are not adhered to in practice, what purpose are they intended for? If the framework is found to be incompatible or inconsistent with practice, then it seems sensible to ask what role the framework is playing in the work of accountants and what benefits are being derived from the costs incurred to produce it (Lee, 1992). Demski (1973) questioned the possibility of accounting regulation. In his Impossibility Theorem he provided a demonstration that is no set of standards exists that will single out the most preferred accounting alternatives without specifically incorporation of the individual's beliefs and preferences.

Furthermore, the development of an accounting framework faces the dilemma of achieving multi-objectives. When there are several objectives of financial statements, there is likelihood of conflict or inconsistency arising in their application. When such conflict arises, which of the objectives or which need of which group of users will be considered as the determining factor? It does not help when the objectives as specified are not ranked in order of importance. Similarly, the uses of financial statements are not ranked.

Another difficulty facing the development of an accounting framework is the lack of knowledge about users' needs. It is generally acknowledged that the underlying objective of publishing annual reports is to satisfy the perceived information needs of external users of such reports. One of the most difficult problems faced by management who issue annual reports, is that of balancing the information needs of different audiences. A balance must be struck between the needs of different investor groups and also between the needs of individual investors and non-investors. Underdown and Taylor (1991, p. 11) stated that "Objectives are normative in character and will tend to reflect the value judgements of those who formulate them. This tendency will be greater, other things being equal, the more ignorance there is of users' needs". However, even if users needs were known their variety in terms of decision differences will impose its own problems. Each user group will make its own decisions which may required different information. Furthermore, this information required in making decisions will be vary between individuals within a given user group according to their level of education and their experience (Underdown and Taylor, 1991).

A further complicating factor is that the objectives of management in providing such information may not always be aligned with the information needs of external users to whom management is accountable. The interest of three groups: users, corporations and the accounting profession are likely to be in conflict. The accounting profession, for example, have the duty of providing "reliable" information - what does reliable mean? There will clearly be a tension between the preparers of accounting information and the users. Does reliable information mean information that can be verified - i.e. has an "audit tail"? If so, this will rule out options for value which cannot be verified. Therefore, formulating objectives for accounting depends on resolving such conflicts.

5.3. Characteristics of Accounting Information

Many attempts have been made to identify the qualitative characteristics of financial statement and accounting information viewed as desirable for the fulfilment of their fundamental objective. Some light will be shed on some of the major characteristics of financial statement and accounting information.

(1) Financial Statement and Accounting Information Should be Relevant

For financial information to be useful, it must therefore be relevant to the decisions made by users; irrelevant information can be misleading and might result in incorrect decisions. According to the Corporate Report, disclosed financial statement information should be relevant in that it satisfies users' information needs and is appropriate to their decision-making requirements. The Accounting Standards Board (ASB) in its statement of principles issued in 1991 Stated that "information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming, or correcting, their past evaluations" (Para. 23). In practice the information conveyed tends to be directed towards a standardised decision-making model associated with the rational, utility-maximising, consistent user. Thus some sophisticated users are provided with insufficient relevant information others receive information irrelevant to their decision-making needs. Craswell (1969) and Lee (1976, p.55) argue for multiple specialist reports, in addition to a simpler generalised report, as a potential solution, though this could increase complexity and reduce understandability.

Al-Bogami (1996, p. 100) argued that relevant information therefore helps investors, creditors and users (i) make predictions about the outcome of past, present and future events (predictive value), (ii) confirm or correct prior expectations (feed back), or (iii) be available to a decision maker before it loses its capacity to influence their decisions (timeliness). FASB (1980) included that for information to be relevant, it must be timely which means that it must be "available to decision maker before it loses its capacity to influence decisions". Although it seems there is a conflict between timeliness and other functions of relevance as information can be more complete and accurate if the time constraint is relaxed, several authors such as Gilling (1977), Courtis (1976), Dyer and McHugh (1975) and Whittred (1980) provide compelling evidence for the improvement of timeliness in the provision of disclosures in order to ensure relevance.

(2) Financial Statement and Accounting Information Should be Reliable

The credibility of financial information is vital to users and confidence in accuracy and reliability of accounting statement information is of paramount importance. Reliability implies that users of accounting information can depend on the information included in financial statements with a degree of confidence and an accounting system output can be used with a degree of trust. The FASB No. 2 (1980) defined reliability in paragraph (xvi) as: "the quality of information that assures that information is reasonably free from error and bias, and faithfully represents what it purports to present". The Accounting Standard Board (1991) stated that "information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully in terms of valid description that which it either purports to represent or could reasonably be expected to represent" (Para. 26). Reliability of accounting information stems from the following three characteristics: representational faithfulness, verifiability, and neutrality (Wolk et al, 1992). It should be clear that trade-off effects are present between these characteristics of reliability. There can easily be a conflict between verifiability and representational faithfulness, and the need to make trade-off between them may well arise. Moreover, the trade-off effects are present not only within aspects of relevant and reliability, but also between relevant and reliability as total concepts. For example, current value figures might be more relevant for predictive purpose than historical costs. However, historical costs might be more verifiable than current value measures. Macdonald et al (1975) argue that if this credibility is to be backed by audit, and the provision of statistical measures of probability, then both relevance and timeliness may need to be sacrificed because of the increased lag before publication. Wright (1980) argues that such improvements will increase complexity and reduce the understandability of the accounts for all but the most sophisticated of users.

(3) Financial Statement and Accounting Information Should be Understandable

For information to be useful, it must be capable of being understood (CICA, 1991). Ijiri et al. (1966) suggested that accounting disclosure should be presented in an obvious and understandable form in order to enable users of the financial reports to make the right decisions. Buzby (1974a) argued that to make disclosure adequate and readable, information should be presented in an understandable and grouped manner and organised appropriately.

Understandability might be achieved through improvements in readability and comprehension by simplifying both content and format and improving presentation. Doing so might reduce the quality and extent of information provided and in addition, reduce comparability. Moreover, simplifying the content of financial statements to satisfy the needs of a user group may result in providing irrelevant information for other user groups. However, The ASB (1991) emphasised that "information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand" (Para.38). Wolk et al (1992) argued that even if users are assumed to be knowledgeable, information itself can have different degrees of comprehensibility. The quality of understandability is a characteristic influenced by both users and preparers of accounting information. The approach in search of improved understanding has been taken up by several researchers e.g. Adelberg (1979), Lothian (1978), Hamill (1979), Lee and Tweedie (1976), Smith and Taffler (1984) and Abdelsalam (1990). However, it is not clear what criteria have to be achieved to assure understandability. The idea may be untestable.

(4) Financial Statement and Accounting Information Should be Comparable

Comparability is another important quality of financial statements permitting the identification of trends in the results of a given organisation over several time periods, or between several organisations at the same time. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprise (Mathews and Perera, 1991, and Accounting Standards Board, 1991). However, Wolk et al (1992) argued that such a definition is too simplistic to be operational.

There is a necessary trade-off between comparability and information which reflects reality in each particular circumstance. For example, capitalisation of product development costs might provide a realistic and accurate picture in one situation but not in another. Since comparability is largely dependent on the amount of uniformity attained in recording transactions and preparing financial statements, standardisation in the provision of information might make such a comparability feasible. Bedford (1984) argues for greater standardisation in the provision of information to improve comparability, while Parker (1981) argues that "standardisation does not really help the lay investor, since it is not a substitute for clarity or effective communication".

The argument for some degree of uniformity is that the wide variety of acceptable practices makes comparability among different firms impossible or at least difficult. Furthermore, the freedom of management to choose their own methods may introduce the possibility of bias, through manipulation of reported information to suite the purposes of those who control the reports. On the other hand, the main opposition to uniformity is that it would infringe on the basic rights and freedoms of management. Moreover, it would place accounting in a straitjacket of rules and procedures that would make financial statements less comparable (Hendriksen, 1982, p. 120). However, even that there is a need for formulating accounting standards to narrow the areas of differences in financial reporting, judgement will not be entirely removed and will still be a necessary and inevitable aspect of financial reporting. Since it is impossible to anticipate all of the possible economic consequences, there is some merit in permitting each firm to make some choices so long as users are not harmed by so doing.

The importance of these qualitative characteristics is in determining how to provide users of financial statements with the most useful information. However, accountants are facing the challenge in ensuring that these qualitative characteristics, with all their various separate functions, are adhered to in practice. Judgement is necessary for trade-off among the characteristics. The ASB (1991) acknowledges the necessity of balancing between both qualitative characteristics and costs and benefits. The benefits derived from maintaining any characteristic should exceed the costs of providing it. Stamp (1982) identifies several pairs of criteria that might be perceived to be in conflict, so much so that a trade-off is necessitated in their fulfilment:

1. Relevance-------------Objectivity
2. Comparability--------Verifiability
3. Timeliness------------Precision
4. Clarity----------------- Completeness
5. Conservatism --------- Freedom from bias
6. Uniformity ----------- Flexibility
7. Materiality ----------- Precision

However, he makes no attempt to quantify the nature and extent of such trade-offs, preferring to develop absolute weighting scores for each of the criteria. Clearly some compromise position is necessary in order to deal with these inevitable conflicts. The desirable compromise position, and the permitted trade-off between attributes, will likely depend on both the user-group and the decision-making context. Whether criteria can ever be developed to guide implementation of the many potential trade-offs is a very speculative question.

Furthermore, accountants are facing the dilemma in dealing not only with the differences in the perceived importance, but also the differences in the perceived meaning of the attributes. Stamp (1981, p. 216) recognised this as a key area of difficulty for accountants when he stated that "although accounting deals with figures, many of its most important problems arise because of accountants' uncertainty about the meaning of the words they use. We shall never attain the empyrean where everyone is at all times agreed on precisely what is meant by the criteria being applied but this is not reason why we should continue to ignore semantics".

Finally, the problems facing the development of both the objectives and the qualitative characteristics of financial reporting might be causing the shortcomings of existing corporate reporting systems. According to Zairi and Letza (1994) financial reports are deficient in the following areas:

- There is a high suspision of the quality of information provided, and whether the type of information included in reports is of much benefit to the end-users.
- The information included in the reports tends to be of a historical nature, based on compiled data which reflect business behaviour and performance in a retrospective manner. As such, the information is lacking in terms of timeliness, flexibility and an ability to respond effectively to the end-user, with little or no feedback.
- There is too much emphasis on single earnings numbers and very little attention given to organisations' "state of health" in terms of cash flow and liquidity.
- The structure, design and content of most company reports is more concerned with complying with legal conditions than reflecting business and economic performance.

- Vital information on future plans/intentions and commitments for improved performance levels tends to be absent.

While it is possible to agree with these remarks, in special cases there are errors. In the UK, the question of cash flow continues to be addressed. Recently the ASB has revised the standard in cash flow statements - the revised FRS 1 - to come into effect from March 1997.

5.4. Users of Financial Reports

What financial information to be included in annual reports and the level of disclosure of this information depends heavily on the determination of the users of these reports (Moonitz, 1961). Devine (1985) argued that the fact that different users have different objectives is behind the need to determine the classes for whom the information is being disclosed.

Various user groups have been identified in the pronouncements of authoritative standard-setting bodies and by many writers. The Corporate Report (1975) recognised the following seven groups of user:

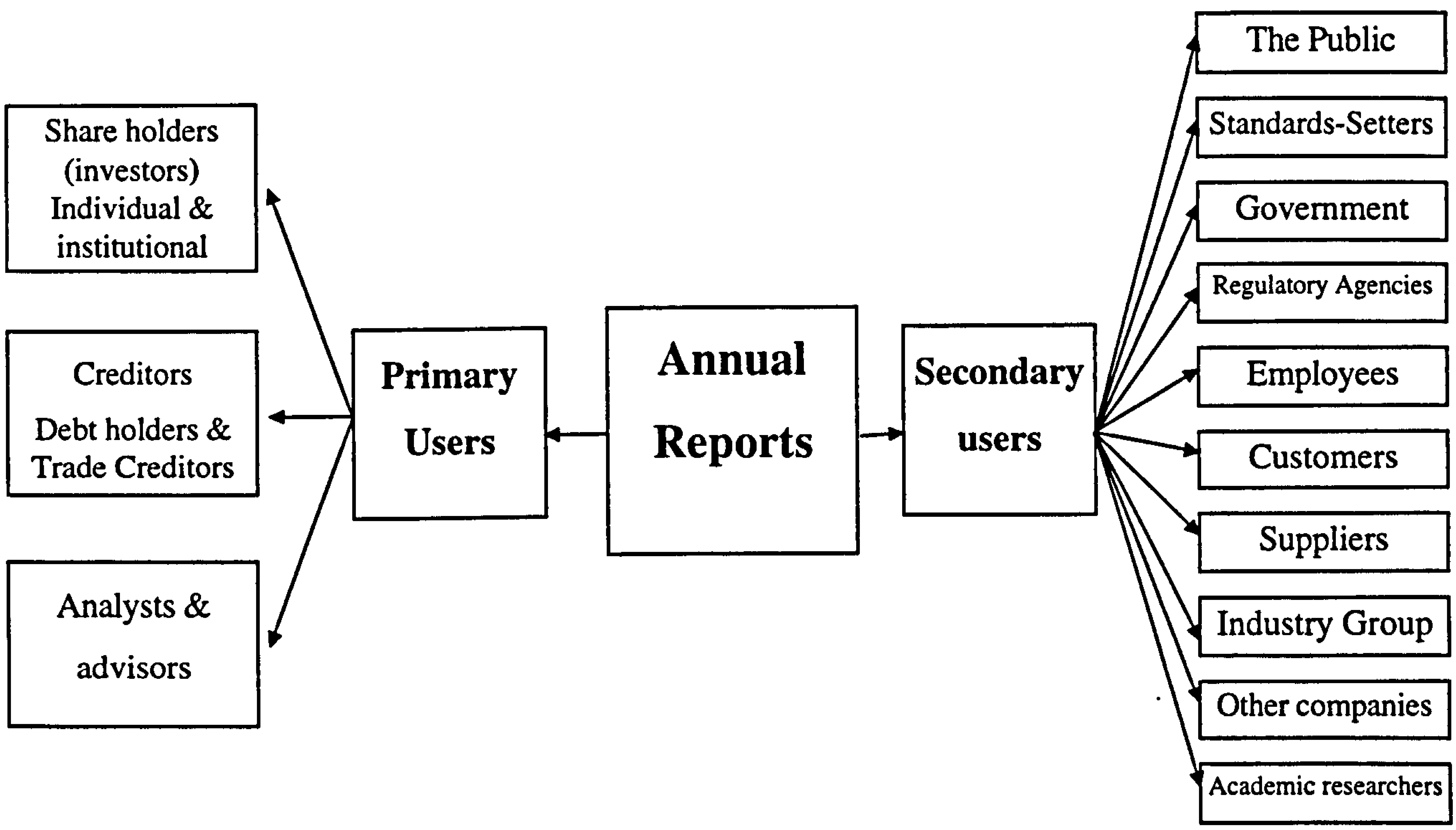
- The equity investor group.
- The loan creditor group.
- The employee group.
- The analysts advisor group.
- The business contact group.
- The government.
- The public.

The Trueblood Committee (AICPA Study Group,1973) has indicated that "an objective of financial statements is to serve those users who have limited authority, ability or resource of information about an enterprise's economic activities. SFACI (1978) argued that in the US emphasis was on two main user groups which are investors and creditors. The Canadian Institute of Chartered Accountants (1991) classified the users of financial information to primary and secondary users. As shown in Figure 5.1 the primary users are shareholders, creditors and analysts and advisors. Eleven more groups were identified as secondary users.

Mautz and Sharaf (1961) suggested that professional financial analysts as the ideal users of the financial reports. While others preferred the average investors with limited skills as the primary users (Cowan 1968, Buzby, 1974). Chetkovich (1955) took a middle position and defines the "standard reader" as someone in between the unskilled and skilled user. Others claim it depends on the objective of financial information. Wallace (1987, p. 197) identifies three types of users. They include "users of financial reports" who want to know how can they dispose their money, skills and technology to different firms, "regulators of financial reports" who set the regulations for reporting, and the "accounting profession" who make sure that firms comply with the requirements issued. Finally, it is worth mentioning, even though it is not a primary concern of this thesis, that the economic environment has changed during the 1980s and 90s with the emphasis upon privatisation. This has created a much greater presence of government and their regulators (not accounting regulators but industry regulators) as primary users of company accounts and reports.

Figure 5-1

Users of Annual Reports



Source: Adopted from The Canadian Institute of Certified Public Accountants, Information to be Included in The Annual Reports to Shareholders, Toronto, 1991.

5.5. Stewardship and Accountability

One of the major purposes of financial statements, along with the development of the corporate form of business entity, is to meet the stewardship function. The management of the company "the stewards" who are being entrusted with the firm's assets and the operations of the business, have a responsibility to act in the best interest of the owners of the company: the shareholders. The financial statements were therefore initially used as a basis for the shareholders to ascertain that the stewards properly accounted for the assets and liabilities of the business. An extension of the stewardship function of the financial statements was its use as a basis for evaluating the performance of the stewards. The responsibility of management to stakeholders referred to as "accountability" (CICA, 1991). Gjesdal (1981) quoted from Rosefield (1974) that "an objective of financial statements is to report on the control and use of resources by those accountable for their control and use to those to whom they are accountable." (p. 209). This definition is quite different from general decision usefulness although it is providing information on how management have used the resources to the shareholders, who may be facing a decision about the management team. Gray et al (1991) argued that stewardship is essentially a special, simple case of accountability. Under it, the steward provides an account of the uses to which the resources entrusted to him have been applied. Therefore, it says nothing about the effects of these uses or about purposes behind the entrusting of the resources to the steward. Accountability, by contrast, requires an account of the extent to which the objectives for which the resources were entrusted have been achieved.

The word that best describes the relationship between a company and its management on the one hand and the external users of the company's published financial reports on the other hand is "accountability". A company reports to outsiders because it feels it is accountable. Based on the relationship the two parties, the accountee "external user" has a certain right to know, at the same time, the accountor "management" has a right to protect privacy. Ijiri (1983, p. 75) stated that more information about the accountor is not necessarily better. It is perhaps better from the stand point of the accountee but not necessarily from the overall accountability relation. He added that subjective information can seriously damage the interest of the accountor, even if it is highly useful to the accountee. The accountor can suffer a variety of losses in recording and reporting certain information. The mechanical cost of preparing records and reports as well as getting them audited and the potential loss the accountor's competitive advantage are some examples for such damage.

Although the stewardship function is still important, there is a gradual shift away from this traditional role of financial statements. The traditional perspective of stewardship and past events orientation of financial reporting has changed to that of providing information for decision making (Anton, 1976). In particular, the modern era has seen the "dawn of the age of user in financial reporting" (Lee, 1981); that is reports and statements are now being conceived and aimed specifically in terms of uses and user needs.

5.6. Decision Usefulness

It is generally accepted that the underlying purpose of accounting is to provide financial as well as non-financial information about the economic entity to those who need such information. Financial reports such as profit and loss accounts, balance sheets...etc., are the output of any accounting information system.

Gjesdal (1981) raised a question about what is meant by the objectives of an economic activity like financial reporting? The author suggested apparently two different answers. (1) Financial statements may be of value to decision-making demand, (2) Investor usually delegates decision making to managers. Then there may be a demand for information about the actions that are taken for the purpose of controlling them (Gjesdal called the latter stewardship demand).Ijiri (1983, p. 75) stated that "in a decision based framework, The objective of accounting is to provide information useful for economic decisions. It does not matter what the information is about. More information is always preferred to less as long as it is cost effective. Subjective information is welcome as long as it is useful to the decision makers.".

Since the accountability approach is not geared to the requirements of any one specific user group other than for shareholders to exercise the accountability and therefore narrow compared to the decision usefulness approach. So, it might be considered less appropriate than the decision usefulness approach. Hodgson et al (1992, p.34) argues that since the early 1960s, the stewardship function of accounting data has been replaced by the decision-making function. Moonitz (1961, p.21) stated that "quantitative data are helpful in making rational economic decisions; i.e., in making choices among alternatives so that actions are correctly related to consequences.".

Perks (1993, p.23) pointed out that the publication of Statement of Financial Concept (SFAC), No.1 in 1978 marked a great shift toward emphasising decision making as the primary objective of financial information instead of stewardship. Although a wide range of potential users of financial information were recognise by SFAC No.1 a great emphasis was put on the needs of investors and creditors in making rational investment and credit decisions.

The decision usefulness approach has achieved greater recognition as the primary purpose of financial reporting following the publication of a number of important studies in the late 1960s e.g. American Accounting Association, 1966; Beaver, Kennelly and Voss, 1968. The decision usefulness approach has long been recognised. According to this approach, the function of accounting statements is to aid various user groups (in particular, shareholders and creditors, both actual and potential) in making decisions about holding, buying or selling company shares...etc.

The Accounting Standards Board in the UK (1991) adopted the decision usefulness approach when they stated that financial statements are intended to "provide information about the financial position, performance and financial adaptability of an enterprise to a wide range of users in making economic decisions." (paragraph 12).

Zairi and Letza (1994) found that the purpose of a company report should be to convey information which is useful to those who have an active interest in organisations concerned, mainly the shareholders. Sterling (1972) concluded that it seems that we all agree that the objective of accounting is to provide useful information.

There are two main areas of research related directly to the evaluation of the usefulness of accounting information and other financial disclosures to investors in making their decisions. The first area of research is the investor surveys which examine how an individual makes decisions in response to accounting information. Secondly, the efficient market hypothesis (EMH) which examines the decision makers' behaviour in the aggregate by focusing on the reactions of stock markets to accounting information (Dyckman et al. 1975 and Gray, 1987). Since the early 1970s, writers such as Gonedes (1972), Gonedes and Dopuch (1972) and Beaver (1979) recommended that researchers concentrate upon the market reaction to accounting information rather than the response of individual users, when assessing the usefulness of accounting information. These two methods of research will be discussed in more detail in the following two sections.

To sum up, ideally financial statements must be constructed for maximum usefulness. Moreover, usefulness requires unambiguous explanations and terminology, and information which is not misleading. Judgement to usefulness is made ultimately by the user, not the producer.

5.6.1. Shareholders Survey

One way of determining the usefulness of financial information is to ask investors how they use annual reports. The main concern of this type of survey is how users of financial information understand, use, and make decisions of such information and what, if any, financial or non-financial information they need (Wolk et al., 1992). Examples of these studies include Baker and Haslem (1973), Chang and Most (1977), Anderson (1981), Ahmad (1988), Abdelsalam (1990) and Bence et al (1995).

Briston (1977) argued that the first major study related to this type of survey was that carried out by the Acton Society Trust in 1959, which was based upon 1,600 questionnaires completed by small investors together with 210 interviews with employee shareholders. The main aim of the study was to analyse the characteristics of small investors and to examine the case for encouraging the spread of share ownership. In 1960 the New Chronicle published the findings of a Gallup Poll which investigated the extent of private share-holding based upon 1,500 interviews. A further survey was carried out in 1962 by Research Services Ltd on behalf of the Wider Share Ownership Committee. This was based upon 568 interviews and was designed to identify savings patterns and attitudes towards share ownership. The most important of the early general studies was that undertaken by the British Market Research Bureau Ltd on behalf of the London Stock Exchange, in 1965. This was based on 3,271 interviews and was designed to measure the extent of share ownership in the UK and to discover the personal characteristics of shareholders and the factors which influenced their choice of shares. Discussions of the findings of many other studies involving investors' uses and understanding of financial information will be presented later in this chapter.

Another type of survey research has asked investors to weight the importance of different items of financial information. The focus of this type of survey is whether the information on certain items of financial information is adequate for investment decisions. Examples of such studies include Singhvi and Desai (1971), Buzby (1974b), Firth (1978), Belkaoui et al (1978), Chow and Wong-Boren (1987), and Streuly (1994).

Some writers such as Glautier and Underdown (1993) and Belkaoui (1992) refer to these types of survey as behavioural accounting research which aimed to understand, explain, and predict human behaviour within an accounting context. Hofstedt and Kinard (1970) defined behavioural accounting research as "the study of the behaviour of accountants or the behaviour of non-accountant as they are influenced by accounting functions and reports." (p. 43).

5.6.2. Efficient Market Hypothesis

The concept of market efficiency defines the relationship between information and security prices. The concept is not new; economists since the time of Adam Smith have debated the benefits of the price system as a low-cost transmitter of information (Griffin, 1987, p. 46).

The efficient market hypothesis states that share prices fully reflect certain kinds of available information and that any new information of this type is immediately and in an unbiased manner impounded in those prices. According to the semi-strong form, any new information of economic value contained in financial reports should cause an immediate reaction in share prices as they adjust to reflect this information.

The word "efficiency" is generally used in relation to the concept of efficiency of capital allocation. A capital market which makes use of all available information is one which would allocate the available capital most efficiently. This is not however, the meaning ascribed to the term in the expression "Efficient Market Hypothesis". The term is used instead to denote "information efficiency".

By developing and refining the work of earlier researchers such as Bachalier (1900), Kendall (1959), Osborne (1953) and Moore (1964), Fama (1970) defined the information based stock market model generally known as the Efficient Market Hypothesis (EMH) as follows:

> "The primary role of the capital market is the allocation of the ownership of the economy's capital stock. In general terms, the ideal is

> a market in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production/investment decisions, and investors can choose among the securities that represent ownership of the firms' activities under the assumption that security prices at any time "fully reflect" all the available information. A market in which prices always "fully reflect" available information is efficient." (p.383).

Beaver (1981) offers a definition of market efficiency based on the information distribution. Specifically, a market is defined as efficient with respect to a specific information set if the price that exists is the same as the price that would exist if every one has that information set. From the definition it is obvious that the efficient market is based on the following hypothesis: (1) A securities market is defined as efficient if the prices of the securities traded in the market act as though they fully reflect all available information; and (2) These prices react immediately in an unbiased manner to any new information. This implies that in an efficient market one can trust prices, in the sense that investors cannot achieve consistently abnormal returns.

Fama (1970) defined three main levels of stock market efficiency with respect to three types of information:

1. Weak form of the EMH: share prices fully reflect the information content of all past prices.
2. Semi-strong form of EMH: share prices fully reflect all past and current information that is publicly available; which includes, for instance, company financial statements, brokers reports and recommendations.

3. Strong-form of EMH: share prices fully reflect all information i.e. publicly available information plus information that is not available to the public.

Fama maintained that in an efficient market, the price of security would adjust instantly to the arrival of new information regarding the value of the security. The price of that security would then instantly reflect the content of that piece of information.

