

CORPORATE GOVERNANCE AND FINANCIAL INFORMATION  
DISCLOSURE IN A DEVELOPING COUNTRY

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A thesis submitted in fulfilment of the  
requirements for the award of the degree of  
Doctor of Philosophy (Management)

Faculty of Management  
Universiti Teknologi Malaysia

MARCH 2018

This thesis is dedicated to my inspiring parents, wife,  
brother and sisters for their endless love,  
encouragement, support and sacrifices.

## ACKNOWLEDGEMENTS

It would not have been possible to write this doctoral thesis without the help and support of the kind people around me, to only some of whom it is possible to give particular mention here. First and foremost, I would like to express my profound gratitude to Lt Kol Dr. Mohd Noor Azli Bin Hj. Ali Khan for being an excellent supervisor. I am immensely grateful to him for his outstanding guidance, encouragement and friendship throughout this PhD. My sincere thanks also go to Dr. Ebrahim Bazrafshan from the School of Accounting and Finance in the Hong Kong Polytechnic University and Professor Esmail Abounoori from the Semnan College in the Iran for their valued words of wisdom and encouragement freely offered along the way. Special mention should be given to them for helping to collect data for the present study.

Last but not the least, this study is dedicated to my family. With deep appreciation, I am eternally grateful to my parents, Ali and Tayyebah for their unwavering support as well as the understanding of me being away from home. My sisters and brothers have been the backbone of me (Maryam, Mohsen, Malihe, Hadi, and Amir Hossein). Moreover, Anahita thank you for being part of my life, and for the continuous patience and emotional support during the process to complete this work. Thanks, Eshghe Man.!

## ABSTRACT

The main objective of this study is to identify the extent of corporate accounting information disclosure in an emerging economy. This study also addresses the determinants of such reporting practices with the interaction of independent board and a large audit firm. Three self-constructed checklists were used to measure the extent of mandatory and voluntary disclosure. The results were analyzed in total (as overall disclosure). Data were obtained from the annual report of 915 listed companies in the Iranian stock market from 2010-2015. A dynamic panel generalized method of moments (GMM) was applied to address endogeneity issue and to control for dynamic endogeneity, unobservable heterogeneity, and simultaneity. Findings revealed that the level of total mandatory disclosures by the all listed companies in Iran are high, while the level of disclosing IAS/IFRS and voluntary information by all of the listed firms are low. Furthermore, data of the overall level of disclosing information by all of the listed firms are 46.69%, suggesting a low level of compliance. The findings also reveal that financial listed firms disclosed more financial information than non-financial firms. The current study found that higher family ownership, managerial ownership, government ownership, and CEO duality are associated with decreased disclosure level. However, concentration ownership and assets in place are not related to disclosure. The interaction of independent board and the audit organization have positive effects on some independent variables that are a leading cause of increasing disclosure level. This study is important for investors, as well as provides useful insights into accounting reporting effectiveness for standard setters and other users. By providing the current status of disclosing mandatory and voluntary financial information, this study contributes to reduce the existing gap in the literature relating to emerging economies and helps to identify the need for international standards.

## ABSTRAK

Objektif utama kajian ini untuk mengenal pasti tahap pelaporan maklumat perakaunan korporat dalam situasi ekonomi yang sedang berkembang. Kajian turut mengkaji faktor-faktor penentu amalan perakaunan dengan interaksi badan bebas dan firma audit besar. Untuk mengukur tahap pelaporan mandatori dan sukarela, tiga senarai semak sendiri telah dibangunkan. Keputusan daripada senarai semak ini telah dianalisis sebagai pelaporan menyeluruh. Data diperolehi daripada laporan tahunan 915 buah firma yang tersenarai di pasaran saham Iran bagi tempoh 2010 hingga 2015. *Dynamic panel generalized method of moments* (GMM) telah digunakan untuk menangani isu *endogeneity* dan untuk mengawal *endogeneity* dinamik, *heterogeneity* yang tidak dapat *unobservable*, dan *simultaneity*. Dapatan kajian menunjukkan bahawa tahap pelaporan menyeluruh firma tersenarai di Iran adalah tinggi, manakala tahap pelaporan IAS/IFRS dan maklumat sukarela bagi firma tersenarai yang sama adalah rendah. Ia terbukti bahawa apabila data yang diperolehi menunjukkan tahap pelaporan maklumat oleh kesemua firma tersenarai ialah 46.69 peratus. Dapatan kajian juga menunjukkan firma kewangan tersenarai melaporkan maklumat kewangan lebih banyak berbanding firma bukan kewangan. Kajian ini mendapati bahawa pemilikan keluarga, pemilikan pengurusan, pemilikan kerajaan dan dua fungsi CEO yang tinggi, mempunyai hubungan dengan tahap pelaporan yang rendah. Walau bagaimanapun, konsentrasi pemilikan dan kedudukan aset tiada kaitan dengan pelaporan. Interaksi antara badan bebas dan organisasi audit memberi kesan positif terhadap beberapa pemboleh ubah tidak bersandar yang menyebabkan peningkatan tahap pelaporan. Kajian ini bukan sahaja penting bagi pelabur tetapi ia memberi petunjuk bermakna bagi pelaporan perakaunan yang berkesan kepada penjuwal piawai dan pengguna lain. Dengan penjelasan status terkini yang berkaitan dengan pengumuman wajib dan maklumat kewangan yang sukarela, kajian ini menyumbang kepada penambahan kajian literatur dalam kemajuan ekonomi dan seterusnya mengenal pasti keperluan piawai antarabangsa.

## TABLE OF CONTENTS

CHAPTER	TITLE	PAGE
	DECLARATION	ii
	DEDICATION	iii
	ACKNOWLEDGEMENT	iv
	ABSTRACT	v
	ABSTRAK	vi
	TABLE OF CONTENTS	vii
	LIST OF TABLES	xv
	LIST OF FIGURES	xvii
	LIST OF ABBREVIATIONS	xviii
	LIST OF APPENDICES	xx
<b>1</b>	<b>INTRODUCTION</b>	<b>1</b>
	1.1 Chapter Overview	1
	1.2 Background of the Study	1
	1.3 Statement of the Problem	6
	1.4 Research Aims	12
	1.5 Research Questions	13
	1.6 Research Objectives	13
	1.7 Conceptual Research Framework	14
	1.8 Scope of the Study	16
	1.9 Significance of Study	18
	1.10 Definition of Terms	22