In the last three decades since Fama's 1970 article appeared, extensive testing of the EMH has produced results which are "generally consistent with the hypothesis" (Hines, 1982) and, according to Chang and Most (1985) and Beaver (1981), the evidence in general tends to support the existence of the weak and semi-strong forms of market efficiency. Kraus and Stoll (1972) and Hagerman and Richmond (1973) had found that the United States stock market is efficient in the semi-strong form. Similar research carried out by Brealey (1970) and Firth (1977) for the UK stock market and Praetz (1969) for the Australian stock market, had shown that the stock market in these two countries is also efficient in the semi-strong form.

A major implication of the EMH concern the information content of annual accounting earning numbers. Research in this area involves analysing share price movements. Generally, the research approach has been to select a particular event (e.g. publication of annual reports and stock dividend announcements) and to measure the effect of the announcement on share prices, and the speed of adjustment of these to the announced events. An example of this type of research is the study carried out by Ball and Brown (1968)which showed that the direction of change in reported accounting earnings was positively correlated with security price movements. Moreover, the study found the price movements anticipated the earnings results and that there was virtually no abnormal price movement one month after the earning were announced. The results of this study which is consistent with the semi-strong form of the efficient market hypothesis were supported by many other studies such as Brown and Kennelly ((1972), Foster (1977), Beaver et al. (1979), Gready and Mynatt (1991). However, Wolk et al (1992) argued that since we could expect accounting income to be part of the information used by investors in assessing risk and return, the results have confirmed an almost self-evident proposition.

Another implication of EMH concerns the effect of alternative accounting policies on security prices. According to Wolk et al (1992) the underlying purpose of this type of research is to investigate whether security prices respond to income levels that differ solely because of alternative accounting methods or not. Examples of this type of research are the studies carried out by Sunder (1973 and 1975) which investigate the effects of stock prices of firms switching the methods of inventory valuation, (from FIFO to LIFO), during periods of inflation. Such change would result in real cash flow consequences due to change in accounting policy. Even though book income is lowered by the use of LIFO, cash flows are higher because the taxable income is lower. Sunder hypothesised that if investors value cash flow and not earnings per share, stock prices of these firms will rise when the firms made such announcements. His results, which showed that there was an increase in the cumulative average residuals, were consistent with the fact that shareholders value cash flow instead of earnings per share. These results implied that accounting methods used in calculating inventory valuations were not important to the investors. The studies by Kaplan and Roll (1972), concerning the use of alternative tax and depreciation methods gave similar results.

Hong, Kaplan and Mandelker (1978) tested the effect of pooling and purchase techniques on stock prices of acquiring firms. The results showed that the investors were indifferent as to which accounting techniques were used by the firms. That is, "investors are not fooled by the accounting conventions" (Copeland and Weston, 1983, p. 323).

There are two important implications of this research to company annual reports; firstly, most of the information contained in the annual reports is accurately anticipated by the market before the annual report is released, thus, implying that new information should be made publicly known by the company, instead of waiting for the publication and release of the annual reports. Keane (1984) argued that a nil price reaction would suggest that the leakage of information contained in financial reports is virtually one hundred per cent before publication, an assumption which is inconsistent with evidence relating to the positive impact of other information contained in financial reports. Therefore, although a systematic leakage of information may be found in individual companies, it is unrealistic to base a disclosure policy on the assumption that total leakage is a universal phenomenon amongst companies. Secondly, it does not make any difference whether cash flow effects are reported in the Balance Sheet, the Income Statement, or footnotes as the market can evaluate the information as long as it is publicly available, "whatever form it may take" (Copeland and Weston, 1983, p.325).

In other words, the EMH asserts that annual report information will be impounded rapidly in the price of the shares and that an investor cannot make abnormal or excess returns in the markets on the basis of this information. Therefore, advocates of the EMH argue that the information contained in company annual reports is not useful in making investment decisions. However, several recent studies, such as Ou and Penman (1989) and Bernard and Thomas (1990), provide evidence that there may be somewhat less than is postulated in the semi-strong form of the efficient market hypothesis. For example, Ou and Penman by using fundamental analysis came to a conclusion that under-priced shares can be found by means of financial statement analysis. This view is directly opposed to the efficient market view that prices of securities rapidly reflect all publicly available information. They used a multivariate model, included twenty accounting measures such as return on total assets and gross margin ratio, to predict whether the following year's income would increase or decrease. In almost 80% of the time they were able to describe the following year earnings correctly. The key point concerns whether their predictors were capturing information that was not already reflected in security prices but that would be subsequently reflected in security prices and would thus result in abnormal security returns if investment were based on the earning predictions of their model. Their analysis indicates that this exactly what would have occurred. These results indirectly counter to the earlier evidence. For example, Hines (1982) suggested that annual reports cannot be used by investors to make abnormal profits because; firstly, annual report content is publicly available information, and as such, it is impounded immediately in market prices of the shares, thus eliminating the possibility of a purchase or sale of shares based upon such information at a price which would yield abnormal return; secondly, the content has already been conveyed to the market by earlier reports, for example by preliminary reports issued by the company.

Ahmad (1988) argued that the EMH in the semi-strong from has a very serious implication for the "sophisticated" investors. If analysts accept the main conclusions of the EMH, and the form of investment analysis based on publicly available information (which includes company annual reports) would be totally futile since the price of every share on the stock market already reflects all that is known about it. Stamp (1979) expressed a similar conclusion when he stated that:

> "...the truth of the hypothesis is dependent upon a general disbelief in its truth. In other words, if stockbrokers, financial analysts, investment bankers, fund managers in insurance companies and pension funds, and all manner of other sophisticated investors did not do their best "to beat the market" by seeking out and analysing all the information they can find, it would in fact be possible to beat the market and efficient market hypothesis would not have been confirmed by empirical evidence." (p. 51).

Moreover, many writers such as Chambers (1974), Anderson and Myers (1975), Findley (1975), Stamp (1979) and Wolk et al (1992) criticised the EMH research by saying that:

- Neither stock markets nor financial information are homogeneous; the efficient market research examines only aggregate effects and ignores differences;
- Existing research concentrates exclusively on the impact of accounting information on share prices and ignores other types of information;
- The EMH has little to say about the quality of information; if for example, the information contained in the financial statements are poor then the market has been impounding poor information in determining share prices;
- There is no clearly defined and universally agreed upon set of conditions for market efficiency and the doubtful existence of all of these conditions in all the stock markets of the world;

- The EMH does not offer any explanation or conceptual framework as to what is happening in the relationship between prices and information: why security prices settle at the level that they do, and what is likely to happen in the future; in other words the EMH has no predictive ability.
- The implication of the EMH is a joint test of both market efficiency and information content. The absence of price response is usually interpreted to mean that the information tested has no information content. This interpretation is correct only if the market is efficient. But what if the market is inefficient?. If the market is inefficient, there is no way of determining what the absence of price response means.
- Efficiency in the context of efficient market theory simply means that the market impounds information quickly. It does not mean that the result of this process is a set of share prices which reflects the intrinsic worth of shares. The evidence says nothing of how the market ought to react to specific and different types of information and should not, therefore, be used by accounting policy makers for judging the desirability of accounting information.

To sum up , the efficient market hypothesis describes a property of share prices, namely, that they reflect certain types of information instantaneously and in a unbiased manner. Researchers, in order to test market efficiency, divide the market into three forms, namely, weak form, semi-strong form, and strong form. The weak form states that, the share prices move independently of previous movements and therefore the future prices cannot be predicted from the past price data, moreover, it is not possible to earn abnormal returns by trading in the market by looking and studying charts of past stock prices, because prices changes are in a random walk manner and prices would respond only to new information or to new economic events. The semi strong form suggests that share prices fully reflect all publicly available information, share prices respond immediately and in an unbiased manner to new information. It is therefore not possible to use public available information such as newspapers or the annual reports of the company to make abnormal returns. The strong form suggests that share prices fully reflect all information, which means not only published information but also all relevant information as "inside information" which is not publicly available.

This distinction of the three forms of market efficiency stimulates a number of points:

(A) The existence of the strong form implies the existence of the semi-strong form which in turn implies the weak form efficiency, but not vice versa.

(B) The prices react quickly in an unbiased manner to new information.

(C) Each form is a function of an information set.

The implication of the results produced by applying the EMH is an anomaly because studies using surveys of analysts and other professional investors found that annual reports information are extremely useful in making investment decisions. It is difficult to explain this anomaly but Hines (1982) suggested:

1. One explanation may be that the shareholders believe that publicly available information may be used when in fact it cannot (i.e. a disbelief in the implications of the EMH).
2. Another explanation for the anomaly might be that share markets are not perfectly efficient and abnormal returns can in fact be earned by investors. The findings of some studies such as Bernard and Thomas (1990) and Ou and Penman (1989), discussed earlier, support this argument.

Of course, if the EMH was true it has nothing to say about financial reporting to other users such as creditors, government and the like. Moreover, it is a difficult step to make from observing the evidence of an EMH and concluding that financial report should be withdrawn. Just because there is no observable share price reaction to their disclosure it does not follow that the level of share prices would remain the same. Managers know that any release of information will be subsequently verified by the stock market.

Finally, in the light of the above discussion the EMH in the semi-strong form has a very serious implication for investment analysts. If they accept the main conclusion of the EMH, its implication is that annual reports are not useful in investment analysis in any efficient market. Investment analysis based on publicly available information, such as company annual reports, would be totally futile since such information is already reflected in share prices. The case will be more difficult in an inefficient stock market such as the Saudi stock market (see chapter three). Therefore, since the purpose of this study is to seek the investment analysts' views and evaluation of the usefulness of the company annual reports in Saudi Arabia, it would be inapplicable to use the EMH.

5.7. Previous Studies

A review of a number of studies which discussed the issue of usefulness of financial information provided in the corporate annual reports for individual shareholders or investors and financial analysts will be presented. The researcher will examine how these studies have dealt with such an issue. Studies focused on the Saudi Stock Market will also be reviewed.

5.7.1. Individual Shareholders (Investors)

There are many studies relating to the importance and usefulness of financial information for individual private shareholders. Baker and Haslem (1973) carried out a study which covered 1,623 individual common stockholders from the customer list of five stockbroking firms in Washington D.C. Questionnaires were sent to them asking them to indicate the most important sources of information that they used in evaluating common shares. The most important source of information, for 46.8 per cent of the respondents, was stockbrokers, while only 8 per cent considered the annual reports as their most important source of company information.

Baker and Haslem (1973) found that user information requirements for investment analysis may very well differ. Comparisons with other research findings suggest that individual investors may have different information needs than have professional analysts. Individual investors are very dependent upon stockbrokers and advisory services for their investment information; and individual investors attach minor importance to financial statements as a source of information.

A study carried out by Epstein (1975) in the United States seemed to confirm the findings made by Baker and Haslem. The study aimed at determining the usefulness of annual financial statements among investors. Epstein found that only 15 per cent of the respondents in the survey relied on annual reports as their primary basis for investment while 49 per cent relied on stockbrokers advice. Based on his findings, Epstein concluded that corporate annual reports were not very useful to stockholders for investment decisions.

However, a study conducted by the Securities and Exchange Commission (1977) arrived at different findings. Questionnaires were distributed to 11,000 individual investors, each of them owned fewer than 1,000 shares of stock in fifteen different companies . Fifty per cent of the respondents rated financial statements as extremely useful, 36 percent moderately useful and 3 per cent rated the financial statements as "not at all useful". This is an interesting result since the respondents hold diversified portfolios and yet they are interested in company specific results. The findings of the study were supported by the findings of other studies carried out in other countries.

Lee and Tweedie (1975) conducted a study to examine whether or not shareholders use information from company financial reports and whether or not they understand the accounting terminology used in the production of these reports. Out of 1,594 questionnaires sent to individual shareholders of one of the largest industrial companies in the United Kingdom, 374 were received with a response rate of 23.5% . It is worth noting that the sample used in this study put some limitation on its findings since it was a self-selecting sample rather than a representative one. The survey indicated that most of the respondents regarded annual financial reports as an important source of information for investment decisions. Financial press reports were considered the most important of all the other sources of information on companies. Stockbrokers' reports were read by many shareholders, but they were not considered as such an important source as half-yearly financial reports (Lee and Tweedie, Autumn 1975). Shareholders with no knowledge of accounting were more interested in the chairman's report than any other section. The chairman's statement was rated by 95.7 per cent of the respondents the most useful part of the annual financial report for investment decision-making purposes. Those shareholders with some form of training in accounting read their report more carefully than those without any such experience and paid particular attention to the profit and loss account. They rated the profit and loss account and balance sheet as the most useful section. Shareholders rated the financial press reports as being slightly more useful in investment decision making than the published profit and loss account. Half-yearly interim accounts were only considered to be of moderate to slight importance, as one third of the respondents considered these reports to be of moderate to slight importance, as one third of the respondents considered these reports to be of no use to them for investment decisions, although those with accounting experience rated them more highly than those without accounting experience (Lee and Tweedie, 1975).

The conclusions which Lee and Tweedie draw from their study are as follows:

1. Shareholders are very interested in information about the future of the company, at present not necessarily provided by the company. However, this reflects the age of this study. Most reports today address the context of the business and prospects.
2. Shareholders without a knowledge of accounting seem to prefer to consider an interpretation of the company's results rather than the published statements themselves.

Wilton and Tabb (1978) carried out a study to investigate private shareholder usage of financial statements in New Zealand. 300 individual investors from two New Zealand companies were covered by the study. The study found that the most thoroughly read section of the annual reports were the Chairman's reports followed by the Profit and Loss account and Balance Sheet. The findings of this study can not be generalised since the sample used was based on investors of two companies only rather than randomly selected.

Lee and Tweedie (Winter,1975) looked at the individual shareholders' understanding of financial statements. Of 68 per cent of the respondents who said that they understood the information contained in annual reports, 59 per cent stated that they found annual reports relevant to their investment decisions. However, tests on various aspects of the reporting process revealed that actual knowledge was well below the respondents` perception of their comprehension. They concluded that an alarming degree of misunderstanding and ignorance of reporting practice has been evidenced amongst the private shareholders.

Chang and Most (1977) conducted a survey of individual investors in two countries, U.S.A(Florida) and New Zealand. In Florida questionnaires were mailed to investors randomly selected from the mailing list of the local office of a large national stock-brokerage firm. 182 questionnaires were received out of 1,034, which represent a response rate of 17.6%. In New Zealand, 300 questionnaires were mailed to investors selected from New Zealand firm for share registrars. Responses were obtained from 85 investors which represent a response rate of 28.3%. Respondents in Florida regarded corporate annual reports as the most important source of information. Newspapers and magazines ranked second; stockbrokers` advice ranked third. However, the New Zealand survey indicated different results. The data revealed that newspaper and magazines were the most important source of information followed by stockbrokers` advice. Company annual report ranked third. The main area of weakness related to this study is the low response rate, specially for the Florida survey where the response rate was only 17.6%. however, statistical tests were carried out by the researchers to test the non-response bias and no such bias was detected.

In Australia, Chenhall and Juchau (1977) carried out a survey which focused on the information needs of investors. From a total population of 1,025 investors, 476 valid replies were received which represent a response rate of 46.4%. Chenhall and Juchau found that these investors rated company financial statements as the most important sources of information for investment decisions. The stockbrokers report and advice was rated as the second most important source of information.

In another Australian study carried out by Winfield in 1978, he surveyed 850 individual shareholders in regarding their opinions relating to published financial statements. He found that the annual reports were the most important source of information for these investors in their investment decisions; followed by the financial press and stockbrokers advice. 56.4% of respondents ranked the chairman's report as the most important section in the annual reports followed by the profit and loss account and balance sheet.

As can bee seen of the above discussion, In the case of the individual investors, the results were mixed. The studies by the Securities and Exchange Commission (SEC) (1976), Chenhall and Juchau (1977) and Winfield (1978) found that the individual and private shareholders regarded annual reports or financial statements as an important source of information for investment decisions. Baker and Haslem (1973), and Lee and Tweedie (1977), found that the individual shareholders rated brokers' advice as more important than the annual reports for investments decisions. Epstein (1975) concluded that annual reports are not useful to the individual shareholders. Even in the same study such as Chang and Most (1977) the results were mixed. According to Chang and Most (1977) these contradictory observations can be viewed in the light of the investor characteristics. They found that the small individual investors who hold common stock investment amounting to less than $10,000 in value regard stockbroker advice as a more important source of information. However, their conclusion is inconsistent with the findings of previous studies by Baker and Haslem (1973) and Epstein (1975). Investors surveyed in both studies regarded stock-broker advice as their primary source of information, even though they were considered to be holders of large portfolios. Epstein study, for example, indicated that more than 55% of the respondents invested more than $50,000, and 40% of respondents invested more than $100,000. One possible reason for this situation might be that the largest individual investors will be in a position to pay for financial analysis tailored to their investment needs, whereas the small investors cannot afford to pay for this service.

Ahmed (1988) criticised the Baker and Haslem Study (1973) which concluded that stock-broker advice is the most important source of information for individual investors. He argued that the sample was drawn from the customer lists of five stock -brokerage firms, therefore it is not surprising that responses regarded stock-broker advice as their most important source of information since they are customers of these firms. However, this argument does not stand for the findings of the Chang and Most study. The results indicated that respondents who were drawn from the mailing list of a stock-brokerage firm (Florida survey) ranked annual reports as their most important source of information. On the other hand, responses who were drawn from New Zealand firm for share registrars, which keep shareholder records for a number of public corporations, regarded stock-broker advice as their most important source of information.

Finally, the heterogeneous nature of the individual investors which may cause these mixed results, all together with the growing influence of investment analysts as a primary user group of corporate reports has shifted the focus of recent studies. Researchers are more concerned with investment analysts views and evaluation of corporate reports. Since they are a primary user group themselves and furthermore, they often serve the needs of the other primary user group, shareholders, by providing them with skilled analyses and interpretation of financial reports

5.7.2. Investment Analysts

In this part of the study the researcher will present a review of the studies and surveys carried out among the "sophisticated investors", i.e. investment analysts, into the importance of company annual reports for investment decisions.

There are many studies relating to financial analysts and the use and usefulness of financial information appearing in the annual reports of companies. We use the word "usefulness" to mean the extent to which information facilitates decision-making (Pankoff and Virgil, 1970). One of the earliest and comprehensive empirical research in this area of annual reports was conducted by Cerf in1961. The main focus of his research was to quantifiably test the association between the characteristics of the firms and disclosure in financial statements. In doing so Cerf pioneered the use of an "index of disclosure" which was developed by asking members of the National Association of Financial Analysts, in a questionnaire survey, to weigh the importance of several items of information contained in the corporate annual reports. For their answers, a weight was attached to these items of information and applied to the financial statements of 527 companies. When an item appeared in the annual reports, the weighted points were given. The sum of the points received divided by the total possible points became the firm's index of disclosure. Cerf concluded that firms with a high index of disclosure had more stockholders, were larger in total assets, more profitable and more likely to be listed on a stock exchange.

There are two main important aspects of Cerf's study:

Firstly, in developing the disclosure index, he had surveyed the professional analysts regarding the importance of the information contained in the financial statements.

Secondly, another important aspect of Cerf's study was that it provided the methodology i.e. the use of a disclosure index, for other studies carried out concerning the evaluation of disclosures in financial statements.

Among the many authors who used this methodology and the countries in which the study was conducted in, are: Singhvi and Desai (1971, US), Singhvi (1968, India), Chandra (1974, US), Buzby (1974 and 1975, US), Barrett (1976, US, UK, Japan, France, West Germany and Sweden), Firth (1979, UK), Gray (1978, Europe) and McNally et al (1982, New Zealand). These studies gave an indication of the "quality of information" contained in the annual reports from the point of view of the professional analysts and provided a useful methodology for comparing the quality of disclosures in financial statements of different countries.

Bradish (1965) conducted a study in the US. In his study he interviewed financial analysts working in security brokers, trust and loan departments of commercial banks, and insurance companies. The main purpose of his study was to determine the types of information provided in corporate annual reports that investment analysts deemed inadequately disclosed and elicit their views on the usefulness of a number of troublesome items such as long-term leases and funds flow statements. He attempted to elicit proposed solutions from the analysts which could correct these problems. His analysis showed that there is a lack of communication between the users of the financial statements and the preparers of financial statements. As his final conclusion Bradish stated that "our major failure as accountants may be in our communication with those increasingly important gentlemen, the financial analysts" (p. 766).

Mautz (1968) conducted a study aimed to learn from the users of published annual reports the ways in which they use these reports and the deficiencies they find in it. In his study, investment analysts were asked to rate the importance of the annual reports as a source of information for analysing the pertaining results of segments of diversified companies. These financial analysts gave financial statements a rating of 67 percentage points (the highest among the other sourses of information) for their relative importance as a source of information in analysing segment performance of diversified companies.

Pankoff and Virgil (April,1970) developed a laboratory experiments approach which was designed so that demand for an information item is measured by the extent to which the item is used as an input for decision-making. They applied their approach in another study (1970) whereby they asked thirty two analysts to make investments decisions by using hypothetical net worth price ratio information. The authors concluded that they had not found much empirical support for the belief that accounting information was highly useful for decision making.

Mason (1971) found that the most important source of information for investing institutions was that received from the stockbrokers. Stockbrokers rated company annual reports as the most important source of information for investment decisions.

The Financial Analysts Federation Study (1972), interviewed senior members on several topics. One of the main question regarding their sources of information for investment decisions or recommendation, most of the financial analysts commented that company accounts and statements were vital for their analysis of different companies.

Chandra (1974) made a study to examine whether those who attest to the corporate reports and those who used such reports- the public accountants and the security analysts- have any consensus about the value of information which is included in published corporate annual reports. A total of one thousand questionnaires were sent to the target group. After analysing the returns, he concluded that accountants generally did not value information for equity investment decisions in the same manner as financial analysts. Chandra gave three explanation for his results. First, a lack of consensus could be due to the lack of communication between the user and preparers group. Another possible reason is that a time lag may exist between what the user group needs and what the preparer group is ready to give. A third factor may be a tendency by accountants to adhere to the established order rather than experiment with new ideas and approaches.

Briggs (1975) Conducted a study in the United Kingdom. He interviewed 25 stockbrokers and officials of unit trusts and trust departments of merchant banks. Briggs found that there was almost unanimous agreement that accounting reports were essential for investment analysts. In his conclusion he suggested that analysts have an important role as interpreters and digesters of published accounting reports. The information contained in the reports should not be geared to the needs of unsophisticated laymen at the expense of the efficient operation of the capital market.

Belkaoui and Peyrard (1978) used a questionnaire to ascertain the value which U.S., Canadian and European analysts attached to twenty-nine items of information contained in financial statements. The authors concluded that there were a significant number of differences between North American and European analysts concerning the perceived value of different information sources.

Lee and Tweedie (1981) conducted a study in the United Kingdom. The findings of the study confirmed that annual reports were perceived to be the most important source of information for investment decisions by institutional investors. Nearly 80% of the respondents also confirmed their confidence in using the information provided in the financial statements for investment decisions. Arnold and Moizer (1984) criticised the Lee and Tweedie study on the grounds that the population from which the sample were drawn were based on organisations rather than individuals, resulting in the sample containing a relatively smaller number of analysts from large firms which may lead to sample bias.

An Australian study was conducted by Anderson (1981). A postal survey was carried out on a sample of 300 Australian institutional investors. Anderson found that institutional investors ranked the annual reports as their most important source of information for investment decisions, followed by stockbrokers` advice and company visits. Moreover, the study showed that the most important sections of the annual report for making investment decisions are the profit and loss account, balance sheet and notes to the accounts.

Arnold and Moizer (1984) carried out a study on the methods used by investment analysts to appraise investments in ordinary shares. They interviewed financial analysts from six financial institutions. Based on the interviews, questionnaires were designed and mailed to 1,654 investment analysts selected from the UK section of the Member Societies Yearbook of the European Federation of Financial Analysts` societies. A sample size of 465 individuals (response rate of 28.1%) was obtained. Their study also seems to confirm the results of the study by Lee and Tweedie in that the analysts perceived the company annual reports to be the most important source of information for investment analysis.

In another study, Moizer and Arnold (Autumn, 1984) categorised investment analysts either as portfolio managers or as information intermediaries. Portfolio managers are those investment analysts who themselves use the information gathered for their own appraisal of equity shares in the management of portfolios. Information intermediaries are those investment analysts whose equity share appraisal information is used by third parties but not by the analysts themselves. The study indicated that portfolio managers analysed corporate reports in less depth than Information intermediaries, and spend less of their working week analysing company shares. Information intermediaries made greater use of sources of information. The only source of information of more importance for portfolio managers was information from other analysts.

The researcher identified several reason of these differences based on the different contexts and objectives utilised by each group. These reasons included, first, intermediaries tend to specialise in one area of the market, whereas portfolio managers cover the whole market. Second, portfolio managers spend time actually buying and selling shares, whereas intermediaries do not trade.

Chang and Most (1985) carried out a comparative study involving three countries: the U.S., UK and New Zealand concerning the perceived usefulness of accounting and other information contained in annual reports to three groups of investors: the individual shareholders, institutional shareholders and financial analysts. They concluded that the three investor groups value corporate annual reports as an important source of information useful for investment decisions.

Day (1986), conducted a project to investigate the use of and usefulness to investment analysts of the information contained in annual reports. The focus of this study was to assess the usefulness of current cost accounting information to investment analysts. In doing so, Day interviewed fifteen financial analysts employed by firms of stockbrokers. She discovered that a majority of the financial analysts agree that the financial statements of companies are an important source of information. She also found that the analysts are especially interested in additional or improved disclosures in segment information, detailed half yearly and quarterly reports and the Chairman's Statement to be made more detailed including such data as management's intentions. The main weakness associated with this study is that the number of analysts interviewed was clearly not a large enough (or random enough) to draw statistically valid conclusions.

A Malaysian study was conducted by Ahmad (1988) whereby questionnaires were sent to investment analysts employed by institutional investors, merchant banks and stockbrokers. The main objective of this study was to evaluate the importance of the annual reports and the information contained therein for investment decisions. A major conclusion of the study was that the investment analysts ranked company annual reports as the most important source of information for investment decisions. This study also showed that the investment analysts made considerable use of the company annual reports for investment analysis. Moreover, the study indicated that the investment analysts regarded the balance sheet and profit and loss account as the most important sections of the annual reports.

Gniewosz, G. (1990) conducted a case study, investigating the use of accounting information and information from other sources, in the share investment decision process of an institutional investor. He concluded that the annual financial report is one of the major information sources used in the continuous process of share investment decision making. In terms of time spent on information received from one source at a single point in time, the annual report dominates all other sources. Of all the information sources used, the annual report is not only considered by analysts as most extensive and comprehensive but also as most important source of information. The annual report acts not only as a source of information to an inquiry but also provides the stimulus for identifying questions to be pursued via other sources.

Pike. R., Meerjanssen, J. and Chadwick, L. (1993) carried out a study to examine the changes in the approach to appraising ordinary shares by UK investment analysts over the past decade during which fundamental market developments have occurred, and to compare the approaches and goals adopted and information sources employed by UK analysts in evaluating shares with those of their German counterparts. They concluded that there has been a definite shift in attitudes towards personal company contacts and meetings as the most important source of information. The researchers argued that one possible reason for this shift toward greater reliance on personal contact with companies may be a response by analysts to the allegation that there was a lack of communication between institutional investors and company management. They added that an alternative explanation for the responses indicating greater personal contacts could be that there not necessarily any more meetings than there were but rather that analysts are now more willing to admit to them.

An important study was carried out by Streuly (1994) which was design to address the importance, adequacy and the usefulness of corporate annual reports. Questionnaires were sent to a random sample of 928 Chartered Financial Analysts (CFAs) in United States. 508 of these questionnaires were received which represent a response rate of 54.7 percent. After analysing the data, the author suggested that the primary objective of financial reporting is being met because of the following:

- The majority of respondents indicated that the information disclosed in annual reports is adequate for investment decisions;
- The primary financial statements (income statement, cash flow statement and balance sheet) are very useful to CFAs in investment decisions;
- The vast majority of individual financial statement line items and notes examined are more than moderate useful to CFAs in investment decisions.

Bence, D., Hapeshi, K., and Hussey, R. (1995) carried out a study which was designed to focus on sophisticated users with an interest in a particular company and with knowledge of the relevant industry: the chemical and pharmaceutical sector. The aim of the study was threefold. First, to ascertain whether different clusters of sources of financial information are used by different groups of sophisticated users. Second, to examine a specificity of relationships that would provide a fuller understanding of the financial reporting process. Third, to develop a construction of information sources by using statistical techniques not applied in previous studies of this topic. The study confirmed the general conclusion drown by other researchers as to the respective importance of sources of information, furthermore, the study indicated that there is general agreement between investment analysts and institutional investors on the importance of each source of information, and this confirms the finding of the earlier study by Moizer and Arnold (1984). However the application of the technique of cluster analysis has revealed that the users employ a limited range of information sources. For investment analysts, the main cluster would appear to be that which can be classified as routinely received information, such as company annual reports and interim statements, with the emphasis on short-term information. With institutional investors, the predominant cluster encompasses information sources where the user takes steps to obtain the information and it is of less of short-term nature, such as company visits and personal interviews. The results of this study would have been more meaningful if it included other companies in various industries and compared their results. Moreover, the sample size used in this study (21 investment analysts and 12 institutional investors) might affect the validity of the statistical analysis.

It is clear from the discussion above of the studies involving investment analysts and their uses and evaluation of corporate annual reports that the results are more consistent than the results from the studies involving individual investors. Investment analysts' studies indicated that the annual report is the most important source of information for investment decisions and recommendations. Although in a number of studies, e.g., Mautz (1968) and, Pankoff and Virgil (1970), the analysts stated that additional information should be disclosed by the companies, they still regarded the annual reports as the major source of information.

As a final note, it is emphasised that, in general, analysts are reasonably satisfied with the present form and content of corporate information. Having the assumption that judgement regarding usefulness is made ultimately by the user, not the producer, the investment analyst is a primary user of published annual reports. He represents probably a very large percentage of existing investment capital. Analysts' opinions and procedures offer a source of valuable information that as yet has been tapped only lightly.

5.7.3. Saudi Arabia Surveys

In this part of the analysis the researcher will discuss the findings of previous studies relating to the usefulness of financial reports in the Kingdom of Saudi Arabia (KSA).

Bahjatt (1986) conducted a study aimed to investigate the level of information disclosed by Saudi companies in the annual reports. Moreover, the study examined the role of external auditors in the process of presenting the accounting information. He employed an index of disclosure to measure the adequacy of the information provided in published annual financial statements of 28 Saudi corporations over the period 1981 to 1984. The study showed that the level of disclosure in the Kingdom was lower than that for US corporations but higher than that for US unlisted corporations. With regard to the external auditors role, Bahjatt found that corporations which were audited by small audit firms seemed to published more information than those audited by large firms.

Midani and Abdeen (1987) carried out a study to investigate disclosure aspects in the annual reports of Saudi listed companies with regard to the information contained in financial statements, the detail of the auditor's report and the content of the board of director's letter to the stockholders. A framework which covered the definition, objective, content, and extent of disclosure was established in order to evaluate the disclosure practices in the annual reports of 17 Saudi companies over a three-year period 1980-1982. A number of deficiencies were identified with regard to the disclosure practices in the Kingdom such as a long delay in reporting to shareholders and insufficient data presented in the financial statements. The serious shortcomings were especially pronounced in the income statements. Other shortcomings including the problem of classification in the financial statements and the absence of comparative figures were also highlighted.

Felemban (1989) conducted a study involving questionnaire survey of small and medium investors (holding less than 5000 shares). 600 questionnaires were distributed and 210 questionnaires were returned (a response rate of 35 per cent). Felemban found that the annual financial reports considered to be the third prime source of information for investment decisions after SAMA's share price list and newspapers. A minority of respondents indicated that information available to the investor in the Saudi stock market was comprehensive. The study showed that the majority of the small investors are not satisfied with the information reported in the financial statements as they cannot understand and use it, so they do not rely on it.

Abdelsalam (1990) conducted a survey to investigate the hypothesis that Saudi investors do use financial statements as an important source of information when making decisions. It also looked at the specific financial items that investors find most useful. Four hundred questionnaires were delivered to Saudi investors and 231 questionnaires were returned (53 per cent). The main purpose of this survey was to reveal the importance of specific sections in the annual reports for investment decisions. The survey indicated that 85.3 per cent of the respondents rely on corporate financial reports when making economic decisions related to the buying or selling of Saudi shares. Furthermore, the study revealed that the profit and loss account and balance sheet are the most important sections in the Saudi corporate financial reports for investment decisions. Finally, the study showed that Saudi investors want more information when making investment decisions, such as management and directors of the firms, general economic conditions and the financial policies of the companies.

Ba-Owaidan (1994) investigated the role of the accounting information systems in facilitating the share trading activities in the Saudi Stock Market. In doing so, he analysed the individual Saudi investors' use and understanding of the data published in annual financial reports for their investment decisions. Three hundred questionnaires were distributed (of which 135 were completed) to small investors owning shares to value less than SR 500,000 (US$ 133,000). He also interviewed some investors who had agreed to be interviewed. The study showed that the majority of those who responded

66.7 per cent indicated that they bought shares for both dividend and capital gain, while 22.2 per cent bought shares for dividend only and 9.6 per cent for capital gain only. Furthermore, study indicated that 61.5 per cent of the individual investors believed that financial statements gave them useful information for investment decisions. Most of the respondents (61.5 per cent) agreed that the purpose of the financial statements was to give shareholders data for use in investment decisions.

According to the survey, company annual reports were ranked first by 65.2 per cent of the respondents as the most valuable and useful sources of information in making investment decisions, followed by SAMA share prices data, news in financial press, and news in the daily press.

Al-Bogami (1996) carried out a study to examine the usefulness of interim financial statements to investors in the Saudi stock market. The purpose of the study was to examine the usefulness of quarterly financial reporting in the Kingdom by surveying the attitudes of users and preparers towards interim financial statements. The data for the study was collected through questionnaires. Three subject groups were chosen, (i) financial managers representing preparers, (ii) institutional investors and (iii) private investors as user groups. He concluded that a study of the responses to this survey shows that institutional and private investors in the Kingdom do use quarterly financial statements and also that investors and preparers both feel quarterly financial statements are useful in making investment decisions. Quarterly financial statements were ranked as the second most important source of information, after annual reports.

Looking at the above discussions, there appears to be a consistency, with regard to the mixed results of individual investors perceived of the usefulness of accounting information for their investment decisions, between the Saudi studies and the studies involving individual investors in developed countries which were discussed earlier in this chapter.

5.8. Summary

The main purpose of this chapter was to review the literature related to the usefulness of financial information. In doing so, the chapter is divided into three sections. The first section dealt with the objectives of financial reporting. The conclusions of some authoritative bodies regarding the objectives of corporate reports were presented. The second section discussed the characteristics of the accounting information. These characteristics included relevance, understandability, reliability, completeness and comparability. The users of financial information and their classification as primary and secondary user groups were presented in section three. The main conclusion of this section is that investment analysts are viewed as a primary user group of corporate report.

The accountability or stewardship and the decision usefulness as the main two approaches associated with the objectives of financial reporting were examined in detail. Investors survey and efficient market hypothesis (EMH) which are commonly used in previous studies as the two main methods for evaluating the usefulness of financial information were also presented in sections four and five.

Previous studies involving the usefulness of accounting information were reviewed in the last section of this chapter. The review included both studies, the usefulness of accounting information for individual investors, and studies involving investment analysts uses and evaluation of accounting information provided in corporate reports. Furthermore, the section has also examined the studies which surveyed the Saudi investors and their attitude toward accounting information.

Chapter Six

The Research Methodology

6.1. Introduction

The main objective of this study is to evaluate the importance of companies annual reports to the investment analysts in Saudi Arabia. A survey was carried out to obtain the investment analysts views of the annual reports, the importance they attached to them and the uses of these reports in their investment activities.

This chapter focuses on discussing the method which is used in carrying out this survey, in particular this chapter has the following aims:

- To discuss the various methods that have been used in previous and similar studies.
- To justify the choice of the method employed in this research.
- To explain the steps that have been taken in designing the questionnaire.
- To describe the survey sample.
- To describe the Questionnaires distributing procedures.

The researcher , in this chapter, discusses the two main methods which are used in similar studies: the interview technique and the questionnaire method. Advantages and disadvantages of each method have been examined. A justification of using the questionnaire (mail and self administered questionnaire) method is presented.

Explanation of the questionnaire design and question wording and order are also included in this chapter. In addition, pilot testing and sampling procedures are reviewed.

6.2. Definition of Methodology

The term methodology in its original and proper usage refers to "the systematic and logical study of the principles guiding scientific and philosophical investigation" (Gould and Kolb, 1964, p. 425). Roberts defines the methodology as the study of the utility and validity of methods of investigation, in the context of a particular scientific discipline or area under consideration. Also the selection of such methods, in advance of an investigation, that are considered likely to be appropriate and fruitful (Roberts, 1971).

Methodology is thus concerned with various models, classifications, and conceptual schemes that exist, the techniques that are available for investigatory purposes, research procedures used in the past, and their validity, etc., all for the purpose of discovering new knowledge and ordering it meaningfully, or in order to test existing propositions (Roberts, 1971).

Scruton argues that methodology is a word that should mean the study of methods, but is often used simply to mean "method", as in "the methodology of the social sciences". If there is a subject then there is a method of investigation determined by it. There may be more than one method used to discover some matter, and in this case it is possible to speak of methodology, as the discipline which attempts to describe the method which best achieves the required result (Scruton, 1982).

In short, methodology is a system of explicit rules and procedures on which research is based and against which claims of knowledge are evaluated. (Nachmias and Nachmias, 1992).

6.3. Research Methodology

The main objective of this study is to examine and evaluate the usefulness of companies annual reports for the investment analysts as sophisticated investors in Saudi Arabia. This section discusses research methods that have been adopted in previous studies concerning the usefulness of the information provided in the financial statements. The methods that were considered are the main two methods which were commonly used in previous studies and these are interviews and postal questionnaires.

6.3.1. Interview Method

Nachmias, and Nachmias (1992) stated that "the interview can be regarded as face-to-face interpersonal role situation, in which the interviewer asks respondents questions designed to obtain answers pertinent to the research hypotheses. The questions, their wording and their sequence define the extent to which the interview is structured".

The interview method has been used in a number of previous studies regarding the usefulness of the information provided in financial statements such as Mason (1971), Briggs (1975), Lee and Tweedie (1981), Arnold and Moizer (1984), Day (1986), Gniewosz (1990) and Bence, Hapeshi and Hussey (1995).

6.3.1.1. Advantages of Interview Method

Using the interview method as a technique of data collection has many advantages. The interview method is considered to be the most effective method in achieving a high response rate and that is because of the interviewer can increase the chances that the individual will participate in the study by arousing his or her initial interest (Warwick and Lininger, 1975). However, some authors argue that the high response rate might be true in general population samples, but when we are dealing with specific or more homogeneous groups mail surveys seem to be about as good as interviews (De Vaus, 1996, p. 99 and Oppenheim, 1992, p. 81).

In terms of question design, control in the process of questioning and in the context which questions are asked and answers given, the interview method provides the greatest flexibility. When an item is not understood the interviewer can repeat it and also clarify ambiguous answers. More importantly, the interviewer can improve the quality of the data by probing for added detail where response is incomplete or seemingly irrelevant. Moreover, the interview method performance is good in handling complex questions that could not be included in a postal questionnaire either because of the difficulty of answering them or because of the difficulty in recording the answers correctly (Hoinville, 1978, p. 99 and De Vaus, 1996, p. 101). Finally, according to Oppenheim (1992) it can be said that the longer, the more difficult and the more open-ended the question schedule is, the more we should prefer the use of interviews.

6.3.1.2. Disadvantages of the Interview Method

Using the interview method has several disadvantages. One major problem can arise in obtaining accurate answers from respondents. Responses to sensitive or controversial questions can be affected by social desirability considerations: getting acceptable rather than true opinions as people sometimes say things intended to put them in a good light or try to avoid offending others. However, such things may lead to bias in the information gathered. Another problem which has been mentioned concerns the inference of the responses by the interviewer. There are issues regarding whether or not the data collected by interview on such matters as attitudes, beliefs and actions are adequate surrogates for data about actual activities (De Vaus, 1996 and Ackroyd and Hughes, 1992).

The most serious problem of the interview method relates to its implementation. De Vaus (1996) states that "personal interviewers require careful training, need to be available for night and weekend work, must be willing to face potentially unpleasant situations alone and be able to approach strangers, and need to have the personal skills to conduct an objective interview. Because of difficulties in readily obtaining such interviewers it is often necessary to rely on less than well trained or committed people thus creating the possibility of not following proper sampling procedures, subversion, expressing their own opinions and responding inappropriately to the respondent's answers. This undermines many of the potential advantages of the face-to-face interview" (p. 111).

"The principal application of the interview in social science", as John Madge says, "is its use for the purpose of making people talk about themselves" (Madge, , 1965). As such, interviews for social research purposes have certain disadvantages. The most important of these is perhaps the fact that the interviewer is a supplicant dependent on the good will of the respondent. It is the interviewer who is asking for the help. (Stacey, , 1970).

The predominant interest of early research workers in the interview method was in biasing influence of interviewers' opinion. Would such opinions, if strongly held, communicate themselves to respondents and influence their answers? If the interviewers' opinions were evident from the way they asked the question, then some respondents would undoubtedly tend to agree - or disagree- with them, depending on their temperament. Or, if their opinions influenced the way interviewers interpreted - and coded- doubtful answers or paraphrased the replies to open questions, bias would result (Moser and Kalton, 1993, p. 277). However, Cicourel states that a strong argument can be made for eliminating much interviewer bias by the introduction of a fixed-choice questionnaires. Standardised questions with a finite number of choices that are self-administered give the appearance of objectivity and lend themselves to translation into numerical representations (Cicourel, 1964,p 105). Fixed choice questions supply the respondent with highly structured clues about their purpose and answers expected (Cicourel, 1964).

The respondent may give an answer other than the correct one because he lacks the knowledge to give the latter, because his memory plays him false, because he misunderstands the question or because consciously or unconsciously, he does not wish to give the correct answer. Although such errors are appropriately laid at the door of the respondent rather than the interviewers, the root cause is essentially the reaction of one to the other (Moser and Kalton, 1993).

Carelessness in recording is another potential source of error. Interviewers may omit to record answers, or may record them incorrectly or ambiguously. If a respondent gives a long rambling answer, the interviewer may, perhaps unconsciously, select for recording that part of it which tallies best with the other answers (Moser and Kalton, 1993).

The subjective nature of the interview is another disadvantage which may result in bias and error. Interviews with persons who play a role in the investment activities might help to supply useful information. However, the problem here is that the interviewees might resort to an answer which caused the least pain and embarrassment but which is often not completely in accord with reality (Astal, 1995).

One grave danger of relying on the information provided by the informant through discussion is that the conclusions or inferences drawn from such information may tend to get coloured by the personal prejudices of the informants (Dasgupta, 1968).

One of the limitations of the interview is the involvement of the individual in the data he is reporting and the consequent likelihood of bias. Memory bias is another factor which renders the respondent unable to provide accurate information and the inability of the respondent to provide certain types of information (Festinger, and Katz,, 1954, p. 330).

6.3.2. The Questionnaire Survey

A questionnaire is a highly structured data collection technique where by each respondent is asked the same set of reformulated written questions. The questionnaire can be carried out either by mailing it to respondents or by personal administration whereby the questionnaire is presented to the respondents with explanation of the purpose of the inquiry, and then the respondent is left alone to complete it, which will be picked up later (Oppenheim, 1992).

With regard to the usefulness of the information provided in financial statements the questionnaire survey has been used in several previous studies such as Baker and Haslem (1973), Lee and Tweedie (1975 and 1976), Chenhall and Juchau (1977), Chang and Most (1977 and 1985), Anderson (1981), Ahmad (1988), Abdelsalam (1990) and Ba-Owaidan (1994).

6.3.2.1. Advantages of Questionnaire Survey

A self-administered questionnaire is the best technique for collecting data when we are dealing with a survey that is confined to a local area. This method of data collection ensures a high response rate within a short period of time. Using this method also gives the researcher the chance to introduce the research topic and motivates the individual to participate in the survey. Another advantage associated with the self-administered questionnaire is that it is less expensive (i.e. low cost) and less time-consuming than interviewing and it requires fewer skills to administer than to conduct interviews (Sekaran,1992, p. 201).

Wide Geographical Area

A related advantage of postal surveys (questionnaires) is that they can reach isolated areas and those members of the population whom interviewers find it difficult to catch at home. When the people to be surveyed are widely spread geographically then the questionnaire may be the obvious method for making contact, since interviews could well be impossibly expensive. The mail questionnaire is usually used when the survey covers a wide geographical area. A major advantage of this method is the low cost of data collection when compared with interview surveys and the low cost of processing also. When we are dealing with respondents that request complete anonymity when answering the questions the mail questionnaire is again the best method. Using the mail survey will also result in the elimination of the major problem associated with interview survey which seriously undermine the reliability and validity of the survey and that interviewer error and bias. Mail questionnaires allows for more time when questions demand a considered rather than immediate answer, especially, if the answer requires a consultation of documents. Moreover, the mail questionnaire is considered to be the least demanding in terms of its implementation such as staffing requirements compared with all other methods (Moser and Kalton, 1993 and Oppenheim, 1992).

Impersonal

It can also be urged that one attraction of a well-designed questionnaire is that it is impersonal. By this the researcher means that there can be no possibility of interviewer bias when there is no interviewer, the respondent does not have to tell a *person* anything and so long as the questionnaire is well designed then respondents receive the same stimuli in the same order. This may appear to make the stimulus-response situation rather more "mechanical", but in some research this may not matter too much. Not every survey needs to probe into people's innermost thoughts and any questionnaire can quite easily include attitude questions ad open-ended questions where people write in whatever they want to say (Mann, 1985)

Low Cost

On cost grounds a postal questionnaire (survey) has considerable advantage over and interview survey. Economy is one of the most obvious appeals of mail questionnaires. Unlike the interview, the mail questionnaire does not require a trained staff of interviewers; all it entails is the cost of planning, sampling, duplicating, mailing, and providing stamped, self-addressed envelopes for the returns. Processing and analysis are usually also simpler and cheaper than for other survey methods. The lower cost in the administration of a mail questionnaire is particularly evident when the population under study is widely spread geographically. Under such circumstances, the cost of interviewing could become prohibitive, and the mail questionnaire may be the only practicable instrument (Nachmias and Nachmias, 1992).

Reduction in Biasing Error

The mail questionnaire reduces "biasing errors" that might result from the personal characteristics of interviewers and the variability in their skills. Personal interview situations are fraught with possibilities for bias due to the nature of the interaction between the interviewer and the respondent. This can be completely avoided with mail questionnaires (Nachmias and Nachmias, 1992).

Greater Anonymity

The absence of an interviewer also provides greater anonymity. The assurance of anonymity with mail questionnaires is specially helpful when the survey deals with sensitive issues. On such issues, a mail questionnaire may elicit a higher response rate than a personal interview (Nachmias and Nachmias, 1992).

Considered answers and consultations

Mail questionnaires are also preferable when questions demand a considered (rather than immediate) answer or if answers require consulting personal documents or other people (Nachmias and Nachmias, 1992). Mail questionnaire (postal survey) also allow respondents time to reflect on the questions (and possibly to look up records). The presence of an interviewer may inhibit some respondents from taking time to look up information or cause people to answer inaccurately.

Flexibility of Mail Questionnaire and Self-administered questionnaire (survey)

Another related advantage of postal survey is that it can be used in conjunction with other methods such as a self-administered survey; interview surveys and self-completion supplements which can be left with the respondents at the end of an interview to be returned by post. This can be useful if respondents need to read through some material (e.g. planning proposals,) before completing part of the questionnaire or to consult other staff members (Hoinville and Associates, 1978).

Response Rate: Postal Survey vs. Interview

Since the postal survey is carried out without the benefit of personal contact between respondents and interviewers (to introduce, complete and return questionnaires), many people assume that they will automatically generate low response levels and poor questionnaire completion. This is not so. Both the level and quality of response are frequently equal to, and some case better than, those achieved in interview surveys. (Hoinville and Associates, 1978).

6.3.2.2. Disadvantages of the Questionnaire

There are a number of disadvantages attached to the mail questionnaire. It requires simple questions. The mail questionnaire can be used as an instrument for data collection only when the questions are straightforward enough to be comprehended solely on the basis of printed instructions and definitions(Nachmias and Nachmias, 1992).

There are some disadvantages associated with the mail questionnaire, one of them is the low response rate in general. For many mail surveys, the reported response rates are much lower than for personal interviews. However as mentioned before this might not be true in all cases. The researcher can overcome such a problem by using complementary methods.

No opportunity for probing answers is given to the researcher who is using a mail questionnaire. Because no personal contact is involved, mail questionnaires have difficulty in coping with boring questions and non-response items and no opportunity to correct misunderstandings or probe, or to offer explanation or help (Oppenheim,1992). The answers have to be accepted as final, there is no opportunity to probe beyond the given answer, to clarify ambiguous answers, or to appraise the non-verbal behaviour of the respondents (Nachmias and Nachmias, 1992).

With a mail questionnaire, researchers have no control over the respondent's environment; hence they cannot be sure that the appropriate person completes the questionnaire. An individual other than the intended respondent may complete it (Nachmias and Nachmias, 1992)

A good response rate is very important in any survey and it is the proportion of replies to numbers of questionnaires that matter, not just numbers. One must also be careful not to overload a questionnaire with too many, or too complicated, questions. Every respondent can look through the whole of a questionnaire before even answering the first question and if it seems too much then the response may well be lost all together. Also, in reading through all the questions, the respondent may read into the whole questionnaire certain implications that were never intended. Without interviewer to keep the responses on the right lines the self-completed questionnaire has a lot of work to do on its own. Of course some people are disinclined to commit themselves to paper anyway and, no matter how much the covering letter may assure them that the replies are anonymous and the forms will be destroyed, recipients may still remain suspicious. Unless the recipients have both an interest and a trust in the purpose of the survey they may well decide not to help (Mann, 1985).

There is also a problem that can arise with questionnaires, of people simply entering replies in wrong boxes. Human errors, which an interviewer could easily, go uncorrected when the respondent is alone (Mann, 1985).

To have control over who completes the questionnaire is a necessary step to obtain a representative sample. With mail questionnaire this seems to be difficult, even though we can ask for the appropriate person to fill out the questionnaire, we cannot be sure that this happens (De Vaus, 1996). It may be noted that some of the disadvantages of the mail questionnaire can be overcome by combining it with a self-administered questionnaire. Thus questionnaires can be sent by mail and collected personally whereby answers can be checked to insure complements and difficulties can be clarified.

6.4. Research Method Used in The Survey

Having discussed the two main methods commonly used in previous studies, regarding the usefulness of the information provided in the financial statements, we must decide which method can be used. According to De Vaus (1996, p.113) it is impossible to decide which method is the best. The relative strengths and weaknesses vary according to the characteristics of the survey. There are many factors affecting which method is the most suitable for a survey such as the purpose of the study, sample size and distribution, the time available and the environment and conditions under which the study is conducted.

Since the main objective of this study is to reveal the views of investment analysts regarding the usefulness and the importance of companies annual reports for investment decisions or recommendations, therefore we are dealing with a specific educational group where such a study would be in their interest due to two reasons. Firstly, it is related to their job and daily work and should also therefore be related to their educational background. Secondly, the study findings which depend on the investment analysts participation might facilitate their job in the future. Therefore, situations like this will undermine many of the mail questionnaire disadvantages. The environment in which investment analysts in Saudi Arabia are working puts some limitations on gaining access to them since their organisations may be reluctant to allow access to employees, especially if the interview method was used as it would take up a lot of the valuable time of these investment analysts. Confidentiality and anonymity are paramount requirements for obtaining co-operation in the investment community in Saudi Arabia. As far as these requirements are concerned the mail questionnaire is considered to be the best in dealing with them. Moreover, the purpose of this study is to obtain the views of as many investment analysts as possible, so it would not be practical to use the interview method because it is too time-consuming.

In view of the above factors and to cope with the main disadvantages of a mail questionnaire, a combination of self-administered and mail questionnaires were chosen to be used in this study.

6.5. Questionnaire Design

There are two basic goals in questionnaire design: (1) to obtain information relevant to the purposes of the survey and (2) to collect information with maximal reliability and validity. These goals can be called "relevance" and "accuracy". To ensure relevance, the researcher must be clear about the exact kinds of data required in the study. Accuracy is enhanced when the wording and sequence of the questions are designed to motivate the respondent and to facilitate recalls (Warwick and Lininger, 1975, p. 46).