1.11	Organization of Thesis	25
<b>2</b>	<b>LITERATURE REVIEW</b>	<b>27</b>
2.1	Introduction	27
2.2	Historical and Economic Background of Iran	28
2.2.1	Historical Perspective of Islamic Republic of Iran	28
2.2.2	Accounting History in Iran	29
2.2.2.1	Accounting Development After the Islamic Revolution	30
2.2.3	History of Accounting Standards in Iran	31
2.2.3.1	Accounting Standards Setting Process in Iran	33
2.2.4	Regulatory Framework for Accounting and Financial Reporting in Iran	35
2.3	Introduction for IASs/IFRSs	36
2.4	Corporate Governance	37
2.4.1	Review of Corporate Governance Mechanisms	38
2.4.2	Review of Literature between Corporate Governance Mechanisms and Corporate Disclosure	41
2.5	Review of Empirical Literature on The Extent of Corporate Disclosure	43
2.5.1	Mandatory Disclosure and Mandatory IAS/IFRS Adoption	47
2.5.1.1	The Level of Disclosure in Developed Countries	47
2.5.1.2	The Level of Disclosure in Developing Countries	50
2.5.2	Voluntary Disclosure and Voluntary IAS/IFRS Adoption	52
2.5.2.1	The Level of Disclosure in Developed Countries	52



2.5.2.2	The Level of Disclosure in Developing Countries	57
2.6	The Extent of Corporate Financial Reporting in Iran	59
2.7	Summary and Discussion about the Gaps in Previous Researches	69
2.8	Theories of Corporate Financial Reporting	71
2.8.1	Agency Theory	72
2.8.2	Signaling Theory	74
2.8.3	Capital Need Theory	76
2.8.4	Economic Theory	77
2.8.5	Theories Assessment	78
2.8.6	Developing a Theoretical Framework	80
2.9	Hypothesis Development	83
2.9.1	The Level of Adoption and NASs and IAS/IFRSs-Required Disclosure	83
2.9.2	Level of Voluntary Disclosure between Financial and Non-Financial Firms	85
2.9.3	Relationship among Corporate Governance and Attributes Factors and the Level of Corporate Financial Disclosure	86
2.9.3.1	Disclosure and Ownership Structure	87
2.9.3.2	Disclosure and Duality in Position	92
2.9.3.3	Disclosure and Assets-In-Place	93
2.9.4	The Interaction Variables	95
2.9.4.1	The Role of Independent Board and Independent Audit Firm as Monitoring	96
2.9.4.2	The Effect of Independent Board and Independent Audit Firm on The Level of Disclosed Information	98
2.9.4.3	Disclosure and Board Composition	98
2.9.4.4	Disclosure and Auditor Type	103
2.9.5	Control Variables	105

	2.9.5.1	Disclosure and Firm Size	106
	2.9.5.2	Disclosure and Leverage	106
	2.9.5.3	Disclosure and Profitability	107
	2.9.5.4	Disclosure and Liquidity	108
2.10		Summary	110
<b>3</b>		<b>METHODOLOGY</b>	<b>115</b>
3.1		Introduction	115
3.2		Research Process	116
3.3		Research Paradigm	117
3.4		Research Design	118
	3.4.1	Approach of the Study	120
3.5		Content Analysis Method	121
3.6		Sampling Size and Techniques for Content Analysis	122
3.7		Data Gathering Method for Content Analysis	123
	3.7.1	Foundations of Data	124
	3.7.2	Construction of the Disclosure Index and Checklist	124
	3.7.3	Data Collection Mechanism	126
3.8		Selection of Accounting Standards and Developing the Checklists	126
	3.8.1	The National Accounting Standards Checklist	128
	3.8.1.1	Industry-Specific	129
	3.8.1.2	Specific Accounting Standard	129
	3.8.1.3	Superseded by Newer Standard	130
	3.8.1.4	Eliminated by Audit Organization	130
	3.8.2	The IASs/IFRSs Checklist	130
	3.8.2.1	Applicability and Relevance to the Iranian Financial Environment	131
	3.8.2.2	Superseded by Newer Standard	132
	3.8.2.3	Eliminated by IASB	133

	3.8.2.4 Industry-specific/ Specific Accounting Standard	133
	3.8.2.5 Appropriately Incorporated into Its National Equivalent	133
	3.8.3 The Voluntary Checklist	134
3.9	Dependent Variable (Overall Disclosure Index)	135
3.10	Weighting and Scoring the Overall Disclosure Index	136
3.11	Statistical Techniques to Test Validity and Reliability of Instrument	139
	3.11.1 Validity	140
	3.11.2 Reliability	142
	3.11.3 Regression Model	143
3.12	Methods of Analysis	147
	3.12.1 Panel Data	148
	3.12.2 Dynamic Panel GMM	149
	3.12.2.1 Check for Potential Misspecification of the Model	152
	3.12.2.2 Dynamic Endogeneity	153
	3.12.3 Hausman Test	154
3.13	Summary	154
<b>4</b>	<b>ANALYSIS AND FINDINGS</b>	<b>157</b>
4.1	Introduction	157
4.2	Overall Perception of Importance Items for Disclosure	158
4.3	Descriptive Statistics for All Listed Firms	177
	4.3.1 Descriptive Statistics for Non-Financial Firms	181
	4.3.2 Descriptive Statistics for Financial Firms	183
4.4	Correlation	185
4.5	Multicollinearity Tests	188
	4.5.1 Variance Inflation Factor	188
	4.5.2 Condition Index	189

4.6	Empirical Results	191
4.6.1	Regression Results for Overall Disclosure Index	192
4.6.2	Interaction Results (Board Composition) in Overall Disclosure Regression	198
4.6.3	Interaction Results (Auditor Type) in Overall Disclosure Regression	203
4.6.4	Regression Results for National Accounting Standards Index	208
4.6.5	Regression Results for International Financial Reporting Standard Index	212
4.6.6	Regression Results for Voluntary Disclosure Index	216
4.7	Summary of Results	221
<b>5</b>	<b>DISCUSSION AND CONCLUSION</b>	<b>226</b>
5.1	Introduction	226
5.2	Overview of Study	226
5.3	Discussion of Findings	228
5.3.1	The Level of Corporate Accounting Information Disclosure	228
5.3.2	The Effect of Corporate Governance and Attributes Factors on Financial Disclosure Level	232
5.3.2.1	The Effect of Family Ownership on Financial Disclosure Level	232
5.3.2.2	The Effect of Ownership Concentration on Financial Disclosure Level	233
5.3.2.3	The Effect of Managerial Ownership on Financial Disclosure Level	234
5.3.2.4	The Effect of Government Ownership on Financial Disclosure Level	235