In designing questions and questionnaire schedules the first question that needs to be addressed concerns the objective of the study. What information is the questionnaire intended to elicit from the respondent? (Ackroyd and Hughes, 1992, p.74).

Questionnaires may be administered to respondents by interviewers or may be "self-completed". The two situations require different approaches to questionnaire design (Rose, 1992).

Since the questionnaire technique was chosen, as the discussions in the previous sections concluded, based on the conditions and the environment under which the study was undertaken, it is necessary to know how to design an effective questionnaire. The questionnaire is considered to be effective if it suits the study's aims and the nature of the respondents. A good questionnaire has to be clear, unambiguous and encourage the respondents participation.

6.5.1. Questionnaire Wording

The question must be worded so that the respondent understands it (Nachmias and Nachmias, 1992). The principle of question wording is an essential factor affecting the designing of an effective questionnaire. According to Kervin (1992) good question wording accomplishes the following objectives:

- It ensures measurement validity: the question must measure what you want it to measure.
- It minimises measurement errors: bias and unreliability.
- It minimises item non-response.

Proper attention should be paid to the design of questionnaires and the wording of questions. One major distinction is between questions which are "fixed-choice" (e.g. How long have you lived at this address? Less than a year/1-2 years/Over 2 years?) and the "open-ended" (e.g. What do you think of the market situation?) (Rose, 1992).

6.5.2. Question Wording and Order

The foundation of all questionnaires is the question. The wording of the question is as important as the form. A question should be free of ambiguity, precise and clear and each question should express a single idea. The questionnaire must translate the research objectives into specific questions; answers to such questions will provide the data for hypothesis testing. The question must also motivate the respondent to provide the information being sought. The major considerations involved in formulating questions are their content, structure, format, and sequence (Nachmias and Nachmias, 1992).

The questions which are predetermined may also be divided into those which are "open-ended" and those which are closed. In open-ended questions respondents are free to reply to the questions in any way they wish. In "closed-ended" questions they must reply in one of a predetermined number of ways such as "yes", "no", or "don't know" (Stacey, 1970). The disadvantage of open-ended questions is that they produce a mass of different words meaning the same thing, and some using the same words and meaning different things. Open-ended questions are often necessary, particularly in matters to do with beliefs and feelings (Stacey, 1970). Moreover, the open-ended question has many other advantages stemming from the fact that the respondent is encouraged to structure his answer as he wishes. This provides a means for obtaining information which cannot be obtained adequately by use of a closed question (Festinger and Katz, 1954). Another advantage of the open-ended question is the information which the answers indicate with respect to the respondent's level of knowledge or degree of expertness (Festinger and Katz, 1954).

Careful attention to the order in which the questions are asked is important for three reasons (Kervin, 1992):

- A logical flow of questions helps guide respondents through the instrument with a minimum confusion and frustration. Topics that are raised once should not be raised again later in the instrument.

- Asking a right question at the right time, especially the opening and closing questions, can increase respondents' commitment to the questionnaire or interview and reduce item non-response.
- The influence of earlier questions on the answers to later ones, known as "order effect", can be reduced through attention to question sequence

The general order of questionnaire's questions should be based on the principle of "funnelling" and the implicit logic of the variables. Includes bridges and filter questions where necessary (Kervin, 1992).

6.5.3. Funnelling

The order of questions is another matter which needs careful attention: initial questions may predispose answers to late ones. A technique known as "funnelling" in which more general questions are followed by more specific ones amplifying the general ones can be useful in guiding the interviewer through the schedule and encouraging the respondent to give fuller answers (Ackroyd and Hughes, 1992).

Arrange the questions on a particular topic in a funnel order. Begin with the most general ones and then move to increasingly specific items. This provides a natural focus for the respondent's thoughts as the researcher moves to the specific topics of interest. (Kervin, 1992)

6.5.4. Implicit Logic

In questionnaires, particularly, the sequence of questions should natural flow the logic implicit in the topic. Failure to follow a logical pattern can frustrate and confuse respondents.(Kervin, 1992).

6.5.5. Bridges

Bridges are short phrases that introduce the next section of the questionnaire. They help to keep smooth flow, break up the monotony of questions, and can help the respondents shift mental gears and adopt the desired frame of reference for the next set of questions.

6.5.6. Filter Questions

Not all questions will be relevant for all respondents. To minimise respondents frustration with inapplicable items, filter questions can be used to determine whether a set of questions is relevant. (Kervin, 1992)

6.5.7. Sequencing Questions

Sequencing questions can play a helpful role in easing the respondent into the interview. Uncontroversial and fairly routine questions should normally come at the beginning, leaving personal and more intimate ones for later (Ackroyd, and Hughes, 1992).

6.5.8. Skills needed to write a good questionnaire

Writing a good and effective questionnaire requires many skills. First, to be clear and specific by avoiding vague and general words and phrases and avoiding the use of ambiguous terms. The second skill relates to the use of appropriate language. The level of sophistication of the language and vocabulary used have to be comprehensible to all respondents. The third skill associated with question wording is neutrality. Questions should not be phrased in such a way that they lead the respondents to give answers that the researcher would like them to. The last skill relates to maintaining relevancy by asking only questions applicable to the respondents and justifying questions that appear unrelated to the research (Kervin, 1992).

6.5.9. Types of Questions and the Respondent

Another important factor in writing questions is the distinction between question types and responses format. There are two types of questions, factual and attitude. Factual questions ask for information about characteristics, behaviours, events and experiences. Attitude questions ask about attitude, beliefs and feelings. With regard to the format of responses there are two types, open and closed response. A closed response question is one in which the respondents are offered a choice of alternative replies and asked to tick or underline their chosen answers. The closed questions are easy and quick to answer and easy to analyse too. A disadvantage of closed questions is the loss of spontaneity and expressiveness. Open response questions are not followed by any kind of choice and the answers have to be recorded in full. The main advantage of the open question is the freedom it gives to respondents in answering questions. However, the open questions are often easy to ask, difficult to answer, and still more difficult to analyse (Oppenheim, 1992).

To overcome the main problem associated with mail questionnaires which is the low response rate, there are many factors which have been found to increase the response rate, these are the following (Oppenheim, 1992, Kervin, 1992 and De Vaus, 1996):

- **Sponsorship**: this may take the form of the researcher identification card with a pamphlet describing his organisation, or a letter of introduction from someone expected to be influential.
- **Envelope**: to get the respondent to open the envelope, it is important to personalise it and make it look professional. A stamped, self-addressed envelope should be included to minimise the effort involved in returning the questionnaire.
- **Confidentiality**: to overcome any possible apprehensions, respondents must be ensured that all survey data will be treated as confidential and only the researcher will have access to them.
- **Prenotification**: a telephone call in advance of a mailed questionnaire can bring a significant improvement to the response rate.
- **Salience**: if the respondent is identified as a member of a particular group rather than just a member of the general public, and the questionnaire addressed an issue of some important to the group this will lead to a substantial improvement in the response rate.
- **Length**: number of pages and time required to complete the questionnaire are believed to affect the response rate.
- **Follow up**: reminders are needed to increase the response rate by providing an opportunity to persuade the respondent to complete the questionnaire.

6.5.10. Cost

Cost is another element which may be taken into consideration in designing a questionnaire. With the spread of computer typesetting and the increasing use of word processing today, it is much easier now for researchers to get well-produced questionnaires at quite reasonable costs. A properly printed questionnaire probably still looks the best of all, but some very good results can be obtained from cheaper methods. Once again, costs will often determine what can be done. If the researcher does become involved in a very large-scale and expensive survey it may well be worthwhile taking advice from a qualified designer who can advise on layout and type-face. The only caution against this is that sometimes they put art before utility. (Mann, 1985).

A last point to consider is that questionnaires nearly always have to be folded into envelopes and will receive a fair amount of manhandling before they are dealt with. A good-quality paper is a sensible investment. Not only does the quality surface give a satisfactory appearance, but it means that by the time the document gets to the coders it will not be just a tattered wreck. (Mann, 1985).

Undoubtedly, a great attraction of the questionnaire (in particular self-completed questionnaire), compared to the interview, is its cheapness. Interviews are expensive in time and labour and therefore are bound to be costly per informant reached. The questionnaire gets the informants to do more of the work for the researcher.

Generally speaking, the self-completed questionnaire is a very valuable research tool which should be used carefully and with discrimination. It is best suited for particular groups of people who are spaced geographically and who may be expected to have an interest in the topic under survey. It cannot get the "depth" that a good personal interview can achieve, but it is very well suited to "breadth" and can include interesting, and even stimulating, questions if it is well designed. (Mann, 1985)

6.6. Questionnaire Design and Designing the Questionnaire used in this study

In designing the questionnaire used in this study most of the above factors had to be taken into account. The questionnaire consists of thirteen pages including the cover page which was used to state briefly the objective of the questionnaire and also to ensure the confidentiality of all information provided and that information will be used for the purpose of the study only. To encourage investment analysts to participate and respond to the questionnaire we must ensure the confidentiality with regard to the questions content by avoiding asking certain questions to obtain information the investment analysts are not willing to reveal, such as questions regarding their clients or the size of their holdings. In order to maximise the response rate the questionnaire was aimed to emphasise the investment analysts views regarding the research topics instead of asking questions that reveal what might be considered as confidential disclosure. Moreover, to ensure anonymity of the respondents no questions were asked to directly identify the respondents or their organisations.

The questionnaire used in this study was based on earlier studies such as Lee and Tweedie (1981), Chang and Most (1977) and (1985), Anderson (1981), Ahmad (1988) and Abdelsalam (1990). However adjustments were made on the original questions to match the specific objectives of this research and financial reporting and investment environment in Saudi Arabia.

The questionnaire was divided into two parts The first part dealt with the respondents background by asking them five questions related to their university degree , educational background, experience, position in the management hierarchy and types of decision . One aim of this part was to obtain a profile of the respondents who participated in this research . Moreover the major objective of this part was to use the background information when we analyse the data obtained from part two of the questionnaire to see if these background elements have any effect on the respondent's answers.

The second part of the questionnaire was designed to focus on the main objective of the study which is revealing the investment analysts views of companies annual reports in Saudi Arabia and the importance they attached to them in their investment activities. This part consists of eight questions. The purpose of the first question was to evaluate the importance of the various sources of information and how the corporate annual reports stand between them. Using a scale of five where one means "very important" and five "not important at all", respondents were given eight sources of information to evaluate. The respondents were also given the choice to state any other source of information they may find important. To be more specific with regard to the importance of these sources of information the respondents were asked in the second part of this question to rank them. To find out the uses of corporate annual reports respondents, in the second question, they were given eight investment activities and asked to evaluate them using the same scale used in the first question. The importance of this question is to indicate the degree of involvement the corporate annual reports have in the investment activities.

The third question dealt with the importance of the various sections of corporate annual reports. Seven sections of the annual reports were presented to the respondents to evaluate them using the same scale used in previous questions. These sections are: income statement; balance sheet; directors report, auditor's report; statement of changes in financial position; statement of accounting policies; and notes to the accounts. These sections were chosen based on the accounting reporting environment in Saudi Arabia and the requirements of the General Presentation and Disclosure Standard which was issued by SOCPA[1] (see chapter 4). The second part of question three asked respondents to rank these sections.

The aim of question four was to indicate the degree of accounting adjustment (major, minor or no adjustment) the investment analysts usually make for various items in companies financial statements. The items in the companies financial statements include fixed assets valuations; annual depreciation expense; inventory valuations; earnings per share; extraordinary items; intangible assets such as goodwill; effects of changes in exchange rate; investment and other. Moreover, the second part of this question dealt with the importance of the causes of such adjustment. The respondent was asked "if you do adjust one or more of the above items what is the importance of the following: valuation base; recognition of revenue; determination of cost and other."

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[1]Saudi Organisation for Certified Public Accountants.

The respondents perceived understanding, relevance and confidence of corporate annual reports was the purpose of question five. In the first part of the question the respondents were asked to indicate their degree of understanding of the information contained in the company annual report (fully understand; understand; 50 % understand; little understand and do not understand). They were also asked to indicate the degree of relevancy of the information contained in company annual reports with regards to investment decisions (very relevant; relevant; 50% relevant; little relevance and no relevance). In the third part of question five the respondents were asked to indicate the degree of confidence in using the company's annual reports for investment decisions (very confident; confident; 50% confident; little confidence; and no confidence).

The last three questions of the second part of the questionnaire were aimed to reveal the investment analysts views in improving the accounting reporting in general in Saudi Arabia.

In question six the factors that affect the confidence in using corporate annual reports in investment activities were presented to the respondents to evaluate them using a scale of five: greatly increase confidence; increase confidence; no change in confidence; decrease confidence; and greatly decrease confidence. Four factors were given to the respondent in question six. These factors are: all companies using a standard format for presenting financial statements; audit carried out by an international firm of accountants; accounting standards are set by an independent body instead of the government; and increasing government regulations concerning the preparation of company annual reports. The respondents were given the opportunity to add other factors.

Question seven is associated with the respondents attitude toward the presentation of financial statements and accounting profession practices. Seven sentences (statements) were presented to respondents to indicate their degree of agreement or disagreement using a scale of five: "strongly agree"; "agree"; "indifferent"; "disagree"; and "strongly disagree". The sentences which were presented to the respondents were: all accounts presented by companies should be standardised; the ability of the company's management to decide which reporting practices to use should be restricted; all companies should prepare their financial statements using the same accounting practices; the company's external auditors are independent of management influence; the SOCPA (Saudi Organisation for Certified Public Accountants) should enforce strictly its rules of professional conduct; the auditors exercise strict rules regarding codes of ethics and standards of professional behaviour; and the auditors qualifications and experience are adequate to prevent abuse and misrepresentations in the accounts of companies.

The last question asked about the usefulness of additional disclosure of items that are not currently published regularly for the investment analysts in their investment activities. The respondents were asked to express their views about how they would rate the usefulness of seven items if they were regularly published in annual reports. These items include future of the company; general economic condition; directors of the company and senior management; expected profits for next year; dividends forecast for next year and financial policy of the company. The respondents were given the opportunity to add other items. A scale of five was also used in answering the question: "very useful"; "useful"; "neutral"; "not very useful"; and "not useful at all".

The final issue that had to be dealt with regarding the questionnaire design was the translation. Because the respondents might not have been able, or had some difficulties in answering an English questionnaire, a multi-language questionnaire (English and Arabic) was used. A copy of the questionnaire is shown in Appendix A.

As it can be seen from the above, the questionnaire was designed to suit the study objective and the nature of the respondents. The questionnaire was also designed to be easy to answer and easy to analyse the data obtained, as the scaling system was used. Moreover, the questionnaire was designed to fit the criteria that was discussed earlier in this chapter for designing an effective questionnaire. For example, with regard to question wording it can be seen by looking at the questionnaire in Appendix A that all questions are clear, precise, free from ambiguity and each question expresses a single idea. Another example is the application of the funnelling technique which suggests that the questions should be arranged to begin with the most general ones and then move to increasingly specific items. As can be seen from the questionnaire it follows this pattern. The questions were arranged as follows: the importance of various sources of information, the uses of the corporate annual report, the importance of the various sections in the corporate annual report, the level of adjustments and reason for adjustment.

6.7. The Pilot Testing

Once the questionnaire has been developed, each question and the questionnaire as a whole must be evaluated. Such pilot work was useful in refining the wording, ordering, layout and filtering and in controlling the questionnaire length. Although the questionnaire used in this study was based on previous studies, there still remains the task of making quite sure that this will work with our population and will yield the data required. One of the main objectives of the pilot testing was to make sure that the translation would not lead to any misunderstanding of the questionnaire. Oppenheim (1992) stated that "the translation of questionnaires from one language to another is akin to entering a series of mine fields" , because of that more consideration was given to the translation process in the pilot testing .

In carrying out the pilot work, twenty investment analysts were interviewed in Saudi Arabia. The questionnaire was presented to these investment analysts and they were asked about each individual question and about the questionnaire as whole. As a result, some changes were made to the questionnaire, most of them relating to the translation. For example, the translation of some of the terminology may cause confusion if there are no terms in Arabic that can match them as in the case of credit rating. There is no term or two words in Arabic that give you the same meaning that this term gives in English. So it has to be spelt out in a long sentence which may be expressed in different ways. To overcome this problem more than one sentence was presented to the analysts to see which was the most appropriate translation. the majority view was then accepted. This indicates one possible source of ambiguity but as has been explained every attempt was made to minimise it.

6.8. The Sample and the Questionnaire Distribution

The ideal way of selecting a representative sample in a research survey is to draw or select individuals from the target population. The selection of such samples requires a sampling frame, that is a list of all cases within the target population being included in the study which is, in this research the investment analysts in Saudi Arabia.

Unfortunately, such lists for investment analysts do not exist in the Kingdom. Hoinville and Jowell (1978) suggested an alternative method for sampling such a small professional group and that is through intermediate units. For the purpose of this study the intermediate units were the organisations that normally employ investment analysts. These organisations are commercial banks, investment firms and investment consulting institutions. Lists of the investment firms and investment consulting institutions which are involved in local shares investment activities were obtained from the Chambers of Commerce and Industry in the three main regions of Saudi Arabia (Eastern, Central, Western). Table 6-1 shows that there are sixty-three investment firms and investment consulting institutions distributed in all three regions. Add to this number the twelve commercial banks operating in Saudi Arabia (see chapter 2) and a total of seventy-five organisations were available to be intermediate units. Since this number is considered to be small it, was decided to approach all these organisations to get as many as possible of the investment analysts to participate in this survey. The questionnaires were distributed to these organisations to be redistributed to the investment analysts employed by them.

Table 6–1

The Number of Investment Firms and Investment Consulting Institutions Which are Involved in the Local Shares Activities in the Three Main Regions in Saudi Arabia

Name Of The Region	Investment Firms		Consulting Firms		Total	
Eastern Region	9	20%	3	18%	12	19%
Central Region	22	48%	9	53%	31	49%
Western Region	15	32%	5	29%	20	32%
Total	**46**	**100%**	**17**	**100%**	**63**	**100%**

As discussed earlier in this chapter a combination of two methods, posted questionnaire and self-administered questionnaire, were chosen for carrying out this survey. The reason for this choice was to cope with the major problem usually associated with using posted questionnaires alone, which is the poor response rate. It was believed that hopefully by applying this combination method the response rate would be increased.

As can be seen in Table 6-2 the total number of questionnaires distributed was two hundred and forty nine questionnaires. A total of seventy six questionnaires were distributed personally which represents 31% of the total questionnaires distributed. The rest of the questionnaires were distributed by post.

With regard to the procedure of carrying out the self-administered questionnaires the following steps were taken:

- Prenotification telephone calls were made to set appointments to visit these organisations.
- The researcher visited several organisations from all the groups, investment firms, commercial banks and investment consulting institutions.
- During these visits the researcher held meetings with the investment analysts employed by these organisations. In some cases the meetings took the form of group meetings where more than one investment analyst was present at the same time. In the other cases the researcher had to meet with each investment analyst separately.

- In these meetings the researcher explained the objective of the questionnaire, emphasised the importance of the investment analysts participation for the research project and answered their questions.
- Then the questionnaires were left with the investment analysts to complete them to be collected personally later.

Table 6–2

The Number of Questionnaires Distributed

Name Of Organisation	No. Quest Personally	%	No. Quest Posted	%	Total	%
Investment Firms	41	54%	97	56%	138	55%
Commercial Banks	18	24%	42	24%	60	24%
Consulting Institutions	17	22%	34	20%	51	21%
Total	**76**	**100%**	**173**	**100%**	**249**	**100%**

Quest.: Questionnaire.

For the posted questionnaire packages which consisted of a set of questionnaires, a stamped self addressed envelope and a covering letter briefly outlining the objective of the questionnaire and ensuring the confidential treatment of all the data obtained, were sent to the investment analysts through their organisations which belong to the various groups of the target population. Moreover, follow up and reminder letters were sent out fifteen days after the questionnaires were posted. The purpose of these letters was to encourage the investment analysts to respond to the questionnaires by emphasising the importance of their participation in insuring the success of the research project.

Using both methods, self-administered and posted questionnaire, a total of two hundred and forty nine questionnaires were distributed to the investment analysts in seventy five organisations. The response rate to the questionnaires will be discussed in the next chapter.

6.9. Summary

Although two main methods (interview and questionnaire) have been outlined, various combinations of these methods can be developed. For example, interviews can be supplemented by a leave-behind questionnaire that the respondent mails back later. Mail surveys can be supplemented by a follow-up telephone interview. Longitudinal surveys might commence with interviews at the first stage but once personal contact has been established in this way, mail or telephone methods might be used for further stages.

The decision about the method by which a questionnaire will be administered must take into account the content matter of the survey, the nature of the survey population, the importance of sample quality and size and amount of time and money available. Once a decision about method is made, attention has to be given to motivating the respondent to participate, ensuring that the information provided is complete and accurate and on the way to successfully completing the administration phase.

The first aim of this chapter was to describe in detail the two methods (interview and posted questionnaire) that were considered in carrying out the survey among the investment analysts in Saudi Arabia. These two methods were chosen because they were the most common methods used in similar previous studies. The advantages and disadvantages of these two methods have been discussed. Based on this discussion and in view of the study's objectives and the environment and conditions under which the study was conducted, it was decided that a combination of postal and self-administered questionnaire would be the most suitable technique to be employed.

Another major aim of this chapter was to discuss the designing of a good and effective questionnaire. Many factors affect the designing of a good questionnaire, such as question wording, question types and response formats, which were presented and discussed. The factors that were considered to be helpful in increasing the response rate, which is considered to be the major problem associated with posted questionnaires, were also presented.

The questionnaire used in this study consisted of two parts. The first part dealt with the respondents' background and the second part focused on revealing the investment analysts views of companies annual reports and their importance and uses. The questionnaire questions and their order have been reviewed and the aim of each question has been discussed and clarified. To test the questionnaire a pilot study was carried out using the interview method with a number of investment analysts in Saudi Arabia.

To cope with the wide geographic area of Saudi Arabia, the researcher was flexible in using the technique of interview in a pilot testing of the questionnaire and another two techniques in distributing the questionnaire: the mail questionnaire and self-administered questionnaire.

Finally, this chapter discussed the sample and the distributing procedures with regard to both the posted and self-administered questionnaire.

Chapter Seven
The Survey Response and the Respondents Background Characteristics

7.1. Introduction

The method that has been used in carrying out this survey was presented in the previous chapter. The results of the initial analysis of the questionnaire will be discussed in this chapter. In doing so this chapter is divided into three sections. A brief discussion of the statistics tools and tests that have been used in carrying out the analysis of the data obtained from the survey is given in the first section. In the second section the survey response is presented together with the results of the non-response bias test that was carried out to be more confident in generalising the results obtained from this survey. The third section of this chapter is concerned with the profile of the respondents who took part in the study.

7.2. Analysis of data

Data obtained from the questionnaires were entered into a computer file where the Minitab for Windows Release 10 which is considered to be a powerful statistical software package was used in processing and analysing the data (Bryman and Cramer, 1996). Descriptive statistics as well as inferential statistics were used in examining the data obtained from the survey. Descriptive statistics allow us to know how frequently certain phenomena occur (frequencies) and what is the average score when a set of figures are involved. The arithmetic mean was computed in order to provide a single figure that would summarise the responses and serve as a basis for comparing the degree of importance the respondents attribute to each variable (Cohen and Holliday, 1982).

Furthermore, the standard deviation, which is the most commonly used and the most important measure of variability, was also used to determine whether the scores are generally near or far from the mean. In other words, the standard deviation approximates the average distance from the mean. The coefficient of variation was also used to relate diversity of responses to the average response. This measurement was needed because the standard deviation is expressed in absolute terms and given the same unit of measurement as the variable itself. There are occasions, however, when this absolute measure of dispersion is inadequate and the relative form becomes preferable, e.g. if a comparison between the variability of distribution with different variables is required, or to compare distributions with the same variable but very different arithmetic means (Yeomans, 1971, p. 112).

Inferential statistics allow us to know how variables relate to each other, whether there are any differences between two or more groups, and the like. In carrying out such statistics three types of tests were applied to the obtained data. These are T-Test, Analysis of Variances (ANOVA), and Chi-Square Test (X^2) for independence. The T-Test was used to see if there are any significant differences in the means of two groups of variables in the case of the test for non-response bias, as well as to test specific hypotheses regarding the characteristics of respondents and answers obtained from the questionnaires. Whereas the T-Test indicates whether or not there is a significant mean difference between two groups, the Analysis of Variances (ANOVA) was used to examine if there are significant mean differences among more than two groups.

The Chi-Square Test is a test for independence between two sets of variables. This statistical method was used when categorical data is involved since the T-Test can not be used in such cases as it is meaningless to calculate the means of data denoted on a categorical scale.

7.3. Survey Response

In the previous chapter, it was explained that a combination of self-administered and mail questionnaires were chosen to carry out this study. The reason for the combination of these two methods was to cope with the main disadvantage associated with mail questionnaires which is the low response rate. The procedures used for carrying out both the self-administered and mail questionnaires were also discussed in the previous chapter. As a result of those steps a total of 99 questionnaires were received, which represents a response rate of 40%. Furthermore, 27 questionnaires were received as a result of the follow-up letters that were sent fifteen days after the initial postings. Thus out of 249 questionnaires that were distributed a total of 126 were collected which represents a response rate of 51%.

Table 7-1 shows the response rate according to the method of distribution. As can be seen from this table, out of 76 questionnaires distributed personally 62 were collected (response rate of 82%) which clearly shows the advantage of using this method although it is expensive and time consuming. With regard to the mail questionnaires, a total of 64 questionnaires were received from 173 sent out which represents a satisfactory response rate of 37%.

Table 7–1

Response Rate According to Method of Distribution

Name of Method	No. Distributed	%	No. Collected	%	Response Rate
Personal Distribution	76	31%	62	49%	82%
Postal Distribution	173	69%	64	51%	37%
Total	**249**	**100%**	**126**	**100%**	**51%**

The response rates according to the various group of respondents, investment firms, consulting institutions and commercial banks, are shown in Table 7-2. Investment firms reported the highest response rate of 56%, whereas consulting institutions reported the lowest response rate of 19%. This table also shows the breakdown of responses by region. As can be seen all three groups as well as the three regions are represented in the responses except in the case of commercial banks in the eastern region since not one of the twelve commercial banks has its headquarters in this region, nine of them are in central region and the remaining three in the western region. It follows that there is a good geographical spread of responses from which sound inferences can be drawn for the whole of Saudi Arabia.