5.3.2.5	The Effect of Role Duality on Financial Disclosure Level	236
5.3.2.6	The Effect of Assets in Place on Financial Disclosure Level	237
5.3.3	Interaction of Board Independence on Relationship between Corporate Governance and Attributes Factors and Overall Disclosure Level	238
5.3.3.1	Interaction of Board Independence on Relationship between Family Ownership and Overall Disclosure Level	238
5.3.3.2	Interaction of Board Independence on Relationship between Ownership Concentration and Overall Disclosure Level	240
5.3.3.3	Interaction of Board Independence on Relationship between Managerial Ownership and Overall Disclosure Level	240
5.3.3.4	Interaction of Board Independence on Relationship between Government Ownership and Overall Disclosure Level	242
5.3.3.5	Interaction of Board Independence on Relationship between Role Duality and Overall Disclosure Level	243
5.3.3.6	Interaction of Board Independence on Relationship between Assets-In-Place and Overall Disclosure Level	244
5.3.4	Interaction of the Audit Organization on Relationship between Corporate Governance and Attributes Factors and Overall Disclosure Level	244
5.3.4.1	Interaction of the Audit Organization on Relationship between Family Ownership and Overall Disclosure Level	244

5.3.4.2	Interaction of the Audit Organization on Relationship between Ownership Concentration and Overall Disclosure Level	246
5.3.4.3	Interaction of the Audit Organization on Relationship between Managerial Ownership and Overall Disclosure Level	246
5.3.4.4	Interaction of the Audit Organization on Relationship between Government Ownership and Overall Disclosure Level	247
5.3.4.5	Interaction of the Audit Organization on Relationship between Role Duality and Overall Disclosure Level	247
5.3.4.6	Interaction of the Audit Organization on Relationship between Assets-In-Place and Overall Disclosure Level	248
5.4	Contribution to Knowledge	249
5.5	Limitation of the Study	253
5.6	Suggestions for Future Studies	254
5.7	Concluding Remarks	255
	<b>REFERENCES</b>	<b>258</b>
	Appendices A-C	304-307

## LIST OF TABLES

<b>TABLE NO.</b>	<b>TITLE</b>	<b>PAGE</b>
2.1	Empirical studies on Mandatory and Voluntary disclosure in developed countries	62
2.2	Empirical studies on Mandatory and Voluntary disclosure in developing countries	66
2.3	Research Questions and Related Theories	112
3.1	Description of Variables and their Expected Sign	144
4.1	Profile of Respondent	159
4.2	National Accounting Standards Items	161
4.3	International Accounting Standards Items	167
4.4	Voluntary Items	173
4.5	The Rank of All Items	175
4.6	The Rank Items of NASs	175
4.7	The Rank Items of IASs/IFRSs	176
4.8	The Rank Items of VOL	176
4.9	Descriptive Statistics Analysis for All Firms	180
4.10	Descriptive Statistics Analysis for Non-Financial Firms	182
4.11	Descriptive Statistics Analysis for Financial Firms	184
4.12	Correlation Matrix of the Pearson	186
4.13	Correlation Matrix of the Spearman	187
4.14	Variance Inflation Factors	189
4.15	Condition Index	190

4.16	GMM Findings, Relationship between Corporate Characteristics and Overall Disclosure Index	196
4.17	Relationship between The Interaction Tests (Independent Board) in Overall Disclosure Regression	201
4.18	Relationship between The Interaction Tests (Audit Organization) in Overall Disclosure Regression	206
4.19	GMM Findings, Relationship between Corporate Characteristics and National Accounting Standard Index	210
4.20	GMM Findings, Relationship between Corporate Characteristic and International Financial Reporting Standard Index	214
4.21	GMM Findings, Relationship Corporate Characteristics and Voluntary Disclosure Index	219
4.22	Summary of Hypotheses Testing	224



**LIST OF FIGURES**

<b>FIGURE NO.</b>	<b>TITLE</b>	<b>PAGE</b>
2.1	The Research Framework	110
3.1	Research Process	117
3.2	Research Design	120
3.3	Endogeneity Problem	151

**LIST OF ABBREVIATIONS**

ADSC	-	Accounting Declaration Setting Committee
ASSC	-	Accounting Standards Setting Committee
AT	-	Auditor Type
BC	-	Board Composition
CAR	-	Corporate Annual Report
CCGI	-	Code of Corporate Governance of Iran
CCGI	-	Code of Corporate Governance of Iran
CEO	-	Chief Executive Officer
CG	-	Corporate Governance
DV	-	Dependent Variable
FO	-	Family Ownership
FRA	-	Financial Reporting Act
FRQ	-	Financial Reporting Quality
GAAP	-	Generally Accepted Accounting Principles
GMM	-	Generalized Method of Moments
GO	-	Government Ownership
IACPA	-	Iranian Association of Certified Public Accountants
IAO	-	Iran Audit Organization
IAS	-	International Accounting Standards

IASB	-	International Accounting Standards Board
IFAC	-	International Federation of Accountants
IFRS	-	International Financial Reporting Standards
IICA	-	Iranian Institute of Certified Accountants
IMF	-	International Monetary Fund
IAS	-	International Accounting Standards
IOAS	-	Iran Official Accountant Society
IV	-	Independent Variable
LEV	-	Leverage
LIQ	-	Liquidity
MO	-	Managerial Ownership
NAS	-	National Accounting Standards
OC	-	Ownership Concentration
ODI	-	Overall Disclosure Index
PROF	-	Profitability
SAC	-	Standards Advisory Council
SEO	-	Securities and Exchange Organization
SIC	-	Standing Interpretations Committee
SPSS	-	Statistical Package for the Social Sciences
TSE	-	Tehran Stock Exchange
VOLI	-	Voluntary Index

**LIST OF APPENDICES**

<b>APPENDIX</b>	<b>TITLE</b>	<b>PAGE</b>
A	Iranian National Accounting Standards (NAS) which inclusion in the compliance Index or not	304
B	International Financial Reporting Standards (IFRS) which inclusion in the compliance Index or not	305
C	Survey Questionnaire	307

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Chapter Overview**

This chapter is focused on the background of the study, the problem statement, research aims, research questions, the objectives of the study, and conceptual research framework. Then, in this chapter, the focus is on the scope, significance of the study, limitations of the study, defined the terms used and finally, organization of thesis.

#### **1.2 Background of the Study**

The definition of accounting is system of rules aiming to facilitate the recording of commercial transactions and the production of stewardship reports, or a fully developed social service with practical rules and supporting theories (Mathews and Perere, 1996). There are those who argue that accounting is an art, stressing that accounting skills can be taught and suggesting that a legalistic approach to accounting could be adopted by codifying its practices (Glautier and Underdown, 1997). Accounting is a service activity which aspires to be at the core of the working of the economy. Its role is to produce useful economic information so as to aid users'

decision making, whether in the deployment of resources in profit and non-profit organizations or in the economy in general (Jahankhani, 1991; Mathews and Perere,1996). For the purposes of both practice and study, accounting is usually divided into financial accounting, whose objective is to provide information for use by parties both internal and external to the enterprise, and management accounting, whose primary concern is the provision of information for management purposes. While information provided by the former is essentially a review of past performance and current financial position, the latter incorporates feedback on current performance as well as forecasts concerning future activities and events (Bedford 1973; Mathews and Perere,1996).

The definition of disclosure in the realm of accounting literature is making informed the public and audience through the financial statement of the company. To indicate the meaning of disclosure, it is also said that “the announcement of economical information, whether quantitative or qualitative, financial or non-financial” (Owusu-Ansah, 1998). Information disclosure system means a series of behavioral regulations and activity standards for relevant parties in the securities market who publicize the information related to securities by certain way in the process of issuing stocks, listing on the market, and trading, according to laws, and rules of securities administrative agencies and stock exchanges (Tian and Chen, 2009). Therefore, accounting is essentially a process of communicating economic information. Bedford (1973) conceptualizes this process as consisting of four procedural steps: the perception of an organization’s significant activities, the symbolization of the perceived activities in order to grasp an understanding of their interrelationships, the analysis of the activities in order to summaries, organize and lay bare their interrelationship and, finally, the communication of the analysis to different interested parties. While the perception and symbolization steps constitute the process of accounting measurement, the analysis and communication steps constitute the process of accounting disclosure. These two processes together give financial information disclosure its substance (Choi and Mueller, 1992).

Companies, which are the form of business organization of interest in the thesis, disclose economic information to interested users via a variety of formal and informal forms (such as interim statements, prospectuses, news releases, ad hoc

statements etc.). However, it is widely accepted that the most appropriate way in which information can be presented to meet the objective of corporate financial information disclosure is the set of corporate annual financial statements (CAFSs) (International Accounting Standards Board (IASB), 2006). These statements normally include a balance sheet, an income statement, a statement of changes in financial position and other explanatory notes and statements. They may also include supplementary schedules and information, but do not include the directors' and chairman's reports or other management information that are usually included (in addition to the CAFSs) in a company's annual report (CAR) (Nobes, 1990; JavadianKootanaee *et al.*, 2013).

The major role of financial information disclosure is the effective transfer of financial data to people who are outside the organization in a way that is valid and timely (Bolo and Hosseini 2007; Salehi and Azary, 2008). One of the most important goals of corporate financial disclosure level, which is to provide necessary data to evaluate the function of economic agencies and its ability to make profits (Salehi and Abedini, 2008). The necessary condition to achieve this is to provide financial data in such a way that the evaluation of the previous functions becomes possible and effective in measuring the ability to make profits and in predicting future activities of economic agencies (Talebnia *et al.*, 2011). Considering the importance of high level of financial information disclosure on improving the functional economic agencies, previous studies suggest that higher-level financial information disclosure can promote economic development and to attract foreign capital (Bushman and Smith, 2001; Aggarwal, 2005; Lambert *et al.*, 2007; Albu *et al.*, 2014). Institutional investors (local and foreign) are doubtful in capitalizing in emerging nations due to lack of transparency and lack of acceptance with internationally recognized reporting standards. Emerging nations such as Iran in need of external finance from both private and institutional sources in order to increase domestic growth and economic well-being has been under pressure to improve the level of corporate financial reporting (Ali *et al.*, 2004; Khani and Rodbari, 2013).

Financial information disclosure can be categorized into two classifications including voluntary and mandatory (Cheung *et al.*, 2010). Mandatory disclosure indicates that rules and regulations oblige the firms to present their monetary

information disclosure (Meek *et al.*, 1995) and is prepared in accordance with the legislation of the jurisdiction (Smith and Taffler, 2000). There are strict regulatory requirements for mandatory information disclosure of listed companies. These include some basic accounting, financial, and operational information (Cheung *et al.*, 2010). Voluntary disclosure by definition is that type of disclosure beyond what is stated by the law which represents a free option by the executives for the sake of revealing supplementary data (Meek *et al.*, 1995) and provides narrative information together with tables and graphs (Smith and Taffler, 2000) and also is not governed by regulations, information items are included at the discretion of management (Clatworthy and Jones, 2001). The users of corporate voluntary disclosure become more aware and the need for voluntary information of firms has increased worldwide (Tuhin and Hasan, 2014). The information made available at the discretion of the corporation is regarded as corporate voluntary disclosure. The voluntary disclosure level is determined by modifications in the attitudes in society, economic features and behavioral aspects such as the particular corporate culture. The items of voluntary disclosure may be categorized into historical, current, and predictive items, depending on the past, present or envisaged performance of the firm (Rouf, 2011).

Previous surveys have correctly assessed disclosure practices in different socio-economic and political settings, to enhance our knowledge of the dynamics of disclosure practices (Nobes, 1998; La Porta *et al.*, 2008). This current study addresses disclosure practices in a developing economy, especially Iran, which is categorized as a developing country, provides an interesting culture contrast to western countries because of the new emphasis on Islamic laws and values after its political revolution in 1979 (Etemadi *et al.*, 2009). In this concern, Iran possesses a new functional market that was established in 1966 (Yaftian and Mirshekary, 2009). Due to the fact that the greater part of shareholders is not easily received in implementing yearly reports for the purpose of making a decision, companies in Iran perhaps are somehow unwilling to publish the data (Modarres *et al.*, 2014).

Tehran Stock Exchange has included financial and non-financial sectors. The financial sector is a category of stocks containing firms that provide financial services to commercial and retail customers; this sector includes banks, investment funds, insurance companies and real estate. Financial services perform best in low-



interest rate environments. A large portion of this sector generates revenue from mortgages and loans, which gain value as interest rates drop. Non-financial corporations produce goods and services for the market and do not, as a primary activity, deal in financial assets and liabilities. This sector includes, for example, Agriculture and related services, textile, wood products, paper products, publishing, printing and reproduction, rubber and plastic, basic metals, machinery and equipment, vehicle Industries, sugar industry, food and drink, pharmaceutical products, chemical, ceramic tile, transportation, oil products (Khani and Rodbari, 2013; Exchange, 2016).