Table 7–2

The Response Rate for Each Group of Respondents

Name of Group	No. Distributed				%	No. Collected				%	Response Rate
	E	C	W	Total		E	C	W	Total		
Investment Firms	27	66	45	138	56%	16	34	21	71	56%	51%
Consulting Institutions	9	27	15	51	20%	4	15	4	23	19%	45%
Commercial Banks	-	45	15	60	24%	-	23	9	32	25%	42%
Total	36	138	75	249	100%	20	72	34	126	100%	51%

E: Eastern Region. C: Central Region. W: Western Region

7.3.1. The Non-Response Bias Test

Even though the response rate for this study (51%) is considered to be satisfactory, a non-response bias test was carried out in order to be more confident in generalising the result obtained from the survey. It is important for the researcher to attempt to assess whether those who did not respond would have reacted differently to the questionnaire than those who did respond to the survey. One possible approach to carry out the non-response bias test is to compare the replies of the respondents to the second posting (the reminder letters) with the replies of the respondents to the first posting. It is assumed to be likely that the non-respondents are closer in their characteristics to those who respond to the follow-up effort than to those who do so to the initial posting (Moser and Kalton, 1993). If the results of such compression indicate no significant differences in the answers between the two groups, then it may be concluded that the respondents were representative of the whole group. This approach of testing for non-response bias was selected because it was considered to be practical and applicable to the circumstances of this study and also because it has been used in previous studies such as Chang and Most (1985) and Ahmad (1988).

To carry out the non-response bias test all received questionnaires were classified into two groups (see Appendix B). The first group consisted of the 99 questionnaires that were collected personally and received four days after the follow-up letters were sent out. The remaining 27 questionnaires that were received on the fifth day of sending the follow-up letters or later were classified as the second group.

To determine whether there was any non-response bias, the t-test for differences in the means was performed on all of the questions in Part Two of the questionnaire except Question 4-A. For this question the chi-square test for independence was applied since it was based on a categorical scale (see Appendix A). In applying the t-test the hypothesis that was tested was that the means of the two groups (early and late reply) are equal. As can be seen from Tables 7-3, 7-4, 7-5, 7-7, 7-8, 7-9, 7-10, and 7-11 this hypothesis cannot be rejected except in the case of two variables (Q1, government publications and Q6, standard set by an independent body) at the 0.05% level of significance. According to Sekaran (1992) a significance of $p \leq 0.05$ is the generally accepted conventional level in social science research. Based on the t-test results it was concluded that there is a lack of non-response bias since there were no significant differences in mean scores of the variables between the two groups.

With regard to the chi-square test which was used for Question 4-A the hypothesis being tested was that the two variables (types of response and variables in the questionnaire) are independent. The results of this test are given in Table 7-6 and indicates no significant differences between the two groups at the 0.05% level of significance. Therefore, the hypothesis that there is no relationship between types of reply and answers to the questionnaire can not be rejected.

Table 7-2 shows that all three groups, investment firms, consulting institutions and commercial banks, as well as the three regions are represented in the sample. However, to ensure the confidentiality and anonymity of the respondents, which was considered to be of paramount importance for obtaining co-operation in the investment community in Saudi Arabia, it was not possible to identify the firms inside each group or region. So there is still the possibility that some firms in a particular group or region did not respond to the questionnaire. This disadvantage is undermined by the fact that investment analysts from all three groups and regions participated in the study which rule out the possibility of demographic or categorical bias.

In the light of the above discussion it can be concluded that the answers given by the respondents to the survey are representative of the population of investment analysts as a whole in Saudi Arabia and the results obtained from this survey may be generalised. The lack of non-response bias and the representativeness of the sample mean that inferences may be drawn with some confidence.

Table 7–3

T-Test Results For Non-Response Bias

(Q. 1) Importance of Various Sources of Information

Sources of Information	G 1 Mean	G 2 Mean	T-Test	D.F.	$p < .05$, Two-tailed
Corporate Annual Reports	1.172	1.074	1.12	124	N. S
Corporate Interim Reports	1.293	1.185	1.00	124	N. S
Government Publications	2.44	1.963	1.96	122	S
Direct Contact with Management	2.47	2.19	1.06	124	N. S
Newspaper & Business Magazines	2.495	2.259	1.10	122	N. S
Advisory Services	2.71	2.78	-0.28	122	N. S
Prospectuses	2.99	2.89	0.43	122	N. S
Tips and Rumours	3.29	3.04	0.94	124	N. S

Group 1: Early reply.
Group 2: Late reply.
D.F: Degree of freedom.
N. S: Not significant.
S: Significant.

Table 7–4

T-Test Results For Non-Response Bias

(Q. 2) Uses of Information Contained in Company Annual Reports

Usefulness of Company Annual Reports	G 1 Mean	G 2 Mean	T-Test	D.F.	*p*< .05, Two-tailed
Provide primary data	1.354	1.296	0.46	124	N. S
Investigate to make investment	1.414	1.259	1.24	124	N. S
Forecast profits & EPS	1.384	1.593	-1.38	124	N. S
Comparison over time	1.475	1.556	-0.52	124	N. S
Comparison with other companies	1.616	1.630	-0.07	124	N. S
Monitor previous investment	1.687	1.519	1.11	124	N. S
Prepare ratios or commentaries	1.606	1.89	-1.43	124	N. S

Group 1: Early reply.
Group 2: Late reply.
D.F: Degree of freedom.
N. S: Not significant.
S: Significant.

Table 7–5

T-Test Results For Non-Response Bias

(Q. 3) Importance of Sections of Financial Statements

Annual Reports Sections	G 1 Mean	G 2 Mean	T-Test	D.F.	$p < .05$, Two-tailed
Income Statement	1.081	1.074	0.11	124	N. S
Balance Sheet	1.186	1.074	1.39	122	N. S
Statement of Changes in Financial Position	1.566	1.630	-0.37	124	N. S
Statement of Accounting Policies	1.866	2.111	-1.33	122	N. S
Notes to the Account	1.979	1.926	0.25	122	N. S
Auditor's Report	2.051	1.815	1.13	124	N. S
Director's Report	2.24	2.22	0.08	124	N. S

Group 1: Early reply.
Group 2: Late reply.
D.F: Degree of freedom.
N. S: Not significant.
S: Significant.

Table 7–6

Chi-square Test Results For Non-Response Bias

(Q. 4-A) Adjustment to Items in Company Annual Reports

Name of the Item	Major Adjustment		Minor Adjustment		No Adjustment		D. F	X^2	$\alpha = .05$
	G1	G2	G1	G2	G1	G2			
Fixed assets valuation	44%	55%	32%	30%	24%	15%	2	1.574	N. S
Depreciation Expense	35%	30%	37%	41%	28%	29%	2	0.218	N. S
Inventory valuation	27%	41%	35%	26%	38%	33%	2	1.936	N. S
Earnings per share	31%	41%	29%	18%	40%	41%	2	1.488	N. S
Extraordinary items	19%	19%	46%	33%	35%	48%	2	1.644	N. S
Intangible assets	31%	26%	39%	22%	30%	52%	2	4.612	N. S
Effects of exchange rate	17%	15%	42%	48%	41%	37%	2	0.396	N. S
Investment	27%	33%	49%	30%	24%	37%	2	3.257	N. S

Group 1: Early reply.
Group 2: Late reply
D.F: Degree of freedom.
N. S: Not significant.
S: Significant.

Table 7–7

T-Test Results For Non-Response Bias

(Q. 4-B) Reasons for Adjustment made by Investment Analysts

Reason for Adjustment	Group1 Mean	Group 2 Mean	T-Test	D. F	$p < .05$, two-tailed
Valuation Base	1.376	1.435	-0.34	114	N. S
Recognition of Revenue	1.699	1.957	-1.27	114	N. S
Determination of Cost	2.02	2.17	-0.63	113	N. S

Group 1: Early reply.
Group 2: Late reply
D. F: Degree of freedom.
N. S: Not significant.
S: Significant

Table 7–8

T-Test Results For Non-Response Bias

(Q. 5) Perceived Understanding, Relevance and Confidence in Using Company Annual Reports by Investment Analysts

.Description	Group1 Mean	Group 2 Mean	T-Test	D. F	$p < .05$, two-tailed
Level of Understanding	1.970	1.889	0.46	124	N. S
Degree of Relevance	1.859	2.074	-1.19	124	N. S
Level of Confidence	2.535	2.556	-0.11	124	N. S

Group 1: Early reply.
Group 2: Late reply
D. F: Degree of freedom.
N. S: Not significant.
S: Significant

Table 7–9

T-Test Results For Non-Response Bias

(17th. 6) Factors Effecting Confidence in Annual Reports

Name of Factor	Group1 Mean	Group 2 Mean	T-Test	D. F	$p< .05$, two-tailed
Standard Format	1.586	1.481	0.71	124	N. S
Standards Set by an Independent Body	1.81	1.333	2.11	124	S
Increased Government Regulation	1.838	1.593	1.38	124	N. S
Audit by International Firm	1.909	1.96	-0.25	124	N. S

Group 1: Early reply. S: Significant D. F: Degree of freedom.
Group 2: Late reply N. S: Not significant.

Table 7–10

T-Test Results for Non-Response Bias

(17th. 7) Investment Analysts Attitudes Towards Annual Reports

The Statements	Group1 Mean	Group 2 Mean	T-Test	D. F	$p< .05$, two-tailed
All accounts should be standardised	1.768	1.667	0.55	124	N. S
Reporting practices should be restricted	1.808	1.630	0.90	124	N. S
Using the same accounting practice	1.707	1.370	1.74	124	N. S
External auditors are independent	1.242	1.148	0.79	124	N. S
The SOCPA enforce its rules	1.212	1.296	-0.61	124	N. S
Auditors exercise strict rules	1.152	1.037	1.59	124	N. S
Auditors qualifications are adequate	1.212	1.037	1.94	124	N. S

Group 1: early reply. Group 2: late reply. D.F: degree of freedom. N. S: Not significant. S: Significant.

Table 7–11

T-Test Results for Non-Response Bias

(Q. 8) Investment Analysts Views about Additional Disclosure

Disclosure Requirement	Group1 Mean	Group 2 Mean	T-Test	D. F	*p*< .05, two-tailed
Future of the Company	1.566	1.370	1.23	124	N. S
General Economic Condition	1.889	2.22	1.57	124	N. S
Directors & Senior Management	2.172	2.333	-0.77	124	N. S
Amount of Sales Next Year	1.374	1.259	1.03	124	N. S
Expected Profits Next Year	1.343	1.185	1.38	124	N. S
Dividends Forecast Next Year	1.384	1.222	1.31	124	N. S
Financial Policy of the Company	1.596	1.704	-0.70	124	N. S

Group 1: Early reply.
Group 2: Late reply
D. F: Degree of freedom.
N. S: Not significant.
S: Significant

7.4. Profile of the Respondents

The respondents were asked in Part One of the questionnaire to provide background information relating to their qualifications, experience, and so on. Examining the background information of the respondents has two main aims. First, to assess the importance of the sample group as a primary user group of the accounting information. If the answers to this part of the questionnaire were to indicate that the respondents are very knowledgeable in accounting and that they are members of middle and senior management, then their views may be judged as important in improving the quality of corporate annual reports.

The second reason for examining the background characteristics of the respondents is to see if such characteristics effect their views, evaluation and perception of the importance and usefulness of corporate annual reports.

7.4.1. The Respondents' Academic Background

The first question of Part One of the questionnaire dealt with respondents qualifications and academic background. The respondents were asked whether or not they hold a university degree in business, and for those who have such a degree to name their major. Furthermore, the respondents were asked to indicate whether they obtained their degree from local or overseas universities. The purpose of examining these academic background factors is to determine the extent of their influence on the respondents' views and evaluation of the usefulness of corporate annual reports.

Table 7–12

The Respondents' Academic Background

Name of Degree	No.	%
Business Degree	116	92%
No Business Degree	10	8%
Total	**126**	**100%**

Table 7-12 shows that 92% of the investment analysts who participated in this survey have a university degree in business. In order to be more specific with regard to the level of knowledge in accounting, those respondents were classified into two categories, those who specialised in accounting and those who have other business majors. This classification is especially important in examining the extent of the adjustment to the reported figures in financial statements and whether more qualifications in accounting influence the level of adjustment made by investment analysts.

Table 7-13 reveals that 38 investment analysts out of 116 who have a degree in business are specialised in accounting. The other 76 investment analysts have a degree in other business majors such as economics, finance and marketing. The results in Tables 7-12 and 7-13 indicate that investment analysts as a major user group of financial reporting are well educated and considered to be knowledgeable and sophisticated users. Therefore, their views regarding corporate annual reports would be important and useful for both preparers of theses reports and standard setters .

Table 7–13

Respondents' Academic Qualifications in Accounting

Name of Major	No.	%
Accounting	38	33%
Other Business Majors	76	66%
No Response	2	1%
Total	116	100%

Table 7–14

Degree Obtained from Saudi or Abroad

Place of University	No.	%
Local Universities	43	34%
Overseas Universities	74	59%
No Response	9	7%
Total	116	100%

Table 7-14 shows whether the respondents obtained their degree from Saudi Arabia or abroad. 59% of the investment analysts who took part in this study obtained their degree from overseas universities and 34% indicated that they obtained their degree from local universities. The remaining 7% of the analysts did not response to this question. The importance of this result is in highlighting the fact that more than 50% of the investment analysts are trained abroad where the economic environment and accounting practices may well be very different from those in Saudi Arabia. However, this factor will be examined later to see if it had any influence on the perception and understanding of corporate annual reports.

7.4.2. Number of Years and Country in which Experience was gained

An investment analyst's experience is believed to be an important factor affecting his views, perception and evaluation of the usefulness of corporate annual reports. Number of years of experience, as well as, the place where such experience was gained are of great importance since each country has its own economic environment and accounting practices. To examine these factors investments analysts were asked to indicate the name of the country where their experience was gained as well as the number of years of experience they have had as investment analysts.

With regard to the place of experience Table 7-15 shows that 59% of the investment analysts have obtained their experience from Saudi Arabia only and have not worked as investment analysts in any other country. Of the remaining 52 investment analysts who have experience from other countries 40% obtained their experience from other Arab countries such as Egypt and Jordan. The breakdown of the respondents' country of experience is shown in Table 7-16.

Table 7–15

Where Respondents' Experience Obtained

Name of Place	No.	%
Saudi Arabia	74	59%
S.A with Other Country	52	41%
Total	**126**	**100%**

Table 7–16

Countries where Respondents' Experience Obtained

Name of Country	No.	%
Arab Countries	21	40%
U.S.A	11	21%
Asian Countries	10	19%
European Countries	4	8%
Others	2	4%
No Response	4	8%
Total	**52**	**100%**

The years of experience which the respondents have had as investment analysts is presented in Table 7-17. 30% of the respondents had more than 10 years experience and more than 60% had more than five years of experience as investment analysts. This result is significant because it shows that the majority of the respondents who participated in this survey are considered to be experienced in the investment analysis process.

Table 7–17

Respondents' Years of Experience as Investment Analysts

Number of Years	No.	%
1 -------- 5 Years	48	38%
6 -------- 10 Years	40	32%
11 -------- Up	38	30%
Total	**126**	**100%**

7.4.3. Respondents' Job and Decision Description

The responses to the job description question are presented in Table 7-18. It can be seen from this table that the majority of the respondents described themselves either as security analysts (35%) or as investment advisors (24%). 38% of the respondents described their jobs as fund\money managers.

Table 7–18

Respondents' Job Description

Job Description	No.	%
Security Analyst	44	35%
Fund\Money Manager	48	38%
Investment Advisor	30	24%
Other	4	3%
Total	**126**	**100%**

Table 7–19

Respondents' Decision Description

Decision Description	No.	%
Security Recommendation	95	75%
Business Valuation	22	18%
Credit Rating	5	4%
Other	4	3%
Total	**126**	**100%**

Respondents were also asked to provide a description of their decisions. The overwhelming majority of the respondents, as can be seen from Table 7-19, described their decisions as security recommendations . 18% of the respondents indicated that their decisions involved business valuation, while only 4% involved credit rating. This result implies a strong emphasis upon the shareholder perspective.

7.4.4. Respondents' Management Position in their Organisation

Table 7-20 shows that 50% of the respondents are in senior management positions and 40% in the middle management positions in their respective organisations. The significance of this result is in supporting the argument that investment analysts as a major user group of corporate annual reports are an influential group not only in their own organisations but also in the investment community as a whole in Saudi Arabia.

Table 7–20

Respondents' Management Hierarchy

Management Hierarchy	No.	%
Lower Management	12	10%
Middle Management	51	40%
Senior Management	63	50%
Total	**126**	**100%**

7.5. Summary

This chapter was devoted to reporting the results of the initial analysis of the survey. When analysing the data several statistical analysis techniques, such as T-Test and Chi-Square as well as frequencies, were applied. As a result of the method that has been used in distributing and collecting the questionnaires a total of 126 questionnaire were received out of 249 that were distributed which represents a response rate of 51%. The sample is considered to be representative since investment analysts from all three groups and regions participated in the study. Furthermore, a non-response bias test was performed and based on its results it was concluded that the survey is representative of the population of investment analysts in Saudi Arabia.

The background characteristics of the respondents who participated in the survey was also analysed and presented in this chapter. Based on the findings of this analysis the profile of the respondents can be summarised as follows:

- An overwhelming majority (92%) of the investment analysts have a university degree in business studies.
- 33% of those who have a business degree are specialised in accounting.
- 59% of the respondents have obtained their degree from overseas universities.
- 41% of the respondents have worked as investment analysts in countries other than Saudi Arabia.
- 30% of the respondents have more than ten years experience while 40% of them have less than five years experience as investment analysts.

- 59% of the respondents described their job either as security analysts or investment advisor and 38% as fund/money manager.

- 75% of the respondents described their decisions as security recommendations.

- 90% of the respondents are either in middle or senior management positions.

Finally, these findings indicate that the investment analysts as a user group of financial reporting are well qualified and have considerable experience of financial affairs. They are clearly an influential and important group and therefore it is highly relevant to ask them to express their views on the usefulness of financial reports.

The findings of the detailed analysis of the questionnaire regarding the importance of the corporate annual reports and its usefulness to the investment analysts will be presented in the next chapter.

Chapter Eight

Results and Findings of the Investment Analysts Survey

8.1. Introduction

The main aim of this study was to investigate the usefulness of the corporate annual report to investment analysts in Saudi Arabia and how they perceive and evaluate the various information provided in this report. To achieve this aim a questionnaire survey was carried out among the analysts. The results of the initial analysis into the questionnaire survey were presented in the previous chapter. These results included the response rate, tests for non-response bias and profile of the respondents. A detailed analysis of the responses are discussed and presented in this chapter.

To report the results and findings of this analysis, this chapter is divided into the following seven sections:

- The importance of the various sources of information to the investment analysts.
- The importance of various sections of the corporate annual report.
- The uses of the corporate annual report.
- Levels of adjustments of corporate report items.
- Investment analysts understanding and confidence in using corporate annual reports.
- Investment analysts attitudes towards corporate annual reports.
- Investment analysts demands for additional disclosure.

8.2. The Importance of Various Sources of Information to Investment Analysts

The respondents were asked to rate the importance of various sources of information for their investment decisions or recommendations. In doing so a scale of five points was used with 1 being very important, 2 important, 3 neutral, 4 not very important, and 5 not important at all. Using the mean scores as well as the standard deviation and the coefficient of variation the responses to this question are tabulated in Table 8-1.

Table 8-1 shows that investment analysts ranked corporate annual reports as the most important source of information for their investment activities with a mean score of 1.151. Corporate interim reports were ranked as the second most important source of information with a mean score of 1.270. Government publications (mean score of 2.339) and direct contact with management (mean score of 2.413) were ranked as the fourth and the fifth most important sources of information respectively, with tips and rumours being the least important source of information (mean score of 3.238) for investment activities.

The corporate annual report has the lowest standard deviation of 0.401 which is an indication of the level of agreement among the investment analysts as to its importance. Corporate annual reports also have the lowest coefficient of variation of 0.349 which is an indication of the responses dispersion relative to the mean. The standard deviations and the coefficient of variations for the other sources of information are also shown in this table.

Table 8–1

Importance of the Various Sources of Information

Sources of Information	Rank	Mean	S.D	C.V*
Corporate Annual Reports	1	1.151	0.401	0.349
Corporate Interim Reports	2	1.270	0.497	0.391
Government Publication	3	2.339	1.140	0.487
Direct Contact with Management	4	2.413	1.260	0.522
Newspaper & Business Magazines	5	2.444	0.982	0.409
Advisory Services	6	2.726	1.085	0.398
Prospectuses	7	2.968	1.066	0.359
Tips and Rumours	8	3.238	1.249	0.386

S.D: Standard Deviation.
C.V: Coefficient of Variation.

* The C.V could be difficult to interpret, if the mean is very low it could lead to a higher C. V.

Table 8–2

Frequency of Responses regarding the Importance of Sources of Information

Sources of Information	1	2	3	4	5
Corporate Annual Reports	86%	12%	2%	–	–
Corporate Interim Reports	76%	22%	2%	–	–
Government Publication	26%	36%	24%	8%	6%
Direct Contact with Management	27%	35%	17%	11%	10%
Newspapers & Business Magazines	16%	40%	31%	10%	3%
Advisory Services	8%	40%	34%	7%	11%
Prospectuses	8%	26%	35%	23%	8%
Tips and Rumours	13%	13%	30%	27%	17%

1= very important.
2= important.
3= neutral.
4= not very important.
5= not important at all.

These results are illustrated in Table 8-2 where it can be seen that the vast majority of investment analysts (86%) rated the corporate annual report as very important, 12% as important and only 2% as neutral. With regard to corporate interim reports 76% rated it as very important and 22% as important. None of the investment analysts rated either corporate annual reports or interim reports as not very important or not important at all. As can be seen from discussion above, investment analysts rely heavily on the reports published by the companies themselves: annual and interim reports, in their investment activities rather than information obtained from a third party such as government publications and advisory services. However, the reason for giving corporate annual reports a higher ranking than the interim reports may be due to the fact that later are not required to be audited by an external auditor. While in the case of the annual report such practice is mandatory, thus giving investment analysts a greater degree of confidence in using them for decision making. Another possible reason for the high ranking given to the corporate annual report is the fact that they are easily accessible since all companies are required to publish their annual reports in the newspaper (Companies Act, Article 89). The corporate Annual reports are to be published according to the General Presentation and Disclosure Standard that was discussed in Chapter Four. Furthermore, the corporate annual report can be seen as the basis for the interpretation of any information coming from other sources.

Table 8-3 shows a comparison of the results of this study with previous studies carried out by Ahmad (1988), Pike, et al (1993) and Bence, et al (1995). Even though corporate annual reports were given a high ranking in all the previous studies, there are more similarities and consistencies between the current study and Ahmad's (1988) study than with the other two studies. For example, direct contact with management was ranked as the first source of information for investment activities by Pike et al (1993) and Bence, et al (1995). In contrast, it was ranked as the fourth source of information by both this study and Ahmad's. One possible explanation for this could be that the present study and Ahmed's study were conducted in developing countries (Saudi Arabia and Malaysia) whereas the others were carried out in developed countries (UK and Germany). Possible differences in corporate nature, stock market environment and managerial attitudes between developing and developed countries may contribute to such similarities and differences between the survey results. It should be noticed that direct contact with company's management as a source of information does not provide objective evidence as given by the financial statements. Surely investment analysts should be looking for consistency between what the company's management say to them in their meetings and what they are attempting to communicate in the statements.

Pike et al (1993) suggested two possible reasons for the great reliance on personal contact with companies management by investment analysts. Firstly, it could be a response by analysts to the allegation that there was a lack of communications between them and companies management so their response came as a reaction to such allegation. Secondly, it could be that there are no more meetings than there were but rather that analysts are now more willing to admit to them. So, based in this argument, if investment analysts are not facing any allegation regarding a lack of communication nor they are willing to admit any meeting because of their concern about insider information allegation, as it has been suggested by Moizer and Arnold (1984), direct contact with company management would still be given a low ranking as a source of information. This situation could be the case in developing countries such as Saudi Arabia and Malaysia.

Furthermore, understanding the cultural nature of Saudi Arabia might help in explaining the differences between its investment analysts and those in other developed countries in evaluating direct contact with companies management as a source of information. Analysts in a country such as Saudi Arabia, where there are very strong social relationships, may not consider any information derived from friendly social meetings as a source of information to be used directly in their analysis. However, such information surely will be in the back of their minds when they are making their analysis and it might affect their decisions or recommendations. Therefore, investment analysts in Saudi

Arabia do have meetings with companies management and the information obtained from these meetings might indirectly affect their decisions or recommendations, but because of their cultural understanding of these meetings they are not prepared to accept them as a major source of information.

In the light of the above discussion it can be concluded that the differences between investment analysts in Saudi Arabia and those in developed countries in evaluating the importance of direct contact with management as a source of information might not be due to differences in investment and accounting environment rather than cultural differences. However, even if investment analysts indicated that direct contact with management is an important source of information, the usefulness of such information derived from this source will be limited if it is not combined with the information provided in the corporate annual report.

Even between the current study and Ahmad's study there are some differences such as in the case of government publications which were given a high ranking in this study but low one in Ahmad's. However, the main explanation for the high ranking given to government publications in this study is due to the great involvement of the government through its agency (Saudi Arabia Monetary Agency, SAMA) which is in charge of controlling and monitoring the stock market. In doing this, the agency publishes a great deal of information considered to be useful for investment analysts (see Chapter 3).

Table 8–3

Comparison of Ranking with other Studies on the Usefulness of Sources of Information

Sources of Information	Current Study	Bence, et al, 1995	Pike, et al, 1993	Ahmad, 1988
Corporate Annual Reports	1	2	3	1
Corporate Interim Reports	2	6	3	2
Government Publications	3	13	–	7
Direct Contact with Management	4	1	1	4/5
Newspapers & Business Magazines	5	9	5	8/9
Advisory Services	6	12	6	6
Prospectuses	7	11	–	3
Tips and Rumours	8	–	–	10
Preliminary Profit Announcement	–	4	4	–
Telephone Conversations	–	7	–	–
Company P. R. Department	–	8	–	–
Visits to Company	–	5	–	–
Datastream	–	10	–	–
Company Presentations	–	3	–	–
Analysts Meetings in Company	–	–	2	–
General Meetings	–	–	7	–

According to the roles that were issued in 1985 to regulate the Saudi stock market, SAMA was required to establish a shares control department to handle day-to-day operations. This department has many duties such as determining and controlling the working hours for share trading and reporting the share price list and the daily and weekly trading summary to the public. It is not surprising that if the government through its agency (SAMA) has this power over the stock market any information provided by it will be important for those trading in this market. In other countries such as Malaysia, where there is a stock exchange that the government has no or little power over it, the government publications have much less importance as a source of information for the analysts there. The same explanation can be offered about developed countries such as U K.