In the new directive of Iran's bond market, considerable attention has been paid to the fact that the users of financial information consider financial reports as one of the major sources of financial information, these reports must be created in a way that they prove useful to the financial information users while making economic decisions (Khoram Abadi *et al.*, 2013). Recently, Audit Organization (AO) in Iran has provided National Accounting Standards (NASs). In order to harmonize accounting standards in Iran with global standards, Audit Organization has selected the path to standard setting toward International Financial Reporting Standard (IFRS) (Khodadadi *et al.*, 2012).

Following the Islamic Revolution in 1979, a large number of companies were nationalized. Hence, in order to audit and monitor the state-owned companies, the establishment of state audit entities seemed necessary. In this condition, the state sector, Organization of National Industries and Budget and Planning Organization, and semi-government foundations, Mostazafan Foundation and Shahid Foundation, which had controlled a large number of newly nationalized companies, established their own audit organizations (Noravesh and Dianati, 2003; Mirshekary and Saudagaran, 2005). Therefore, the demand for a private sector auditing service dramatically decreased. However, due to the lack of uniform and national accounting and auditing standards the comparability of financial statements was low. Given this essential requirement, the establishing of the Iran Audit Organization (IAO), by integration of the three aforementioned state auditing organizations, and based on the Law, was ratified in 1983 (Mirshekary and Saudagaran, 2005; Mashayekhi and Mashayekh, 2008; Roudaki, 2008).

Theoretically, this study relies on the level of corporate accounting disclosure literature in developed and developing countries, some variables as corporate features which of these elements are substantially linked to increased or decreased disclosure, and the adoption level of listed companies with national and international accounting standards-required disclosure. The literature provides the theoretical support that is utilized in this study to develop and analyze prior researches (Kyle, 1985; Glosten and Milgrom, 1985; Hossain, 1999; Healy and Palepu, 2001; Akhtaruddin 2005) that extends the understanding of how the level of financial disclosure in different countries and the relationships among accounting information disclosure and corporate characteristics.

### **1.3 Statement of the Problem**

The Asian corporate governance mechanisms were criticized as being relatively inefficient in maintaining fairness and integrity in the stock markets during the Asian crisis (Harvey and Roper, 1999; Greenspan, 1999). Therefore, seeking to better corporate governance levels as well as introducing requirements for corporate governance is increasingly important for restoring the confidence of market participant on the fairness and integrity in the Asia stock markets in most cases and Iran in particular. The policy makers for corporate governance practices in the developed and developing countries indicate that directors who dependent to CEO played impairing role in the string of corporate scandals and crises (Sharma, 2014; Bazrafshan, 2015).

Following regulations and recommendations in developed western stock markets for having a greater level of board independence (Yekini *et al.*, 2015), the most of Asian stock markets started paying attention are to have independent board, and implemented new legislation calling for an increase in the representation of independent directors on boards in the last decade. Lin (2013) noted that this is a popular regulatory reform in Asia after the crisis. Therefore, the percentage of independent director on board exogenously increases after regulation reforms. While

Asian stock markets have experienced a greater level of independent board, the amount of adoption and paying attention to independent board has been uncertain in Iranian listed firms and its effect on ownership structure as a powerful monitor tool (Khani and Rodbari, 2013; Rahmani, 2014; Bazrafshan, 2015). A more independent board will monitor more intensively (Adams and Ferreira, 2009) and they considered as potentially effective in raising the number and level of disclosures by having management complied with accounting rules (Farber, 2005; Cerbioni and Parbonetti, 2007; Donnelly and Mulcahy, 2008).

After the 1979 revolution in Iran, about 580 manufacturing establishments were nationalized. The nationalization process resulted in a change in the ownership and management of all the nationalized establishments. But transferring the ownership and management of large-scale establishments, industries, or services to a state with no management experience proved to be very costly. Conforming to the international forces from the World Bank and the International Monetary Fund (IMF) on the Third World nations for privatization during the 1980s, there has been a growing incidence of privatization in Iran as an objective in the first five-year plan of 1989-1993 (Mashayekhi and Mashayekh, 2008). Globalization and technological innovation are the two main factors that effect on the changes in a business setting over the years. Recently, there has been a significant growth in commercial activities at the Stock Exchanges worldwide and Iran is not isolated from this rule. Iran is the last, large untapped emerging market in the world. According to many experts, the economy of Iran has many investment opportunities, particularly in its stock exchange (Exchange, 2016).

The corporate governance issue was first addressed in early 2000 (when an internal governance structure was dominant) and only a few external control mechanisms are in place (Mashayekhi and Mashayekh 2008). Previous studies (e.g. Mashayekhi and Noravesh, 2008; Khani and Rodbari, 2013; Rahmani, 2014) contended that the effect of ownership structure and board composition as features of corporate governance within Iranian listed companies are unclear. Public sector agencies are the main stakeholders in the TSE and have important effector authority over the firms (Velashani, 2007). Different kind and level of financial disclosure needed to thin out the conflict of profits between public and private sector

stakeholders in the TSE context which is diverse from those in industrialized markets (Arabsalehi and Velashani, 2009). VakilAbad *et al.* (2013) indicated that because of the limited flow of information, the stock market is not suitable for privatization and the posted price of shares by brokers usually higher than what it should be, because of a lack of available public information on financial performance by companies.

In many developing countries, the government is a major shareholder or the government investment in enterprises is a major contributor to the funding of these enterprises (Wallace, 1988). In Iran, the government owns almost all shares in public companies and the majority of shares in private sector companies (Setayesh and Kazemnezhad, 2013; Rahmani, 2014). The corporations with a high percentage of government ownership have a very poor disclosure quality because of the lack of accountability and having the bureaucratic problems of public sector enterprises (Mirshekary, 1999; Molkararee, 2004; Rahmani, 2014). In contrast, a large proportion of listed companies in more developed countries such as the US and the UK are owned by a diverse shareholder population, in which institutional investors such as pension funds and mutual funds predominate. The prevalence of government ownership on a stock exchange may result in less demand for corporate disclosures than found in more developed countries because the major providers of finance already have that information (Chaua and Gray, 2002).

Before the revolution, big international audit firms formed and established their branches through domestic audit firms. However, after the revolution happened in 1979, the state decided to impose such a strict control over the economy, in consequence, the international audit firms' interactions have consequently been suspended. Therefore, within these years, the need for domestic audit firms to verify the expropriated or nationalized companies has enhanced. The Audit Organization was established by merging public sector audit firms to limit and verify these companies, due to the fact that there were not only no branches of foreign companies but also, no affiliation could be seen with the international companies (Mirshekary, 1999).