Furthermore, this situation raises a question regarding the neutrality of the government. Table (3-3) shows that in 1994 the government possesses approximately 40% of the shares volume. Even though these shares are not provided for trading yet, the government has indicated its intention to sell some these shares in the future (see Chapter 3). When this happens there will be a clear conflict of interests if it is not already there.

8.2.1. Respondents' Background Characteristics and their Perception of the Importance of Various Sources of Information

The purpose of this section is to examine whether the differences in background characteristics of investment analysts results in differences in their evaluation of the importance of various sources of information, in particular whether they would still rank corporate annual reports as the most important source of information for their investment decisions and recommendations. The characteristics examined in this section include:

- Accountancy qualifications.
- Place where degree obtained
- Place where experience obtained
- Years of experience
- Management hierarchy

8.2.1.1. Qualification in Accounting

In the previous chapter, Tables 7-12 and 7-13 revealed that out of the 116 respondents who have a business degree (the remaining 10 respondents who do not have business degrees were not included in this analysis) 33% of them had specialised in accounting and 66% in other majors of business. Table 8-4 shows that both groups of analysts ranked the various sources of information almost the same. A t-test for differences in means was performed to see if there were any significant differences between the two groups of analysts in the importance they attach to the various sources of information. The results of this test are shown in Table 8-5. Even though investment analysts who specialised in accounting rated corporate annual reports as slightly more important, as one would expect, than did the other group (mean scores of 1.132 and 1.145 respectively), the t-test results indicate no significant difference between the two groups. This result leads us to conclude that investment analysts, regardless of their accountancy qualification, rated corporate annual reports as the most important source of information for their investment decisions or recommendations. With regard to the other source of information the t-test results indicates a significant differences between the two groups of analysts for two of them. These are direct contact with management and prospectuses. Investment analysts who are not specialised in accounting rated these two sources, with significant differences, as more important than did the other group of analysts.

Table 8–4

Comparison of the Ranking in Importance of the Sources of Information Between the Two Groups of Investment Analyst

Sources of Information	All Rank	Group 1 Rank	Group 2 Rank
Corporate Annual Reports	1	1	1
Corporate Interim Reports	2	2	2
Government Publication	3	3	4
Direct Contact with Management	4	5	3
Newspapers & Business Magazines	5	4	5
Advisory Services	6	5	6
Prospectuses	7	7	7
Tips and Rumours	8	8	8

Group 1: Investment analysts with accounting major.
Group 2: Investment analysts with other business major.

Investment analysts with qualification in accounting can do more analysis and interpretation, because of their knowledge in this field, by the information provided in annual reports than those analysts with other business qualifications. This may explain why they evaluated the corporate annual report slightly as more important than the other group of analysts. On the other hand, investment analysts with other business qualifications may evaluate other sources of information as more important, such as direct contact with management and prospectuses, to compensate for their knowledge shortage in accounting by combining information from the annual report with other sources. An alternative explanation might be that this group of analysts can do more with the information provided by certain source of information than those analysts who are specialised in accounting. For example, analysts with general business degree, because of their skills and knowledge, can get easy access to companies management and also they can get more information from their meetings with them than the other group of analysts.

Table 8–5

T-Test Results of Differences Between the Two Groups of Investment Analysts

Sources of Information	Group1 Mean	Group 2 Mean	T-Test	D.F.	Differences at 5%
Corporate Annual Reports	1.132	1.145	-0.17	112	N. S
Corporate Interim Reports	1.263	1.250	0.14	112	N. S
Government Publications	2.158	2.297	-0.65	110	N. S
Direct Contact with Management	2.711	2.184	2.17	112	S
Newspapers & Business Magazines	2.368	2.419	-0.27	110	N. S
Advisory Services	2.711	2.689	0.10	110	N. S
Prospectuses	3.184	2.757	2.02	110	S
Tips and Rumours	3.342	3.197	0.58	112	N. S

Group 1: Investment analysts with accounting major.
Group 2: Investment analysts with other business major.

N. S: Not significant.
D.F: Degree of freedom.
S: Significant.

8.2.1.2. Places where Degree Obtained

It was pointed out in the previous chapter (Table 7-14) that 59% of the investment analysts who took part in this survey have obtained their degrees from overseas universities. It was assumed that investment analysts with degrees from foreign countries may perceive the importance of various sources of information differently from those who gained their qualification from Saudi Arabia. The main question to be answered in this section is whether corporate annual reports are still the most important source of information even for those who trained outside Saudi Arabia where the economic environment and accounting practices might differ.

The results in Tables 8-6 and 8-7 confirmed the main finding of this part of the chapter which is that investment analysts regardless of their background characteristics, in this case places where degree obtained, evaluated the corporate annual report as the most important source of information for their investment activities. However, these results also indicated that investment analysts who gained their degree from foreign countries rated all sources of information except the corporate annual report as more important than did the other group of analysts. Government publications, newspapers and magazines and prospectuses were rated as more important, with significant differences, by the analysts trained in foreign countries than by the other group. A possible explanation for this result could be that investment analysts who trained in Saudi Arabia are familiar with corporate annual reports in terms of how they are prepared and presented, so they use them with more confidence. Therefore, they care less about other sources of information.

Table 8–6

Comparison of the Ranking in Importance of the Sources of Information Between Investment Analysts According to where Degree Obtained

Sources of Information	All Rank	Group 1 Rank	Group 2 Rank
Corporate Annual Reports	1	1	1
Corporate Interim Reports	2	2	2
Government Publications	3	4	3
Direct Contact with Management	4	3	5
Newspapers & Business Magazines	5	5	4
Advisory Services	6	6	6
Prospectuses	7	7	7
Tips and Rumours	8	8	8

Group 1: Investment analysts with degrees obtained from local universities.
Group 2: Investment analysts with degrees obtained from overseas universities

Table 8–7

T-Test Results of Differences Between

Investment Analysts According to where Degree Obtained

Sources of Information	Group1 Mean	Group 2 Mean	T-Test	D.F.	$p < .05$, Two-tailed
Corporate Annual Reports	1.140	1.162	-0.29	115	N. S
Corporate Interim Reports	1.326	1.243	-0.85	115	N. S
Government Publications	2.54	2.081	2.25	113	S
Direct Contact with Management	2.49	2.27	0.93	115	N. S
Newspapers & Business Magazines	2.721	2.222	2.85	113	S
Advisory Services	2.86	2.64	1.05	113	N. S
Prospectuses	3.163	2.74	2.13	114	S
Tips and Rumours	3.42	3.11	1.28	115	N. S

Group 1: Investment analysts with degree obtained from local university
Group 2: Investment analysts with degree obtained from overseas.
D.F: Degree of freedom.
N. S: Not significant.
S: Significant.

8.2.1.3. Place of Experience

41% of investment analysts who took part in this survey have had experience as investment analysts in countries other than Saudi Arabia whereas 59% of them had worked as investment analysts only in Saudi Arabia (see Chapter 7, Table 7-15). The ranking of the various sources of information according to their importance as given by these two groups of analysts is shown in Table 8-8. Even though the t-test results (Table

8-9) indicate that there are significant differences between the two groups of analysts in their evaluation of the importance of four sources of information out of eight, the corporate annual report is not one of them. Investment analysts who have worked in countries other than Saudi Arabia evaluated direct contact with management, newspapers and business magazine, advisory services, and prospectuses more important than did the other group. Based on the discussion in this section and the previous one it can be concluded that in general, investment analysts who trained or worked in foreign countries perceived these sources of information as more important than did those who had trained and worked only in Saudi Arabia.

One possible reason could be put forward to explain these results. That is some of the information sources, because of the youthfulness of the stock market which was regulated in1985 (see Chapter 3), have not reached the level whereby it enables the analysts to use the information provided in them with confidence. For example, the financial press in Saudi Arabia has not yet establish the degree of integrity and reliability generally associated with the financial press in other countries, such as The Financial Times in UK and The Wall Street Journal in USA. In fact, there is no one paper specialised in financial matters other than one or two pages in the regular newspapers which publish a list of share prices and share trading activities as issued by SAMA. Moreover, all the newspapers and magazines in Saudi Arabia are under direct control of the government. As a result there may be suspicions among investment analysts that the reports and information published in these newspapers and magazines may have a political motive. This picture, which undermine the usefulness of such sources, might not be clear for the investment analysts who trained and worked in foreign countries as it is for those who trained and worked in Saudi Arabia.

Table 8-8

Comparison of the Ranking in Importance of the Sources of Information Between Investment Analysts According to Place of Experience

Sources of Information	All Rank	Group 1 Rank	Group 2 Rank
Corporate Annual Reports	1	1	1
Corporate Interim Reports	2	2	2
Government Publications	3	3	4
Direct Contact with Management	4	5	3
Newspapers & Business Magazines	5	4	5
Advisory Services	6	6	6
Prospectuses	7	8	7
Tips and Rumours	8	7	8

Group 1: Investment analysts with Experience in Saudi Arabia Only.
Group 2: Investment analysts with Experience in S.A and other Countries.

Table 8–9

T-Test Results of Differences Between

Investment Analysts According to where Experience Obtained

Sources of Information	Group1 Mean	Group 2 Mean	T-Test	D.F.	$p< .05$, Two-tailed
Corporate Annual Reports	1.162	1.135	0.38	124	N. S
Corporate Interim Reports	1.270	1.269	0.01	124	N. S
Government Publications	2.46	2.160	1.44	122	N. S
Direct Contact with Management	2.73	1.962	3.52	124	S
Newspapers & Business Magazines	2.61	2.21	2.27	122	S
Advisory Services	2.89	2.50	1.99	122	S
Prospectuses	3.24	2.596	3.44	122	S
Tips and Rumours	3.14	3.38	-1.11	124	N. S

Group 1: Investment analysts with experience obtained from Saudi Arabia only. N. S: Not significant.
Group 2: Investment analysts with experience obtained from S.A and other countries. S: Significant.
D.F: Degree of freedom.

8.2.1.4. Investment Analysts' Years of Experience

Another background factor examined in this section is the number of years of experience the respondents have had as investment analysts. They were divided into three groups. Group One consisted of those analysts who had five years or less (38%), Group Two consisted of those who had 6 to 10 years experience (32%), and Group Three consisted of those who had more than 10 years experience (30%). Table 8-10 shows the ranking given by these three groups to the various sources of information. The corporate annual report was ranked as the most important source of information by all three groups of analysts. F-ratio test (ANOVA) was used instead of t-test, since the latter is not applicable for more than two groups, to examine whether the differences in experience between the analysts would effect their perception of the importance of the various sources of information.

Even though there are little differences in the ranking given to the various sources of information, other than annual and interim reports, by the three groups of analysts, the f-ratio results in Table 8-11 indicate no significant differences between these three groups in their evaluation of any source of information. These results suggest that the number of years of experience has no effect on the perception of the importance of the various sources of information. More importantly, this results confirmed the previous finding which is that investment analysts evaluate the corporate annual report as the most important source of information for their investment activities regardless of the differences in their background characteristics which is in this case number of years of experience.

Table 8–10

Comparison of the Ranking in Importance of the Sources of Information Between Investment Analysts According to Years of Experience

Sources of Information	All Rank	Group 1 Rank	Group 2 Rank	Group 3 Rank
Corporate Annual Reports	1	1	1	1
Corporate Interim Reports	2	2	2	2
Government Publications	3	3	4	3
Direct Contact with Management	4	4	6	4
Newspapers & Business Magazines	5	5	4	5
Advisory Services	6	6	3	7
Prospectuses	7	7	8	6
Tips and Rumours	8	8	7	8

Group 1: Investment analysts with 1-5 years experience
Group 2: Investment analysts with 6-10 years of experience.
Group 3: Investment analysts with 11-up years of experience.

Table 8–11

F-Ratio Results of Differences Between Investment Analysts According to Years of Experience

Sources of Information	Group1 Mean	Group 2 Mean	Group3 Mean	F-Ratio	D.F.	*p< .05*
Corporate Annual Reports	1.083	1.20	1.184	1.11	(2,123)	N. S
Corporate Interim Reports	1.229	1.275	1.316	0.32	(2,123)	N. S
Government Publications	2.167	2.684	2.211	2.60	(2,121)	N. S
Direct Contact with Management	2.208	2.80	2.263	2.87	(2,123)	N. S
Newspapers & Business Magazines	2.292	2.684	2.395	1.78	(2,121)	N. S
Advisory Services	2.771	2.579	2.816	0.52	(2,121)	N. S
Prospectuses	3.083	3.158	2.632	2.86	(2,121)	N. S
Tips and Rumours	3.125	3.050	3.579	2.10	(2,123)	N. S

Group 1: Investment analysts with 1-5 years experience
Group 2: Investment analysts with 6-10 years of experience.
Group 3: Investment analysts with 11-up years of experience.

D. F: Degree of freedom
N. S: Not significant.
S: Significant.

8.2.1.5. Management Level

The last background factor examined in this section is the respondents' management hierarchy. As discussed in the previous chapter (Table 7-20) 50% of the respondents are in senior management, 40% in middle management and only 10% in lower management. Table 8-12 shows the ranking of the various sources of information given by these three groups of analysts. The f-ratio results in Table 8-13 indicate that with the exception of two sources (newspapers and business magazines, and prospectuses) there are no significant differences between the evaluations of the importance of the other sources of information by these three groups.

Table 8–12

Comparison of the Ranking in Importance of the Sources of Information Between Investments Analyst According to Management Level

Sources of Information	All Rank	Group 1 Rank	Group 2 Rank	Group 3 Rank
Corporate Annual Reports	1	1	1	1
Corporate Interim Reports	2	1	2	2
Government Publications	3	6	3	4
Direct Contact with Management	4	4	4	5
Newspapers & Business Magazines	5	5	5	3
Advisory Services	6	6	6	6
Prospectuses	7	3	7	7
Tips and Rumours	8	8	8	8

Group 1: Investment analysts in lower management
Group 2: Investment analysts in middle management.
Group 3: Investment analysts in senior management.

Table 8–13

F-Ratio Results of Differences Between Investment Analysts According to Management Level

Sources of Information	Group1 Mean	Group 2 Mean	Group 3 Mean	F-Ratio	D.F.	$p<.05$
Corporate Annual Reports	1.250	1.078	1.191	1.52	(2,123)	N. S
Corporate Interim Reports	1.250	1.294	1.254	0.10	(2,123)	N. S
Government Publications	2.667	2.286	2.317	0.56	(2,121)	N. S
Direct Contact with Management	2.333	2.490	2.365	0.16	(2,123)	N. S
Newspapers & Business Magazines	2.50	2.726	2.197	4.26	(2,121)	S
Advisory Services	2.667	2.745	2.721	0.03	(2,121)	N. S
Prospectuses	2.167	3.176	2.951	4.63	(2,121)	S
Tips and Rumours	3.167	3.235	3.254	0.02	(2,123)	N. S

Group 1: Investment analysts in lower management.
Group 2: Investment analysts in middle management.
Group 3: Investment analysts in senior management.
D.F: Degree of freedom.
S: Not significant.
S: Significant.

To sum up, the results of the survey into the importance of the various sources of information to investment analysts were analysed and discussed in this section. It was found that the corporate annual report is the most important source of information for investment analysts in their investment activities. 98% of the respondents rated corporate annual reports either as very important or important for their investment decisions or recommendations.

Furthermore, five background characteristics of the respondents were examined to see whether differences in such characteristics would effect their perception of the importance of the various sources of information. The results showed that none of the five factors examined resulted in significant differences in respondents' evaluation of the importance of the corporate annual report. However, some of these factors affected the respondents' perception of the other sources of information. For example, it was found that respondents who worked or trained in foreign countries rated certain sources of information as more important than did the other group. Thus based in the discussion above the conclusion was made that, regardless of respondents' background characteristics, the corporate annual report is the most important source of information for investment analysts.

8.3. Importance of Various Sections of the Corporate Annual Report

The purpose of this section is to examine investment analysts evaluation of the various sections of the corporate annual report. The respondents were asked to rate the importance of seven sections of the corporate report on a five point scale where 1 is very important and 5 not important at all (see Part 2, Question 3 of the questionnaire in Appendix A). Responses to this question are presented in Tables 8-14 and 8-15. Table 8-14 shows the mean scores, the standard deviations and the coefficients of variation. The frequency of responses of the importance of the various sections of the corporate annual report by investment analysts are presented in Table 8-15.

As can be seen from Table 8-14, investment analysts ranked the income statement as the most important section of the corporate annual report with a mean score of 1.079. The balance sheet was ranked the second most important section with a mean score of 1.161. The coefficient of variation for these two sections are the lowest (income statement: 0.251 and balance sheet: 0.318) among all other sections which indicates the level of agreement within the analysts group regarding the importance of these two sections for their investment decisions and recommendations. This finding is confirmed by the results shown in Table 8-15 where all of the respondents perceived the income statement and balance sheet to be either very important or important to their investment activities. The statement of changes in financial position was ranked by the analysts as the third most important section of the corporate annual report (mean score of 1.579) and the director's report the least important section with a mean score of 2.238. The director's report, theoretically, should be influential since in the UK it sets out the future for the company. However, in Saudi Arabia this report provides a summary of the company's achievements for the previous year and it gives little indications for future plans. Such report may be useful for individual and unsophisticated investors, but surely it is in a little use for investment analysts. This may explain the low ranking given to this report by investment analysts.

The findings of this section were expected since the three sections ranked as most important: the income statement, balance sheet and statement of changes in financial position, are widely accepted as being the foundation of a corporate annual report and provide most of the information needed for investment analysis. The sections relating to the basis of preparation of the above sections, such as notes to the account and auditor's report were ranked by analysts next in importance. This may be seen as a surprising result. Certainly an audit qualification would be regarded as very important in the UK or USA. Moreover, the notes to the Accounts should help the analysts interpret the Income Statement, Balance Sheet and statement of changes in financial position. Although, notes to the accounts and auditor's report are shown separately in the annual report they all go together for the purpose of assessing corporate performance.

Table 8–14

Importance of Sections of Annual Reports

Annual Reports Sections	Rank	MEAN	S. D	C. V
Income Statement	1	1.079	0.271	0.251
Balance Sheet	2	1.161	0.369	0.318
Statement of Changes in Financial Position	3	1.579	0.794	0.502
Statement of Accounting Policies	4	1.919	0.852	0.444
Notes to the Account	5	1.968	0.971	0.493
Auditor's Report	6	2.000	0.963	0.482
Director's Report	7	2.238	1.127	0.504

S. D.= Standard Deviation. C. V.= Coefficient of variation

Table 8–15

Frequency of Responses of the Importance of the Sections of Annual Reports

Annual Reports Sections	1	2	3	4	5
Income Statement	92%	8%	–	–	–
Balance Sheet	84%	16%	–	–	–
Statement of Changes in Financial Position	56%	33%	9%	–	2%
Statement of Accounting Policies	34%	45%	17%	2%	2%
Notes to the Accounts	42%	24%	30%	2%	2%
Auditor's Report	35%	41%	13%	11%	–
Director's Report	27%	41%	21%	3%	8%

1= very important. 2= important.
3= neutral. 4= not very important. 5= not important at all.

8.4. Uses of the Corporate Annual Report

Question 2 of Part 2 of the questionnaire asked the analysts to indicate the importance of the corporate annual report with regard to seven areas relating to their investment activities using a five point scale where 1 is very important and 5 not important at all (see Appendix A). The responses to this question are tabulated in Tables 8-16 and 8-17.

Providing primary data for investment activities was ranked by the respondents as the most important use of the corporate annual report with a mean score of 1.341, followed by investigating companies to make new or additional investment with a mean score of 1.381. Forecasting profit and EPS was ranked as the third most important use of the corporate annual report (mean score of 1.429). As can be seen from Table 8-17 none of the above three uses of annual reports rated either as not important at all or not very important.

Using the corporate annual report to make comparisons of the company's performance over time or with that of other companies were ranked fourth and fifth respectively. Preparing ratios or commentaries was ranked as the least important use of the corporate annual report with a mean score of 1.667. The low ranking given to the comparison of inter-company performance revealed an interesting insight into the accounting practice in Saudi Arabia. The limited use of corporate annual reports for the comparison of inter-company performance could be due to that these reports are prepared with varying degrees of quality and accounting policy and practices differed from one company to another.

The main finding of this section, which is that the most important use of the corporate annual report is to provide primary data for investment activities, may explain why investment analysts indicated that corporate annual report is the most important source of information for their investment activities. Its importance derives from the fact that it serves as the basis for the interpretation of all other information from the various sources received during the financial year. This result implies that the usefulness of the information received from any other sources would be limited without combining it with the information provided in the corporate annual report. This suggests that even_though the corporate annual report is issued at the end of the financial year, it is being used by the analysts over the whole year.

Table 8–16

Ranking of the Areas of Usefulness of Company Annual Reports

Usefulness of Company Annual Reports	Rank	Mean	S. T	C. V
Provide primary data	1	1.341	0.568	0.423
Investigate to make investment	2	1.381	0.578	0.418
Forecast profits & EPS	3	1.429	0.698	0.488
Comparison over time	4	1.492	0.713	0.478
Comparison with other companies	5	1.619	0.866	0.535
Monitor previous investment	6	1.651	0.697	0.422
Prepare ratios or commentaries	7	1.667	0.912	0.547

S. D.= Standard Deviation
C. V.= Coefficient of variation

Table 8–17

Frequency of Responses of the Usefulness of Company Annual Reports for Areas Relating to Investment Decisions

Usefulness of Company Annual Reports	1	2	3	4	5
Provide primary data	71%	24%	5%	–	–
Investigate to make investment	67%	28%	5%	–	–
Forecast profits & EPS	69%	19%	12%	–	–
Comparison over time	62%	28%	8%	2%	–
Comparison with other companies	57%	28%	11%	2%	2%
Monitor previous investment	46%	44%	8%	2%	–
Prepare ratios or commentaries	54%	32%	11%	3%	–

8.5. Levels of Adjustment of Corporate Annual Report Items

Eight items were identified and presented to the respondents to indicate the level of adjustment, if any, they usually make to these items in their investment analysis (see Part 2, Question 4-A of the questionnaire in Appendix A). The importance of this question derives from the fact that the responses will give both preparers and standard setters of corporate annual reports a clear indication of the areas that need to be improved. Since increasing the usefulness of the corporate annual report is the main aim of all parties involved, satisfying the needs of a primary user group such as investment analysts is considered to be a major step in fulfilling this objective.

Table 8-18 shows that the item adjusted most by the analysts is fixed assets valuation. 46% of the respondents indicated that they make major adjustments to the fixed assets figures presented in corporate annual reports in their investment analysis and 32% make minor adjustments. Annual depreciation expense figures were the second most adjusted item by the analysts. Effects of changes in exchange rate was ranked as the least adjusted item with only 17% of analysts indicating that they make a major adjustment to this figure.

Normally revaluation of assets would be for inter company comparisons or ratio analysis. However, investment analysts gave a low ranking for both and yet they regarded fixed assets as the most adjusted item in financial statements. These results may appear to be inconsistent, however, one possible explanation may be that inter company comparisons are very important to the analysts and this can be seen in the light of the many adjustments they make to the items in financial statements. On the other hand, the analysts gave a low ranking to inter company comparisons because the corporate annual reports, as prepared today, are not in the ideal status for comparison purposes, so many adjustments had to be made to use these report for inter company comparisons. More over, investment analysts indicated that, as can be seen from table 8-26, the use of a standard format by all companies would increase their confidence in using the corporate annual report. This result is another clear indication of the importance of inter company comparisons for the analysts. So, by looking at these results together, low ranking to inter company comparisons, high ranking to revaluation of assets and high ranking to the use of standard format, it can be concluded that investment analysts look at inter company comparisons as very important use of the corporate annual report, but the way these reports are prepared today does not help them to carry out such comparisons straight away.

Table 8–18

Extent of Adjustment to Financial Statements Items

Name of the Item	Major adjustment	Minor Adjustment	No Adjustment
Fixed assets valuation	46%	32%	22%
Annual Depreciation Expense	33%	38%	29%
Earnings per share	33%	27%	40%
Intangible assets	30%	35%	35%
Inventory valuation	30%	33%	37%
Investment	29%	44%	27%
Extraordinary items	19%	43%	38%
Effects of changes in exchange rate	17%	43%	40%

Investment analysts were asked about the reasons for such adjustment (see Part 2, Question 40-B of the questionnaire in Appendix A). The responses to this question are presented in Tables 8-19 and 8-20. Investment analysts ranked valuation base as the most important reason for their adjustments with a mean score of 1.388, followed by recognition of revenue as the second reason with a mean score of 1.750. As can be seen from results above that all of the items shown in Table 8-18 are adjusted by at least 60%

of the analysts participating in this survey. Moreover, the most adjusted items, fixed assets valuation and annual depreciation expense, are related to the valuation base.

The valuation base used by companies might affect the recommendations or decisions that analysts might make. For example, using acquisition cost (historical cost) as the basis for measuring and recording acquired assets, as it is required by the standard -para 287- issued by Ministry of Commerce (see Chapter 4), without disclosing any information about current market value for these assets. Such practice may lead investment analysts to undertake revaluation of these assets and then calculate companies' results based on the current market value of these assets. In UK, even though, nearly all enterprises prepare their financial statement under the historical cost convention, they are encouraged to disclose information about the current year's result and financial position on the basis of current cost asset valuation (ASC- ED 51, 1991). The financial position of companies can also be affected by the use of alternative treatments for items such as depreciation and inventory valuation. Since the net income for any company can be increased (decreased) by changing from one depreciation or inventory method to another, it is so important for the analysts to know the financial position of the company under different circumstances and alternative treatments. In doing so investment analysts need to undertake many adjustments to the figures appearing in financial statements.