Overseas investors often are hesitant to invest in companies operating in emerging nations due to the lack of transparency and lack of acceptance with internationally recognized reporting standards. Emerging nations in need of external

finance from both private and institutional sources in order to augment domestic growth and economic well-being have been under pressure to improve the quality of corporate financial reporting (Ali *et al.*, 2004; Oluwagbemiga, 2014). The regulatory framework in an emerging economy like Iran cannot reach international standard due to some difficulties such as problems with the complexity of IASs, translation problem, conflict with legal mechanism, knowledge and awareness deficiency, and problems with fair value measurement requirements (Mohammadrezaei *et al.*, 2013). Iran is classified as a code-law country, a poor stock market, having a deficit of safety in investment, legal difficulties, inefficient implementation procedures and a poorly prepared of fiscal recording reporting (Noravesh and Dianati, 2003; Molkararee, 2004; Mashayekhi and Mashayekh, 2008; Khani and Rodbari, 2013). Iran in demand for increased foreign and domestic investment from both private and institutional sources in order to increase domestic growth and economic well-being has been under pressure to improve the level of corporate financial reporting whereas, foreign investments flow more into nations with better disclosure rules in which more compliance with IASs (Dahawy and Conover, 2007; Asadi, 2014). Therefore, this study examines the level to which listed firms in accordance with IAS/IFRS.

The capital market in Iran is new and inefficient (Chatterjee *et al.*, 2010). Davani (2005) reported that one of the biggest problems facing the Iranian investors is the poor quality of annual reports which preclude comprehensive and effective analyzes. In emerging countries, the outcome of non-disclosure from the immature expansion of accounting practice (Osisioma, 2001). Countries like Iran have developing economy and is in need of capital accumulation to promote economic development (Modarres *et al.*, 2014). In either case these countries need to develop their stock markets and the use of the International Accounting Standards can help them in this regard (Vakilifar and Aliakbari, 2012). This study concentrates to characterize the disclosure level in an emerging equity market in a Middle Eastern country and also the research tries to determine whether there are some differences in the extent of disclosure of the sampled financial and non-financial firms.

Knowledge of the overall extent of corporate annual financial report disclosure is necessary to pursue national accounting development. This is especially true for developing countries that are attempting to be self-reliant rather than merely importing

accounting systems from developed countries (Yaftian and Mirshekary, 2009). Until recent years, there has been an obvious and serious lack of available financial reporting and national accounting standards in Iran (Zandi *et al.*, 2010; Mohammadrezaei *et al.*, 2012). Before 1979, Anglo-American practices had greatly affected on financial reporting in Iran (Mirshekary and Saudagaran, 2005).

There were no national accounting standards and disclosure necessities were based on tax law, corporate law, and stock exchange regulations. The tax law requires companies to make ready a balance sheet, income statement, and a list of shareholders (with their holdings) (Mashayekhi and Mashayekh, 2008). One of the problems in Iran is not having the relationship between accounting information and the specific environment because most reporting practices have been imported from other countries (Mirshekary, 1999; Asadi, 2014). This research concentration on the origin and development of accounting standards in Iran with an emphasis on the level of adaptability of the listed companies with these standards.

Management in possession of “good news” (resulting, for example, from better performance) is more likely to disclose more information since this news can lead to increases in share price valuations on the stock market, and can support a continuance of the company’s positions, remuneration and ultimately their stock related compensation plans (e.g. Inchausti 1997; Davani, 2005; Kang and Gray, 2011). Previous studies have noted that managers appear to plan the timing of disclosing good and bad news in order to maximize their compensation (Oluwagbemiga, 2014). For example, Behbahani *et al.* (2013) points out that in order for managers to avoid extreme variability in stock returns and their compensation during periods of uncertainty, managers tend to provide earnings forecasts as a way of reassuring and restoring the confidence of their investors. On the other hand, however, Owusu-Ansah (1998) argues that unprofitable companies are also inclined to release more information in order to defend their poor performance. Managers are more likely to disclose adequate and extra information in their reports in order to mitigate risks and costs (for example in form of penalties) of litigation (e.g. Skinner 1994). In relation to the above, firms that pre-disclose bad news may be subject to lower litigation costs than firms that do not (Skinner 1994) implying that litigants would concentrate on whether there are deliberate delays in disclosure of bad news (Healy and Palepu 2001).

Financial companies are inclined to provide more financial disclosures in order to reduce the monitoring costs for creditors. Managers particularly of those companies with public debt are more likely to voluntarily disclose information about the company's level of indebtedness because in the event of high leverage, creditors will urge the firm to disclose more information to help them handle their own credit risk (Hossain *et al.*, 1994; Khani and Rodbari, 2013; Pourmalar, 2014). Furthermore, when companies have high levels of public debt, the debt-holders are more likely to have close relationships with the firms and consequently require detailed information disclosure to ensure observance of the terms of debt contracts (Pourmalar, 2014).

In summary, it has been shown from the problem statement that firstly, this study concentrates to characterize the disclosure level in an emerging equity market in a Middle Eastern country in which disclosure extent of adequate and trustworthy data from firms in emerging nations lags behind industrialized western capital markets, and regulatory agencies are less efficient in applying the current accounting regulations. Secondly, the regulatory framework in an emerging economy like Iran cannot reach international standard due to some difficulties such as problems with the complexity of IASs/IFRSs, translation problem, conflict with legal mechanism, knowledge and awareness deficiency, and problems with fair value measurement requirements. Countries like Iran have developing economy and is in need of capital accumulation to promote economic development. In either case these countries need to develop their stock markets and the use of IAS can help them in this regard. Next one, seeking to better corporate governance levels as well as introducing requirements for corporate governance is increasingly important for restoring the confidence of market participant on the fairness and integrity in the Asia stock markets in most cases and Iran in particular. While Asian stock markets have experienced a greater level of independent board, the amount of adoption and paying attention to independent board has been uncertain in Iranian listed firms and its effect on ownership structure as a powerful monitor tool. Last of all, one of the most noticeable features of this study is to determine the effect of ownership structure and board composition as features of corporate governance that are unclear within Iranian listed companies.

## 1.4 Research Aims

The purpose of this thesis is to measure the level of disclosure of accounting information in a developing country (Iran) and to determine whether some important corporate governance and attributes factors have any impact on the extent of disclosure in Iran. Considering the importance of high level of financial disclosure on improving the functional economic agencies, previous studies (e.g. Dahawy and Conover, 2007; Khani and Rodbari, 2013; Asadi, 2014) suggest that higher-level financial reporting can promote economic development and to attract foreign capital. In particular, our study pointed to determine which of these factors are significantly related to increased disclosure and also to assess the nature and extent of information that should be made available by management to users of corporate annual financial reports. The main focus of this research is to assess the extent to which listed firms in Iran complied with what were then known as National Accounting Standards and also International Accounting Standards (now known as IFRS).

The other facet of this field based on the object that is to identify the issues of non-adoption with required disclosure of the accounting criteria. In addition, this study tries to find the effect of board composition and auditor type as powerful monitor tools on ownership structure and attributes firm factors and measure their results on the level of disclosure. Governance provisions may improve financial reporting and transparency by the mitigating incentive to misrepresent information disclosures and control management's ability (Leuz *et al.*, 2003). These provisions make it less likely that management discloses information that is less than credible, or does not fully disclose relevant information to shareholders and acting in its self-interest. Governance provisions protect shareholder interests through establishing the CEO career concerns (Manne, 1965; Bazrafshan, 2015), and limit the extent to which CEO can expropriate firm value through shirking, risk aversion, empire building, and perquisites (Bebchuck and Cohen, 2005; Bebchuk *et al.*, 2009).



## 1.5 Research Questions

According to Fraenkel and Wallen (2009), a good research question should fulfill these three conditions: be feasible, clear and significant. Good questions cause good hypothesis and ultimately lead to better studies (Salkind, 2009). Researchers can produce useful results based on the proper research questions. To address the research objectives that outlined in Chapter 1 Section 1.6, four research questions were developed in the light of the literature review. A number of questions addressed in this study includes the following:

- (i) Is there significance difference between overall disclosure level of financial and non-financial firms in Iran?
- (ii) What are the relationship between corporate governance and attributes factors and the level of disclosure in the annual reports of listed companies in Iran?
- (iii) What is the role of board composition in the relationship between the corporate governance, attributes factors and the overall disclosure level?
- (iv) What is the role of auditor type in the relationship between the corporate governance, attributes factors and the overall disclosure level?

## 1.6 Research Objectives

The following research objectives would be worthy of investigation:

- (i) To examine the differences of overall disclosure level (NAS, IAS, VOL) of financial and non-financial firms in Iran;
- (ii) To determine whether corporate governance and attributes factors influence the level of disclosure in the annual reports of listed companies in Iran;
- (iii) To examine whether the board composition interacts the relationship between the corporate governance, attributes factors and overall disclosure level;

- (iv) To examine whether the auditor type interacts the relationship between the corporate governance, attributes factors and overall disclosure level.

## 1.7 Conceptual Research Framework

The framework of this research as shown in Figure 1.1 reflects the theoretical view of this study which is developed based on the research frameworks of Street and Bryant (2000), Ali *et al.*, (2004), Akhtaruddin (2009), Samaha *et al.*, (2012), and Bazrafshan (2015) in the field of disclosure. Adopting research frameworks which were successfully examined in previous studies will be the best basis since there is no one theory that can fully explain disclosure practices and also there is no comprehensive or unifying, theory of disclosure (Wallace and Naser, 1995; Verrecchia, 2001; Hassan and Marston, 2010; Beyer *et al.*, 2010). The focus of this research is to assess the extent to which listed firms in Iran complied with what were then known as National Accounting Standards and also International Accounting Standards (now known as IFRS). The high level of compliance with accounting standards will be improved the level and quality of accounting information disclosure (Vakilifard and Aliakbari, 2012). previous studies (Wyatt, 1989; Adhikari and Tondkar, 1992; Ding, 2002; Dahawy and Conover, 2007; Khani and Rodbari, 2013; Asadi, 2014) suggest that higher-level financial reporting can promote economic development and to attract foreign capital. This indeed is consistent the economic theory and capital need theory which argues that a firm should obtain measurable economic benefits when it adopts and observes IAS (Hodgdon, 2004). Capital need theory suggests that the main motivation for high level of disclosure is the need to raise capital, in which a successful company may increase the dynamic economic growth (Choi, 1973; Modarres *et al.*, 2014). Companies may think that greater financial disclosure will reduce investor uncertainty and reduce the cost of new capital (Choi, 1973; Firth, 1980; Cooke, 1993).

This study also focuses on the extent to which the listed Iranian companies voluntarily disclose information in their annual reports to meet the information needs of users. In order to facilitate national economic development, it is requisite to access to information concerning overall corporate voluntary annual financial disclosure report (Yaftian and Mirshekary, 2009). Globally, for the purpose of satisfying the users of corporate information needs, the users have highly anticipated to intensify and precipitate publishing corporate voluntary disclosure (Yau *et al.*, 2013). The fact that companies have incentives to voluntarily provide information to the market in order to achieve some economic benefit is stated by the signalling theory (Spence, 1973; Hughes, 1986; Morris, 1987) and the capital need theory proposes that the disclosure of voluntary assists in attaining a need of the firm to increase capital at a low monetary value (Choi, 1973).

The next focuses of this study are to determine whether some important corporate governance and attributes factors characteristics have any impact on the extent of disclosure in Iran. Some corporate governance consistent with agency theory (family ownership, ownership concentration, government ownership, managerial ownership, assets in place, and duality in position) (Ho and Wong, 2003; Armstrong *et al.*, 2014; Shamra, 2014) and some factors consistent with both agency and signaling theory (auditor type, firm size, profitability, leverage, and liquidity) (Galani *et al.*, 2011; Lan *et al.*, 2013; Demir and Bahadir, 2014). The theoretical literature points to the benefits of having more independent directors on the board and the type of auditor. To sum up, researchers classify board's activities and auditor firms into two major functions: monitoring and advising (Adams and Ferreira, 2007; Linck *et al.*, 2008; Rahmani, 2014). By increasing independent directors on the board and using audit organization, the board's principal role and audit firm (independent audit firm) shifted from the "advising board" to the "monitoring board". Increase in monitoring provides benefits, but it also entails costs. Benefit: having a better ability to monitor CEO and ownership structure would result in encouraging CEO to disclose more information to outside investors and limit managerial opportunism. Cost: the increasing monitoring gives CEO and ownership structure incentives to engage in value reducing activities intended to make himself appear more capable (Hermalin and Weisbach, 2012). The board's structure and the auditor type as two powerful monitor tools may influence,

for better, the information environment, market makers' confidence, and disclosure level.