An alternative explanation for so many adjustments may be due to the fact that these figures are not adequately disclosed or that the accounting policies used in preparing them were not appropriate. Or it could be that the figures are prepared and disclosed in an appropriate way, but investment analysts need to adjust them in order to fulfil certain special needs of their investment analysis that cannot be seen by the preparers of the corporate annual report. In this case, the preparers are encouraged to provide more information about the figures in the annual report to enable the analysts to more easily carry out any adjustments necessary for their investment analysis. Doing so would greatly increase the usefulness of the corporate annual report for this primary user group. However, releasing information to satisfy the needs of one group may damage the interests of another group. Indeed it may damage the interests -competitive position- of the company itself.

Table 8–19

Reasons for Adjustment

Reason for Adjustment	Rank	Mean	S. T	C. V
Valuation Base	1	1.388	0.732	0.527
Recognition of Revenue	2	1.750	0.874	0.499
Determination of Cost	3	2.052	1.033	0.503

S. T: Standard Deviation.
C. V: Coefficient of Variation.

Table 8–20

Frequency of Responses of Reasons for Adjustments

Reason for Adjustment	Very important	Important	Neutral	Not very important	Not important at all
Valuation Base	69%	26%	2%	1%	2%
Recognition of Revenue	46%	37%	13%	2%	2%
Determination of Cost	33%	41%	19%	2%	5%

8.5.1. Relationship Between Respondents Characteristics and Level of Adjustment

Knowledge of accounting and years of experience are the two main background characteristics that were thought to influence the level of adjustment to the items presented in the corporate annual report. These two background characteristics were tested to see whether there is a relationship between them and the level of adjustment.

Since some of the adjustments made to the figures presented in the corporate annual report are considered to be technically complex, it was hypothesised that analysts who are specialised in accounting would adjust these figures to a greater extent than those who are not specialised in accounting. The same thing can be said about those analysts who have more years of experience in analysing corporate annual reports.

Chi-square tests were performed for both background characteristics and the results are shown in Tables 8-21 and 8-22. The results in Table 8-21 indicate that at the 0.05 level of significant there is relationship between investment analysts' qualifications in accounting and level of adjustment to four figures out of the eight included in this table. These are depreciation expenses, earnings per share, extraordinary items and investment. However, these findings are inconsistent with what has been hypothesised since in some cases analysts who are not specialised in accounting adjust the figures to a greater extent than the other group as in the cases of extraordinary items and earnings per share. 26% of investment analysts who are not specialised in accounting make a major adjustment to extraordinary items where only 10% of those analysts who are specialised in accounting make such adjustment. With regard to earning per share 38% of analysts who are not specialised in accounting and only 20% of the other group make a major adjustment to this item. The question that needs to be addressed is that why would non accounting specialists adjust these items more than accounting specialists. In deed, 60% of the accounting specialists do not adjust extraordinary items at all and 55% of them also make no adjustment to earning per share. A possible explanation could be that the accounting specialists feel that adjusting these items does not add value. So, as can be seen from the discussion above that the results are mixed and no firm conclusion with regard to the existence of a relationship between investment analysts qualification and level of adjustment can be drawn based on such findings.

With regard to the second background characteristic examined in this section the chi-square results in Table 8-22 show the existence of a relationship between all items included in this table and number of years of experience at 0.05 level of significance. Investment analysts with more experience adjust corporate annual report figures to a greater extent than the other groups. For example, 29% of investment analysts with experience less than 5 years make major adjustment to fixed assets where 68% of the analysts with experience more than 10 years make this kind of adjustment. All other items follow the same pattern. So it can be concluded that there is a clear relationship between investment analysts experience and level of adjustment to the various figures presented in the corporate annual report which is consistent with the hypothesis. In other words, these results indicated that the more years of experience investment analysts have the more adjustments they made to the various items that appear in the corporate annual report. Clearly one interpretation of this evidence is that accounting qualifications do matter in revising accounting results, however it is quickly dominated by years of experience.

Table 8–21

Chi-square Test Results of Differences Between Level of Adjustment According to Knowledge of Accounting

Name of the Item	Major Adjustment		Minor Adjustment		No Adjustment		D. F	X^2	α =.05
	G1	G2	G1	G2	G1	G2			
Fixed assets valuation	45%	51%	35%	28%	20%	21%	2	0.62	N. S
Depreciation Expenses	40%	31%	20%	51%	40%	18%	2	12.80	S
Inventory valuation	35%	31%	20%	41%	45%	28%	2	5.79	N. S
Earnings per share	20%	38%	25%	31%	55%	31%	2	7.09	S
Extraordinary items	10%	26%	30%	48%	60%	26%	2	13.74	S
Intangible assets	25%	36%	40%	31%	35%	33%	2	1.66	N. S
Effects of exchange rate	20%	16%	30%	51%	50%	32%	2	5.12	N. S
Investment	30%	28%	30%	54%	40%	18%	2	8.37	S

Group 1: Investment analysts with accounting major. D. F: Degree of freedom. S: Significant
Group 2: Investment analysts with other business major. N. S: Not significant..

Table 8–22

Chi-square Test Results of Differences Between Level of Adjustment According to Experience

Name of the Item	Maj..- Adjus..			Min..- Adjus..			No Adjus..			D.F	X^2	α =.05
	G1	G2	G3	G1	G2	G3	G1	G2	G3			
Fixed assets valuation	29%	45%	68%	33%	45%	16%	38%	10%	16%	4	20.85	S
Depreciation Expense	21%	20%	63%	29%	65%	21%	50%	15%	16%	4	38.49	S
Inventory valuation	12%	45%	37%	25%	35%	42%	63%	20%	21%	4	24.71	S
Earning per share	17%	45%	42%	29%	15%	37%	54%	40%	21%	4	15.96	S
Extraordinary items	17%	10%	32%	25%	60%	47%	58%	30%	21%	4	20.24	S
Intangible assets	25%	15%	53%	25%	60%	21%	50%	25%	26%	4	25.54	S
Effects of exchange rate	0%	25%	29%	46%	55%	26%	54%	20%	45%	4	23.54	S
Investment	17%	30%	42%	37%	60%	37%	46%	10%	21%	4	19.13	S

Group 1: Investment analysts with 1-5 years experience.
Group 2: Investment analysts with 6-10 years of experience.
Group 3: Investment analysts with 11-up years of experience.
D.F: Degree of freedom.
S: Significant.

8.6. Investment Analysts Understanding and Confidence in Using Corporate Annual Reports

The previous sections revealed that investment analysts depend heavily on the information provided in the corporate annual report for their investment activities. For more investigation, the analysts were asked to indicate the following (see Appendix A, Question 5 of Part 2):

- Degree of understanding of the information contained in the corporate annual report.
- Degree of relevance of this information to their investment activities.
- Degree of confidence in using the corporate annual report for investment decisions and recommendations.

Table 8-23 shows that the majority of respondents (79%) either understand or fully understand the information contained in corporate annual report. Only 5% of the respondents indicated little understanding and no one replied that such information is not understood. With regard to the relevance of the corporate annual report, 36% of the respondent said that it is very relevant and 40% rated it as relevant for their investment activities.

The results in Table 8-25 shows that investment analysts are reasonably confident in using the information provided in the corporate annual report. However, only 9% of the respondents replied that they are very confident in using such information. In chapter five it was discussed that the financial information to be useful it has to be relevant, reliable, understandable and comparable. these are the major characteristics of accounting information which have to be met to fulfil the fundamental objective of such information. based on the results in this section and section 8. 4 it can be concluded that the information provided in the corporate annual report are considered by one major group of user - investment analysts - to be relevant, reliable and understandable. however, with regard to comparability the corporate report seems to have failed to meet this characteristics (see Section 8. 4).

Table 8–23

Degree of Understanding of Information Contained in Company Annual Reports

Fully understand		Understand		50% understand		Little understand		Do not understand		Total	
#	%	#	%	#	%	#	%	#	%	#	%
38	30%	62	49%	20	16%	6	5%	-	-	**126**	**100%**

Table 8–24

Degree of Relevance of the Information Contained in Company Annual Reports with Regards to Investment Decisions

Very relevant		Relevant		50% relevant		Little relevance		No relevance		Total	
#	%	#	%	#	%	#	%	#	%	#	%
46	36%	50	40%	26	21%	4	3%	-	-	**126**	**100%**

Table 8–25

Degree of Confidence in Using Corporate Annual Reports for Investment Decisions

Very confident		Confident		50% confident		Little confidence		No confidence		Total	
#	%	#	%	#	%	#	%	#	%	#	%
12	9%	50	40%	48	38%	16	13%	-	-	**126**	**100%**

The respondent were asked to rate four factors thought to effect their confidence in using corporate annual reports (see Question 6, Part 2 of the questionnaire in Appendix A). Their responses are presented in Tables 8-26 and 8-27. Investment analysts indicated that the use of a standard format in presenting the financial statements by all companies would be the most important factor for increasing their confidence in using the corporate annual report in their investment activities. Standards set by an independent body was rated as the second most important factor. At the present time, the Saudi Organisation for Certified Public Accountants (SOCPA) is the body in charge of setting accounting standards. The SOCPA is not an independent body since it operates under the supervision of Ministry of Commerce and all thirteen members of its board of directors are appointed by the Minister of Commerce (see Chapter 4). The findings of this section give an indication of the desire of a major user group for changes to be made to this body (SOCPA) to make it more independent and thus better represent the whole accounting community. Increased government regulation was ranked as the third factor that would increase investment analysts in using the information provided in the corporate annual report. These results might seem to overlap, yet investment analysts want more government regulation when they indicated that they want the standards to be set by an independent body. However it can be interpreted as that investment analysts overall need more regulations to increase their confidence in the corporate annual reports even if these regulations are to be issued by the present body which is considered to be government agency. Furthermore, the analysts confidence in the corporate annual report will increase even more if this body is independent.

The whole idea of increasing accounting standards which is a main demand for investment analysts, is debatable (see Chapter 5). Whether there should be standards for financial reporting, how tight the standards should be, who sets the standards and should it be international standards, all these questions need to be answered before making a recommendation to increase regulations. Increasing regulations might satisfy the needs of a major user group such as investment analysts but ,on the other hand, it may damage the interests of another group such as company management. The interests of all parties involved have to be taken in account when making a recommendation to increase financial reporting regulations as well as the cost associated with it.

It is an important objective for the regulative authority and the accounting professional to determine the needs of all users - external and internal - of financial reporting so they can proceed with the process of setting standards and regulations. Indeed, the main objective of financial reporting is to satisfy the needs of its users. Therefore, its important to carry out a research among these users to determine their needs. Surely there will be conflict of interests between the different user groups, but the first step in attempting to resolve these conflicts is to point them out. This can be done through a comparison of the research findings for each group which will give a clear picture of the similarities and differences between these groups. So this research is one step to fulfil a part of this objective by studying the needs of a major user group -investment analysts - and further research should be carried out to investigate the needs of other groups.

Table 8–26

Responses to Factors Effecting Confidence in Corporate Annual Reports

Name of Factor	1	2	3	4	5
Standard Format	54%	36%	10%	-	-
Audit by International Firm	44%	27%	22%	5%	2%
Standards Set by an Independent Body	59%	23%	11%	3%	4%
Increase Government Regulation	45%	32%	21%	2%	-

1: Greatly increase confidence.
2: Increase confidence.
3: No change in confidence.
4: Decrease confidence.
5: Greatly decrease confidence.

Table 8–27

Ranking of the Factors Effecting Confidence in Corporate Annual Reports

Name of Factor	Rank	Mean	S.D	C.V
Standard Format	1	1.564	0.675	0.432
Standards Set by an Independent Body	2	1.706	1.051	0.616
Increase Government Regulation	3	1.786	0.826	0.462
Audit by International Firm	4	1.921	1.001	0.521

S. D.= Standard Deviation.
C. V.= Coefficient of variation.

8.7. Attitudes Towards the Corporate Annual Report

In Question 7 of Part two of the questionnaire (see Appendix A) the respondents were asked to indicate their degree of agreement or disagreement with seven statements regarding the corporate annual report. A scale of five points was used for answering this question where 1 is strongly agree and 5 is strongly disagree. The responses are tabulated in Tables 8-28 and 8-29.

All respondents indicated that they are either strongly agree (87%) or agree (13%) with that the auditors should exercise strict rules regarding codes of ethics and standards of professional behaviour. This statement obtained the highest level of agreement among investment analysts followed by statement concerns with auditors qualification and experience which should be adequate to prevent abuse and misrepresentation of the information in the corporate annual report. Investment analysts in table 8-14 gave a low ranking to the auditor's report. Then in table 8-26 they indicated that if an audit was carried out by an international firm that would increase their confidence in the corporate annual report. The results in this section show that the analysts are concerned about the role of the external auditor. So one interpretation of these results that the analysts are cuurrently not entirely satisfied with the job of local audit firms.

Tables 8-29 shows that the lowest level of agreement among the respondents is associated with the ability of the company' management to decide which reporting practices should be restricted.

Table 8–28

Attitude Towards Corporate Annual Reports

The Statement	1	2	3	4	5
Auditors exercise strict rules regarding codes of ethics and standards of professional behaviour	87%	13%	-	-	-
Auditors qualifications and experience are adequate to prevent abuse and misrepresentations in the accounts of companies	84%	14%	2%	-	-
Company's external auditors are independent of management influence	82%	14%	2%	2%	-
SOCPA[1] should strictly enforce its rules of professional conduct	82%	13%	3%	2%	-
All companies should prepare their financial statements using the same accounting practices	59%	25%	10%	6%	-
All accounts presented by companies should be standardised	43%	46%	6%	3%	2%
The ability of the company's management to decide which reporting practices to use should be restricted	46%	39%	9%	5%	1%

1: strongly agree.
2: agree.
3: indifferent.
4: disagree.
5: strongly disagree.

[1] Saudi organisation for certified public accountants

Table 8–29

Ranking of Attitude Statements Towards Corporate Annual Reports

The Statements	Rank	Mean	S. D	C. V
Auditors exercise strict rules regarding codes of ethics and standards of professional behaviour	1	1.127	0.334	0.297
Auditors qualifications and experience are adequate to prevent abuse and misrepresentations in the accounts of companies	2	1.175	0.421	0.358
Company's external auditors are independent of management influence	3	1.222	0.550	0.450
SOCPA should strictly enforce its rules of professional conduct	4	1.230	0.635	0.516
All companies should prepare their financial statements using the same accounting practices	5	1.635	0.900	0.550
All accounts presented by companies should be standardised	6	1.746	0.838	0.480
The ability of the company's management to decide which reporting practices to use should be restricted	7	1.770	0.914	0.516

1: strongly agree
2: agree
3: indifferent
4: disagree.
5: strongly disagree.

As can be seen from these tables, the results indicate a higher level of agreement among investment analysts with regard to statements about external auditors compared to those that dealt with other issues such as accounting practices and standards. 87% of investment analysts indicated that they strongly agree with that auditors should exercise strict rules regarding codes of ethics and standards of professional behaviour. The next two statement which obtained a high level of agreement among investment analysts are also concerned with external auditors. In a country such as Saudi Arabia, which has only recently started to develop and set accounting standards and practices (see Chapter 4), it was supposed that investment analysts would be more concerned with this process than with any other issue. However, the findings in this section suggest that the analysts are more concerned about external auditors.

One possible reason could be that investment analysts are not sure if the external auditor's role is carried out correctly. So they emphasised the statements that dealt with external auditor more than those dealt with accounting standards and practices. An alternative reason could be that investment analysts are not interested in strict rules and regulations because it could be argued that if standards are too tight, management cannot signal their financial strategy to investors and influence the company' valuation. Further more, investment analysts would want management to have some discretion in reporting their results so as to reflect the realities of the business. Tight standards might not enable the management to carry out such practice.

8.8. Demands for Additional Disclosure

The last question of Part two of the questionnaire asked the respondents to rate the usefulness of seven items, that are not published regularly in corporate annual reports, for their investment activities by using a scale of five points whereas 1 is very useful and 5 is not useful at all. The purpose of this question was to identify the items that are most needed by the analysts, in order that they may be included in future and thus increase the usefulness of the report.

Table 8-30 shows that more than 80% of the respondents rated all the items except two, general economic conditions and directors and senior management, either as very useful or useful. Expected profit for next year was ranked as the most useful item by the analysts with a mean score of 1.309 followed by expected amount of sales for the next year with a mean score of 1.349 (table 8-31). Directors of the company and senior management was ranked as the least useful item where 8% of the respondents rated it either as not very useful or not useful at all. This is a surprising result, it was expected that knowing those who run the business on behalf of shareholders is important. Indeed in countries such as UK and USA you often find share price reaction to the appointment of new director or the unexpected death of a key director. However, this result may reflect a cultural phenomenon rather than any thing else. In a country such as Saudi Arabia whereas the social relationships are very strong, it is easy to know the name of a company's director through the social activities. So, investment analysts are not interested in this piece of information to be included in the corporate annual report since they can easily get it from other sources.

Table 8–30

Views Regarding Additional Disclosure

Disclosure Requirement	1	2	3	4	5
Expected Profits Next Year	72%	25%	3%	-	-
Expected Amount of Sales Next Year	66%	32%	2%	-	-
Dividends Forecast Next Year	70%	25%	5%	-	-
Future of the Company	62%	24%	14%	-	-
Financial Policy of the Company	49%	41%	8%	2%	-
General Economic Condition	39%	34%	22%	2%	3%
Directors & Senior Management	27%	35%	30%	6%	2%

1: Very useful. 2: Useful. 3: Neutral. 4: Not very useful. 5: Not useful at all.

Table 8–31

Ranking of Additional Disclosure Requirements

Disclosure Requirement	Rank	Mean	S. D	C. V
Expected Profits Next Year	1	1.309	0.529	0.404
Expected Amount of Sales Next Year	2	1.349	0.511	0.379
Dividends Forecast Next Year	3	1.349	0.570	0.423
Future of the Company	4	1.524	0.734	0.482
Financial Policy of the Company	5	1.619	0.703	0.434
General Economic Condition	6	1.960	0.983	0.502
Directors & Senior Management	7	2.206	0.966	0.438

S. D.= Standard Deviation. C. V.= Coefficient of variation

The findings of this section indicate a great deal of demand for additional disclosure by investment analysts. The disclosure of these items in the corporate annual report might increase its usefulness by satisfying the needs of a major user group, however the cost/benefit factor associated with such a practice has to be taken in account. Benefits from increasing the amount of information provided in the corporate annual report are difficult to identify and measure. Although there is evidence that more accounting information is useful to certain user group, as it has been the case for investment analysts in this study, these benefits might be undermined by the damage that such practice might cause to another group. Therefore, the benefits have to be seen from the points of view of all parties involved. On the other hand, the cost of giving more information might not be only the money cost of providing and preparing this information. Releasing more information may lead the company to lose its competitive position in the market, so the opportunity cost should be taken in account when assessing the cost of giving more information.

8.9. Summary

The main objective of this study was to examine how investment analysts in Saudi Arabia evaluate and perceive the corporate annual report and its role in their investment activities. The findings of this study revealed the importance of corporate annual reports to the analysts in making investment decisions and recommendations, the uses of these reports for investment activities and the importance of various sections of the corporate annual report. Moreover, this study investigated the extent of the adjustments made to the figures appearing in corporate annual reports as well as investment analysts' understanding and confidence in using the information provided for their investment activities. Investment analysts' attitudes towards the corporate annual report and their demands for additional disclosure were also presented in this chapter.

All these results and findings were discussed in detail in this chapter and can be summarised as follow:

- Investment analysts regard the corporate annual report as the most important source of information among all other sources for their investment decisions and recommendations. 98% of the respondents rated the corporate annual report either as very important or important.
- A comparison between the current study results, regarding the importance of various sources of information, with those of other similar studies showed more consistency between this study and the study carried out in another developing country (Malaysia) than with those carried out in developed countries.
- The investigation of investment analysts background characteristics indicated that even though some of these factors effected their perception of the importance of the various sources of information, that was not the case with regard to the corporate annual report. Investment analysts, regardless of their background characteristics, evaluated the corporate annual report as the most important source of information.
- Investment analysts evaluated income statements and balance sheets as the most important sections of the corporate annual report.
- It was found that the most important use of the corporate annual report to investment analysts is to provide primary data for their investment activities.
- The results showed that at least 60% of the analysts adjust the items identified in the survey to some degree. The analysis of the relationship between two of the respondents

background factors and level of adjustment revealed mixed results with regard to knowledge in accounting and a clear relationship between years of experience and level of adjustment.

- 79% of the respondents indicated that they either understand or fully understand the information provided in corporate annual reports. The majority of the investment analysts found these reports to be relevant to their investment activities. The results also indicated that the respondents are reasonably confident in using the information included in these reports.

- Investment analysts were found to be more concerned about the role of a company's external auditors than with issues related to accounting practices and standards.

- Finally, the results indicated a great deal of demand for additional disclosure by the investment analysts.

Chapter Nine
Conclusions

The aim of this chapter is to summarise the major findings of the study and suggest some recommendations based on these findings. The limitations of the study as well as suggestions for future research will be presented in this chapter.

9.1. The Research Project

In a developing country such as Saudi Arabia where alternative sources of company information tend to be more limited in a quantity and quality, the role of corporate annual reports for investment activities assumes a much more dominant and prominent role than in the more advanced and economically developed countries. This study was undertaken to examine empirically the usefulness of corporate annual reports to investment analysts in Saudi Arabia and their role in their investment activities.

Before undertaking the empirical investigation it was essential to provide a background of the economic and accounting environment under which the Saudi companies operate and investment activities being carried out. Three chapters are designed to fulfil this objective, these are Chapter 2, 3 and 4. Chapter two was aimed at highlighting the economic development and the components of the Saudi Arabian financial system. The major elements of each development plan in a series of five-year development plans were presented and discussed. The three major components of the financial system, Saudi Arabia Monetary Agency(SAMA), commercial banks and specialist credit institutions, were presented as well in this chapter

Even though accounting information is required for economic analysis, policy formulation and public resource allocation, it was observed that there was no mention of the importance of such information in the development plans. The increasing role of the private sector as a source of investment financing will generate more demand for accounting information to guarantee sufficient investor confidence as well as to encourage the flow of capital. Accordingly, more emphasis needs to be given to the accounting and financial information in the process of economic development planning in the future.

The development of Saudi Arabia stock market was discussed in Chapter 3. The stock market was regulated in 1984 when the government, due to many problems that were facing the market at that time, issued new rules and regulation to monitor and control the share trading activities. A review of the studies that were conducted to measure the efficiency of the stock market indicated that it is an inefficient stock market. This would suggest that there are opportunities for riskless profit but importantly that publicly available accounting information may reduce the returns to private information.

The development of accounting profession and practice and the regulation related to accounting were presented in Chapter 4. It was noticed that until 1986 there were no laws or regulations defining the objective and the functions of the accounting and reporting practices. In fact the only legal requirement for companies was to provide a balance sheet, a profit and loss account, a director's report, and an auditor's report. This requirement was stated in the Company Act which was along with the Accountant Regulations the only authoritative guides for accounting practices. However, no details of the form and content of these reports and statement nor the methods of measurement were given in this Act. An important move towards developing accounting and reporting practices took place in 1986 when the government issued a statement of the concepts and objectives of financial accounting and a general presentation and disclosure standard. This was followed by the creation of the Saudi Organisation for Certified Public Accountants (SOCPA) in 1992. The main aim of this organisation is to review, develop and approve accounting and auditing standards.

The next stage (Chapter 5) was concentrated in reviewing the literature related to usefulness of financial information. This review is believed to be an important step in providing a framework for the empirical investigation. The two main approaches associated with the objective of financial reporting which are the accountability or stewardship function and the decision usefulness were presented and discussed. Investors' survey and the efficient market hypothesis (EMH) are the most common methods used in previous studies for evaluating the usefulness of financial information. Based on the discussion of these two methods, it was concluded that an investors survey will be used in carrying out this project since it was more applicable than the EMH. Previous studies involving the usefulness of accounting information for both individual investors and investment analysts were reviewed and discussed.

9.2. Research Methodology

To achieve the main objective of this research which was to evaluate the importance of corporate annual reports to the investment analysts in Saudi Arabia, a survey was carried out to obtain the investment analysts' views of the annual reports, the importance they attached to them and the uses of these reports in their investment activities.

Interview and postal questionnaire are the most common methods used in previous studies for surveying investment analysts. Based on a discussion of the advantages and disadvantages of these two methods and in the view of the study's objectives as well as the environment and condition under which the study was conducted, it was decided that a combination of postal and self-administered questionnaire would be the most suitable technique to be employed (see Chapter 6).

A total of 249 questionnaires were distributed, from which 126 were collected which represents a response rate of 51% (Chapter 7). Even though this response rate was considered to be satisfactory, a non-response bias test was carried out in order to be more confident in generalising the results obtained from the survey. The results of this test indicated that, generally, the answers given by the respondents to the survey are representative of the population of investment analysts as a whole in Saudi Arabia. So the results obtained from the survey may be generalised.

9.3. Summary of findings

A major finding of the study is that the corporate annual report is the most important source of information for investment analysts in their investment activities. 86% of the respondents rated the corporate annual reports as very important for their investment decisions or recommendations and 12% rated them as important. Significantly, non of the respondents rated the corporate annual reports either as not important at all or not very important.

Five of the investment analysts background characteristics were examined to see whether differences in such characteristics would affect their perception of the importance of the various sources of information. These characteristics are the following:

- Qualification in accounting.
- Places where degree obtained.
- Place of experience.
- Investment analysts' years of experience.
- Management level.

The Statistical tests results showed that investment analysts, despite the differences in their background characteristics, still regard corporate annual reports as the most important source of information for their investment activities. This finding gives both preparers of corporate annual reports and standards setters a clear indication of what a major effect that misleading information contained in these reports would have in the investment community.

In evaluating the importance of various sections of the corporate annual report, the respondents rated the income statement as the most important section followed by the balance sheet. 92% of the respondents rated the income statement as very important and 8% as important for their investment activities. With regard to the balance sheet, 84% of the respondents rated it as very important and 16% as important. Non of the respondents rated either sections as either not important at all or not very important. Streuly (1994) argued that the favourable views of respondents regarding the usefulness of the primary financial statements such as income statement and balance sheet, clearly provide favourable evidence about the attainment of the primary objective of financial reporting.

Another important result of this study indicated that the most important use of the corporate annual reports is to provide primary data for investment activities. The annual report represent the major routine information event over the financial year. This type of information would serve adequately to conduct the fundamental analysis employed by most investment analysts. Gniewosz in 1990 argued that the used made of the annual report, and thus its significance as a major information source, changes during the year. At times it is used as a primary source of information while at other times it is used more in a confimatory role. He added that the annual report acts not only as a source of information to an inquiry but also provides the stimulus for identifying questions to be pursued via other sources. This argument gives explanation to why the annual report was chosen as the most important source of information even though other sources of information might be used extensively by investment analysts.

With regard to level of adjustments to various figures contained in the corporate annual report, the results indicated that 60% of the respondents make either major or minor adjustments to these figures. It was found that fixed assets valuation is the most adjusted item by the analysts followed by depreciation expense. Furthermore, investment analysts knowledge in accounting and years of experience were tested against level of adjustments to see whether there is a relationship between them. With regard to the investment analysts knowledge in accounting, the results were mixed, so no firm conclusion was drown. However, it was found that there is a clear relationship between investment analysts' years of experience and level of adjustments. Investment analysts with more experience adjust corporate annual report figures to a greater extent than those with less experience.

The results of this study also showed that the majority of investment analysts find the information provided in the corporate annual reports to be understood and relevant to their investments activities. However, with regard to their confidence in using annual report information, the result was moderate. Only 9% of the respondents indicated that they are very confident in using such information. The use of a standard format in presenting the financial statements by all companies and standards set by an independent body are the most important factors that were indicated by the respondents to increase their confidence. The first factor which is the use of standard format, may provide some explanation as to why the analysts gave a low ranking for "making a comparison with other companies" as one of the uses of the corporate annual reports. The lack of standard format in presenting corporate annual reports may have forced investment analysts to make so many adjustments in order to make comparisons between various corporate annual reports.

The findings also indicated that investment analysts are very concerned about how external auditors carry out their job. Even though Certified Public Accountants (C PAs) regulations which were issued in 1992 set out rules and technical standards to be followed, it seems to be there is a lack of compliance among external auditors. Article 10 of CPA regulations Stated that "A Certified Public Accountant shall comply with the professional code of ethics as well as accountancy, audit and other technical standards issued by Saudi Organisation for Certified Public Accountants (SOCPA)". As can be seen, the rules and regulations which control the role of external auditors are there, so what is needed is that the SOCPA carry out a review programme in order to insure that those auditors comply with such rules and regulations.

Finally, investment analysts expressed a great deal of demand for more information to be included in the corporate annual report. Company' management expectation with regard to profits, amount of sales and dividends for the future are the most interesting figures for investment analysts. However, a suggestion regarding additional disclosure should always take in mind the cost/benefit factor associated with it.

9.4. Recommendations

This study clearly shows that the corporate annual report is the most important source of information for investment analysts in Saudi Arabia in making investment decisions and recommendations. The rational investment decisions made by investment analysts will be a major step toward the best allocation of resources. For these decisions to be rational they have to based on correct and accurate information, otherwise, they will have a negative effect in the economy as whole. So it is the responsibility of SOCPA to insure that corporate annual reports are prepared and presented in compliance with the standards, rules and regulations. In doing so several steps can be taken such as the following:

- A violation of standards and regulations should be brought to the attention of both the external auditor and the company management.
- Where a company's management or auditor is found to be negligent, despite a warning, further action should be taken such as fines or suspension.

The corporate interim reports were ranked as the second most important source of information for investment analysts in making investment decisions or recommendations. However, unlike the annual reports the interim reports are not required to be audited and disclose the minimum amount of information. Given the importance of the interim reports , as shown in this study, to the investment analysts in Saudi Arabia, there is a need to control the preparation and content of these reports. the accounting profession should take the proper action to control and monitor the preparation of interim reports.

Investment analysts indicated that a major factor that would increase their confidence in using the information provided in the corporate annual report is that accounting standards are set by an independent body. Since its establishment in 1992 the Saudi Organisation for Certified Public Accountants (SOCPA), which is the body in charge of setting accounting standards, operates under the supervision of the Ministry of Commerce - all thirteen members of its board of directors are appointed by the Minister of Commerce. So, it is about time for changes to take place in the structure for this organisation to allow more participation and to be more representative of the whole accounting community in Saudi Arabia. Doing so not only will increase confidence in using corporate annual reports, but also will enhance compliance among companies and auditors with the standards issued by such organisation. If companies and external auditors were involved in the process of setting accounting standards, they would feel more responsible to comply with them than if such standards were enforced upon them.

9.5. Limitations

When interpreting the results and findings of this study the followings limitations have to be taken into consideration:

- The main focus of this study was the importance of one source of financial information namely the annual report of Saudi Arabian Companies. Other sources of information were not examined in detail.
- The findings of this study reflect the views of investment analysts in Saudi Arabia; that is those analysts who are employed by merchant banks, investment consulting institutions and investment firms; investment analysts working in other areas were excluded from this study.
- The findings of this study is limited only to Saudi Arabia. Because of the differences that may exist in the institutions, culture, accounting and investment environment , these findings are not capable of being extended to other countries.
- The limitations inherent to research involving the use of questionnaire methodology was discussed in Chapter 6. In particular, the problem associated with non-response bias. Even though the tests for non-response bias indicated that the answers given could be described as representative of the population of investment analysts, such a problem may still exist. As Courtis (1992) pointed out, "response and non-response survey bias can be reduced through various techniques, but the complete elimination of bias is never certain.".

Nonetheless, while it is recognised that this research has some limitations, it is believed that its findings provide a useful insight into the importance of corporate annual reports and how they have been perceived and evaluated by a major user group that is investment analysts.

9.6. Future Research

In the light of the research findings and conclusions, there is scope for future research in the area of financial reporting and disclosure. Firstly, this study concentrated on the usefulness of Saudi Arabian corporate annual reports to one major user group that is investment analysts. Future research could examine the usefulness of these reports to another major user group such as creditors. Then a comparison can be carried out to determine the differences and similarities among various user groups regarding their perception and evaluation of corporate annual reports.

Secondly, a conclusion reached in this study is that investment analysts are very concerned with how the job of external auditors are being carried out. A detailed study could be conducted to see if auditors fully comply with standards and regulations issued by the regulative authority in Saudi Arabia.

Finally, the findings of this study suggest that investment analysts are not satisfied with the fact that SOCPA , the body in charge of issuing accounting and auditing standards, is supervised and controlled by Ministry of Commerce. Therefore, there is a need for research into the acceptability of the standards issued by this organisation by companies in Saudi Arabia.

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APPENDIX A

QUESTIONNAIRE ON THE USEFULNESS OF INFORMATION PROVIDED IN COMPANIES ANNUAL REPORTS TO INVESTMENT ANALYSTS IN SAUDI ARABIA

إستبيان عن فائدة المعلومات المحاسبية المقدمة في التقارير المالية السنوية للشركات بالنسبة إلى محللي الاستثمار في المملكة العربية السعودية.

The objective of this questionnaire is to obtain your opinions regarding the uses and usefulness of companies annual reports in your investment activities. All information obtained from this questionnaire will be treated with strict confidence and will be used only for purpose of research.

(يهدف هذا الاستبيان إلى معرفة رأيك في استخدام وفائدة التقارير السنوية للشركات في نشاطاتك الإستثماريه مع العلم أن جميع المعلومات المستقاة من هذا الإستبيان سوف تعامل بسريه تامة وتستخدم فقط لأغراض البحث العلمي.)

اسم الباحث:

فؤاد أحمد آل الشيخ مبارك

جامعة الملك فيصل.

كلية العلوم الإدارية والتخطيط،

ألهفوف ص ب: 1760 ،

الرمز البريدي: 31982 .

Name of Researcher:
Faud Al-Mubarak
K.F.U
P.O Box: 1760
Al-Hofuf 31982

PART I

(الجزء الأول)

1. Do you hold a University Degree with a major in some field of business?

(هل تحمل شهادة جامعية في إحدى تخصصات العلوم الإدارية)

No ☐
لا

Yes ☐ Name of your major ....
نعم (التخصص)

Name of University ....
(اسم الجامعة)

2. To the nearest year, how many years of experience do you have as an investment analyst?(كم عدد سنوات خبرتك كمحلل استثمار، مقرباً إلى أقرب سنة)

Saudi Arabia ☐
(السعودية)

Number of years ....
(عدد السنوات)

Other Country ☐ please specify ....
(دولة أخرى) (حدد)

Number of years ....
(عدد السنوات)

3. Would you characterise yourself primarily as a:

(أقرب مسمى وظيفي لطبيعة عملك هو)

(a) security analyst ☐
(محلل استثمار في الأوراق المالية)

(b) fund or money manager ☐
(مدير أو مراقب مالي)

(c) investment advisor ☐
(مستشار استثماري)

(d) other (describe) .... ☐
(غير ما ذكر، حدد)

4. In your organisation's hierarchy, are you in:

(في الهيكل الإداري للمنشأة تلك تكون وظيفتك في)

(a) lower management ☐
(الإدارة الدنيا)

(b) middle management ☐
(الإدارة الوسطى)

(c) senior management ☐
(الإدارة العليا)

5. What type of decisions do you make:

(إلى أي من المجالات التالية يمكن أن تنسب طبيعة القرارات التي تتخذها)

(a) security recommendation ☐
(توصيات الاستثمار في الأوراق المالية)

(b) business valuation ☐
(تقييم التقارير المالية للشركات الأخرى بهدف أعمال تجارية مشتركة)

(c) credit rating ☐
(تقييم التقارير المالية الأخرى بهدف الإقراض)

(d) other (please specify) ☐
(غير ماذكر، حدد)

....

PART II

(الجزء الثاني)

Note:ملاحظة

Please use the following scale for questions 1, 2 and 3:

(الرجاء استخدام المقياس التالي للسؤال الأول والثاني والثالث)

1. very important(مهم جدا)
2. important(مهم)
3. neutral(محايد)
4. not very important(غير مهم)
5. not important at all(ليس له أهمية على الإطلاق)

1.A. In making an investment decisions / recommendations, how do you rate the following sources of information? (Regardless of timing)

(عند إتخاذ قرار الاستثمار أو التوصية بالاستثمار كيف تقيم مصادر المعلومات التالية من حيث الأهمية، بدون النظر للوقت الذي تصدر فيه هذه المعلومات)

1.	Corporate annual reports (التقارير السنوية للشركات)	1	2	3	4	5
2.	Corporate interim reports (التقارير المالية الشهرية أو الربع سنوية)	1	2	3	4	5
3.	Newspapers and business magazines (الجرائد ومجلات الأعمال)	1	2	3	4	5
4.	Direct contact with the company management (الاتصال المباشر بإدارة الشركة)	1	2	3	4	5
5.	Prospectuses (النشرات الإعلامية أو التعريفية للشركات)	1	2	3	4	5
6.	Tips and rumours (الإشاعات)	1	2	3	4	5
7.	Government publications (الإصدارات الحكومية)	1	2	3	4	5
8.	Advisory services eg. accountants, merchant Banks, etc (الخدمات الاستشاري مثل البنوك والمكاتب المحاسبية)	1	2	3	4	5
9.	Other sources (please identify) (مصادر أخرى الرجاء التحديد)	1	2	3	4	5

B. Please rank by order of importance the following sources of information:
(الرجاء ترتيب مصادر المعلومات المذكورة أدناه حسب درجة الأهمية.)

1.	Corporate annual reports (التقارير السنوية للشركات)	
2.	Corporate interim reports (التقارير المالية الشهرية أو الربع سنوية)	
3.	Newspapers and business magazines (الجرائد ومجلات الأعمال)	
4.	Direct contact with the company management (الاتصال المباشر بإدارة الشركة)	
5.	Prospectuses (النشرات الإعلامية أو التعريفية للشركات)	
6.	Tips and rumours (الإشاعات)	
7.	Government publications (الإصدارات الحكومية)	
8.	Advisory services e.g. accountants, merchant Banks, etc. (الخدمات الإستشاريه مثل البنوك والمكاتب المحاسبية)	
9.	Other sources (please identify) (مصادر أخرى الرجاء التحديد)	

2. Please indicate the usefulness of companies' annual reports in the following areas relating to your decision

(الرجاءتحديدفائدةوأهميةالتقاريرالسنويةللشركاتفيالمجالاتالتاليةالمتصلةبقراراتكالاستثمارية)

1.	To provide primary data for investment decisions (تقديممعلوماتأوليةللقراراتالاستثمارية)	1	2	3	4	5
2.	To monitor previous investment decisions (متابعةالقراراتالاستثماريةالسابقة)	1	2	3	4	5
4.	To investigate companies to make new or additional investment (للتحرىعنالشركاتبهدفاستثمارجديدأواضافي)	1	2	3	4	5
5.	To forecast profits and EPS (التنبئوبالأرباحوالعائدعلىالسهم)	1	2	3	4	5
6.	In making comparison of the company's performance with that of other companies (لمقارنةأداءالشركةبأداءالشركاتالأخرى)	1	2	3	4	5
7.	In making comparison of the company's performance over time. (لمقارنةأداءشر كةمعينةعبرالزمن)	1	2	3	4	5
8.	To prepare ratios or commentaries (لإعدادالنسبالماليةوإبداءالملاحظات)	1	2	3	4	5
9.	Other purposes (please indicate) (مجالاتأخرى،الرجاءالتحديد)	1	2	3	4	5

3.A. What degree of importance does each of the following sections of a company's annual report have in relation to your investment decisions / recommendations?
(وضح مدى أهمية كل من مكونات التقارير التالية للشركات بالنسبة لقرارك أو توصيتك الاستثمارية)

1.	Income statement (قائمة الدخل)	1	2	3	4	5
2.	Balance sheet (الميزانية العمومية)	1	2	3	4	5
3.	Directors report (تقرير إدارة الشركة)	1	2	3	4	5
4.	Auditor's report (تقرير المراجع الخارجي)	1	2	3	4	5
5.	Statement of changes in financial position (قائمة التغيرات في المركز المالي)	1	2	3	4	5
6.	Statement of accounting policies (قائمة السياسات المحاسبي))	1	2	3	4	5
7.	Notes to the accounts (ملاحظات على الحسابات)	1	2	3	4	5

B. Please rank the following reports by order of importance.
(الرجاء ترتيب التقارير التالية حسب درجة الأهمية)

1.	Income statement (قائمة الدخل)	
2.	Balance sheet (الميزانية العمومية)	
3.	Directors report (تقرير إدارة الشركة)	
4.	Auditor's report (تقرير المراجع الخارجي)	
5.	Statement of changes in financial position (قائمة التغيرات في المركز المالي)	
6.	Statement of accounting policies (قائمة السياسات المحاسبية))	
7.	Notes to the accounts (ملاحظات على الحسابات)	

4.A. Please indicate the accounting adjustments that you usually make in your analysis for the following items in the company financial statements?
(لكل من العناصر التالية للقوائم المالية الرجاء اختيار مستوى التعديلات آلتي تقوم بها عند تحليل هذه القوائم)

		Major adjustment (تعديل رئيسي)	Minor adjustment (تعديل ثانوي)	No adjustment (لا تعديلات)
1.	Fixed assets valuations (تقييم الأصول الثابتة)	☐	☐	☐
2.	Annual depreciation expense (مصروف الاستهلاك السنوي)	☐	☐	☐
3.	Inventory valuations (تقييم المخزون)	☐	☐	☐
4.	Earnings per share (العائد على السهم)	☐	☐	☐
5.	Extraordinary items (العناصر الاستثنائية أو فوق العادة)	☐	☐	☐
6.	Intangible assets such as goodwill (الأصول غير الملموسة مثل الشهرة)	☐	☐	☐
7.	Effects of changes in exchange rate (أثر التغيرات في معدلات الصرف)	☐	☐	☐
8.	Investment (الاستثمارات)	☐	☐	☐
9.	Other (please specify) (غير ما ذكر، الرجاء التحديد)	☐	☐	☐

B. If you do adjust one or more of the above items what is the importance of the following?

(في حال قيامك بتعديل واحد أو أكثر من العناصر السابقة وضح أهمية الأمور التالية)

Note: (ملاحظات)

Please use the following scale.

(الرجاء استخدام المقياس التالي)

1. very important(مهم جدا)
2. important(مهم)
3. neutral(محايد)
4. not very important(غير مهم)
5. not important at all(ليس له أهمية على الإطلاق)

1.	valuation base (أساس التقييم)	1	2	3	4	5
2.	recognition of revenue (الإقرار بصحة العوائد)	1	2	3	4	5
3.	determination of cost (تحديد التكلفة)	1	2	3	4	5
4.	Other (please specify) (غير ماذكر، حدد)	1	2	3	4	5

5.A. Please indicate your degree of understanding of the information contained in company annual reports.

الرجاء تحديد رأيك في مدى وضوح المعلومات المقدمة في التقارير السنوية للشركات بالنسبة لك

Fully understand	Understand	50% understand	Little understand	Do not understand
☐	☐	☐	☐	☐

غير واضحة البتة   قليلة الوضوح   50 ٪وضوح   واضحة   واضحة تماما

B. Please indicate the degree of relevancy of the information contained in company annual reports with regards to investment decisions

الرجاء تحديد مدى علاقة المعلومات المقدمة في التقارير المالية السنوية للشركا ت بقراراتك الاستثمارية

Very relevant	Relevant	50% relevant	Little relevance	No relevance
☐	☐	☐	☐	☐

علاقة ضعيفة لا علاقة لها   50 ٪متعلقة   ذات علاقة   علاقة قوية

C. Please indicate your degree of confidence in using the company's annual reports for investment decisions

الرجاء تحديد مدى ثقتك في استخدام المعلومات المقدمة في التقارير المالية السنوية للشركات

Very confident	Confident	50% confident	Little confidence	No confidence
☐	☐	☐	☐	☐

ثقة كاملة   أثق   50 ٪وثوق   ثقة قليلة   لا أثق البتة

6. How would the following factors affect your confidence in using company's annual reports.كيف يمكن للعوامل التالية أن تؤثر على ثقتك في استخدام التقارير السنوية للشركات

(Please use the following scale):
الرجاء استخدام المقياس التالي

1. Greatly increase confidence تزيد الثقة بشكل كبير
2. Increase confidence تزيد الثقة
3. No change in confidence لا تغيير
4. Decrease confidence تقلل الثقة
5. Greatly decrease confidence تقلل الثقة بشكل كبير

1.	All companies using a standard format for presenting its financial statements جميع الشركات تستخدم نموذج موحد لعرض قوائمها المالية	1	2	3	4	5
2.	Audit carried out by an international firm of accountants مكاتب محاسبة عالمية تتولى القيام بمهام المراجع الخارجي	1	2	3	4	5
3.	Accounting standards are set by an independent body instead of the government المعايير المحاسبية توضع بواسطة هيئة مستقلة بدلا من جهة حكومية	1	2	3	4	5
4.	Increasing government regulations concerning the preparation of company annual reports قيام الحكومة بزيادة التنظيمات المتعلقة بإعداد التقارير السنوية للشركات	1	2	3	4	5
5.	Other factors (please specify) عوامل أخرى، الرجاء التحديد	1	2	3	4	5

7. Please indicate the degree of agreement or disagreement with the following statements. الرجاءتحديدمستوىموافقتكمنعدمهامع العبارات التالية

The scale is as follows
القياسكالتالي

1. strongly agree أوافقبشده
2. agree أوافق
3. indifferent محايد
4. disagree أعارض
5. strongly disagree أعارضبشدة

1.	All accounts presented by companies should be standardised من المفترض وضع معايير موحدة لجميع الحسابات التي يتم عرضها بواسطة الشركات	1	2	3	4	5
2.	The ability of the company's management to decide which reporting practices to use should be restricted من المفترض الحد من قدرة إدارة الشركات في الاختيار من بين الطرق المحاسبية المختلفة في عرض المعلومات المحاسبية	1	2	3	4	5
3.	All companies should prepare their financial statements using the same accounting practices من المفترض أن تعد جميع الشركات القوائم المالية باستخدام طرق محاسبية موحدة	1	2	3	4	5
4.	The company's external auditors are independent of management influence يجب بأن يتحرر المراجع الخارجي من أي تأثيرات لإدارة الشركة عليه	1	2	3	4	5
5.	The SOCPA[1] should enforce strictly its rules of professional conduct يجب أن تقوم الهيئة السعودية للمحاسبين القانونيين بتطبيق صارم لأنظمتها فيما يتعلق بمزاولة المهنة	1	2	3	4	5
6.	The auditors exercise strict rules regarding codes of ethics and standards of professional behaviour يجب على المراجع الخارجي تطبيق قواعد صارمة فيما يتعلق بآداب وسلوك المهنة	1	2	3	4	5
7.	The auditors qualifications and experience are adequate to prevent abuse and misrepresentations in the accounts of companies يجب بأن تكون مؤهلات وخبرات المراجع الخارجي ملائمة لمنع الأخطاء وسوء العرض في حسابات الشركات	1	2	3	4	5

[1] Saudi organisation for certified public accountants

8. The items in this section are not published regularly in annual reports currently. In making investment decisions / recommendations, how would you rate the usefulness of the following items if they were regularly published in annual reports.

العناصر المعروضة في هذا السؤال لا تنشر بانتظام حاليا في التقارير السنوية للشركات. عند اتخاذك قرار أو توصية بالاستثمار

ما هو تقييمك لفائدة العناصر التالية فيما لو نشرت بانتظام في التقارير السنوية للشركات

The scale is as follows القياس كالتالي

1. very useful مفيدة جدا
2. useful مفيدة
3. neutral محايد
4. not very useful غير مفيدة
5. not useful at all عديم الفائدة

1.	Future of the company الخطط المستقبلة للشركة	1	2	3	4	5
2.	General economic condition الحالة الاقتصادية العامة	1	2	3	4	5
3.	Directors of the company and a Senior Management اسم مدير الشركة والمسئولين في الإدارة العليا	1	2	3	4	5
4.	Expected amount of sales for next year قيمة المبيعات المتوقعة للسنة القادمة	1	2	3	4	5
5.	Expected profits for next year الأرباح المتوقعة للسنة القادمة	1	2	3	4	5
6.	Dividends forecast for next year التنبؤ بنسب توزيع الأرباح للسنة القادمة	1	2	3	4	5
7.	Financial policy of the company السياسات المالية للشركة	1	2	3	4	5
8.	Other (please specify) غير ما ذكر، حدد	1	2	3	4	5

Appendix B

Coding Frame

Ques. No.	Var. No.	Variable Name	Code
A	01	Reply Method	
		received by post	1
		collect personally	2
B	02	Time of Reply	
		early reply	1
		late reply	2

Part One

Ques. No.	Var. No.	Variable Name	Code
Q1	03	Holding of University Degree in Business	
		No	1
		Yes	2
	04	Name of Major	
		Accounting	1
		Other	2
Q2	05	Place Degree Obtained	
		Local	1
		Overseas	2
	06	Place Experience Obtained	
		Saudi Arabia	1
		Other	2
	07	Years of Experience	
		1 - 5	1
		6 - 10	2
		11 - up	3
	08	Country of Experience	
		Arab Countries	1
		Asian Countries	2
		USA	3
		Europe Countries	4
		Other	5

Q3	09	**Job Description**	
		Security Analysts	1
		Fund/Money Manager	2
		Investment Advisor	3
		Other	4
Q4	10	**Management Hierarchy**	
		Lower Management	1
		Middle Management	2
		Senior Management	3
Q5	11	**Decision Description**	
		Security Recommendation	1
		Business Valuation	2
		Credit Rating	3
		Other	4

Part Two

Q1. A		**Importance of Sources of Information**	
	12	Corporate Annual Reports	1-5
	13	Corporate Interim Reports	1-5
	14	Newspapers & Business Magazines	1-5
	15	Direct Contact with Management	1-5
	16	Prospectuses	1-5
	17	Tips and Rumours	1-5
	18	Government Publication	1-5
	19	Advisory Services	1-5
	20	Other Sources	
Q1. B		**Ranking of Sources of Information**	
	21	Corporate Annual Reports	1-9
	22	Corporate Interim Reports	1-9
	23	Newspapers & Business Magazines	1-9
	24	Direct Contact with Management	1-9
	25	Prospectuses	1-9
	26	Tips and Rumours	1-9
	27	Government Publication	1-9
	28	Advisory Services	1-9
	29	Other Sources	1-9
Q2		**Usefulness of Company Annual Reports**	
	30	Provide Primary Data	1-5
	31	Monitor Previous Investment	1-5
	32	Investigate to Make Investment	1-5
	33	Forecast Profit and EPS	1-5
	34	Comparison with Other Company	1-5
	35	Comparison Over Time	1-5

	36	Prepare Ratio or Commentaries
	37	Other Purposes
Q3. A		**Importance of Sections of Annual Reports**
	38	Income Statement
	39	Balance Sheet
	40	Directors' Report
	41	Auditor's Report
	42	Statement of Changes in Financial Position
	43	Statement of Accounting Policies
	44	Notes to The Accounts
Q3. B		**Ranking of Sections of Annual Reports**
	45	Income Statement
	46	Balance Sheet
	47	Directors' Report
	48	Auditor's Report
	49	Statement of Changes in Financial Position
	50	Statement of Accounting Policies
	51	Notes to The Accounts
Q4. A		**Adjustments in Company Financial Statements**
	52	Fixed Assets Valuation
	53	Annual Depreciation Expense
	54	Inventory Valuations
	55	Earnings Per Share
	56	Extraordinary Items
	57	Intangible Assets
	58	Effects of Changes in Exchange Rate
	59	Investment
	60	Other
Q4. B		**Reason for Adjustment**
	61	Valuation Base
	62	Recognition of Revenue
	63	Determination of Cost
	64	Other
Q5. A	65	Understanding of Company Annual Reports
Q5. B	66	Relevancy of Company Annual Reports
Q5. C	67	Confidence in Company Annual Reports
Q6		**Factors Affecting Confidence in Annual Reports**
	68	Standard Format
	69	Audit by International Firm
	70	Standards Set by Independent Body
	71	Increase Government Regulations
	72	Other
Q7		**Attitude Toward Annual Reports**
	73	All Account Should be Standardised

74	Reporting Practices Should be Restricted	1-5
75	Using the Same Accounting Practices	1-5
76	External Auditors are Independent	1-5
77	The SOCPO Enforce its Rules	1-5
78	Auditors Exercise Strict rules	1-5
79	Auditors Qualifications are Adequate	1-5

Q8 <u>Additional Disclosure</u>

80	Future of The Company	1-5
81	General Economic Condition	1-5
82	Names of Directors & Senior Management	1-5
83	Amount of Sales Next Year	1-5
84	Profits Next Year	1-5
85	Dividends Next Year	1-5
86	Financial Policy	1-5
87	Other	1-5