## **1.8 Scope of the Study**

This research attempts to examine the factors influencing the disclosure level of accounting information in financial and non-financial listed firms in Tehran Stock Exchange and explore the origin, growth, development, and level of adoption of National and International accounting standards in Iran. Iran is selected as scope of this research because of following reasons: first of all, Iran, as an Asian country provides an interesting cultural contrast to western countries due to emphasis on Islamic laws and values (Etemadi *et al.*, 2009). Secondly, the economy of Iran, is different from any other Asian country, it is a mixed (in which both the private sector and state direct the economy) and transition economy (which is changing from a centrally planned economy to a free market) with a large public sector. In addition, Iran is an emerging equity market in a Middle Eastern country and the world's seventeenth largest by purchasing power parity (PPP) and also twenty-first by nominal gross domestic product (IMF, 2013).

Meanwhile, most previous studies on adoption of accounting standards by developing countries are country specific (as discussed in problem statements and literature review). Iran is certainly a unique market in the Middle East. It is populous, rich in natural resources and adapt to technological progress and international developments. The country's natural resources create a significant wealth. In fact, based on a resource-based evaluation, the Iranian economy is the 20th strongest in the world (Iran-Investment, 2016). Thirdly, Iran has a new active market that was set up in 1966. Perhaps corporations in Iran are reluctant to disclose more information (Yaftian and Mirshekary, 2009). The stock market has been chosen as the principal vehicle in the privatization program, because of the fiscal condition of this transformation (Mirshekary, 1999; Molkararee, 2004). Though the working of the stock market is

essential to facilitating increased private sector participation in Iran's economic development and growth, the stock market has failed to restore the place of the private sector (Mirshekary, 1999; Vakilifard and Aliakbari, 2012).

Therefore, different national and organizational cultures and the nature of management education have a major impact on the performance achieved from the imported accounting standards (Etemadi *et al.*, 2009). According to Nobes and Parker (2008), such factors as external environment and culture, the legal system, providers of finance, taxation, profession, inflation, accidents and external influences have a greater bearing on the decision to adopt IFRS in a country. On the other hand, educational levels, economic growth, cultural membership, availability of capital market and degree of external economic openness have an impact on the adoption of IFRS by developing countries (Zeghal and Mhedhbi, 2006). The reason for concentrating on Iran is due to the call for increased foreign and domestic investment, according to many experts, the economy of Iran has many investment opportunities, particularly in its stock exchange (Chatterjee *et al.*, 2010; Rahmani, 2014). Iran has made the development of non-oil exports a priority. The country has the advantage of a broad domestic industrial base, an educated and motivated workforce and geographical location, which gives it access to an estimated population of some 300 million people in Caspian markets, Persian Gulf states and countries further east. This has spawned a number of processing industries (Iran-Investment, 2016).

The corporate governance issue was first addressed in early 2000 (when an internal governance structure was dominant) and only a few external control mechanisms are in place (Mashayekhi and Mashayekh 2008). The major growth in the number of listed companies from 6 to 105 took place during 1967-1978. However, Islamic revolution and war lead to major decreases in TSE trading, and the number of listed companies fell to 56. In 2006, the number of listed companies on the TSE increased to 322. The TSE became a member of the Federation of Euro-Asian Stock Exchanges (FEAS) and the World Federation of Exchanges (WFE) in 1995 and 1994, respectively. Until recently there were no financial reporting nor national accounting standards in Iran, although prior to 1979 financial reporting was influenced by Anglo-Saxon practices (Mirshekary and Saudagaran, 2005; Chatterjee *et al.*, 2010). Disclosure requirements were based on tax law, corporate law, and stock exchange

regulations, of which tax law requires firms to prepare a balance sheet, income statement and a list of shareholders (Mashayekhi and Mashayekh, 2008; Chatterjee *et al.*, 2010). With the aim of limiting the scope of the study, the following points would be employed to examine the ingredients that affect more voluntarily information and the measure of compliance of NASs and IAS/IFRSs in developing countries (financial and non-financial listed companies in Tehran Stock Exchange of Iran in particular). These main issues would be analyzed in the theoretical or literature review and the empirical studies of this dissertation respectively.

## **1.9 Significance of Study**

The findings of this research will fill the theoretical gaps regarding the effect of corporate features on the level of disclosure and the compliance level of the listed firms in Tehran Stock Exchange with accounting standards (national and international). Briefly, the findings of this study will develop:

- (i) The disclosure level of accounting information in Iran;
- (ii) The compliance level of the listed Iranian firms with the disclosure necessities of NASs and IASs;
- (iii) The assessment of Iranian companies is offering more information than statutorily required as voluntary disclosure;
- (iv) Factors determining the information disclosure level in the annual reports of listed firms in Iran. This is considered empirically to ascertain whether the corporate governance and attributes found relevant in prior surveys are likewise distinguished in this study or not.

This study contributes to the body of knowledge by responding to the gaps in the literature through examining the association between corporate features and the level of accounting information disclosure and also the overall extent of the corporate accounting information disclosure.

By internationalization of capital markets, the disclosure information importance has enhanced. Countries which require better of accounting information disclosure would have a comparative advantage evaluated to nations with inadequate disclosure. Hence, disclosure requirements may become a competitive tool on the capital market. Some previous researchers propose that foreign investments flow more into nations with better disclosure rules (Bradshaw *et al.*, 2004; Aggarwal, 2005). Companies are penalized for inadequate quality financial reporting, but several elements such as corporate governance, voluntary disclosure choices and disclosure rules and regulations matter on both firm and country level. The research will also measure the voluntary disclosure level by listed firms on the Tehran Stock Exchange and it expected to contribute to the literature on whether the firms' characteristics that researchers have found to be significant in developed countries can be applied in a developing country like Iran, and on other related research works. A valuable practical incentive for this research is the better understanding of the voluntary disclosure practices in a non-Anglo-American nation that has not been comprehensively scrutinized.

The next focuses of this study are to determine whether some important corporate governance and attributes factors characteristics have any impact on the extent of disclosure in Iran. Some corporate governance consistent with agency theory (family ownership, ownership concentration, government ownership, managerial ownership, assets in place, and duality in position) and some factors consistent with both agency and signaling theory (auditor type, firm size, profitability, leverage, and liquidity). The theoretical literature points to the benefits of having more independent directors on the board and the independent audit firms. To sum up, researchers classify board's activities and audit firms into two major functions: monitoring and advising (Adams and Ferreira, 2007; Linck *et al.*, 2008; Rahmani, 2014).

By increasing independent directors on the board and using audit organization, the board's principal role and audit firm (independent audit firm) shifted from the "advising board" to the "monitoring board". Increase in monitoring provides benefits, but it also entails costs. Benefit: having a better ability to monitor CEO and ownership structure would result in encouraging CEO to disclose more information to outside investors and limit managerial opportunism. Cost: the increasing monitoring gives

CEO and ownership structure incentives to engage in value reducing activities intended to make himself appear more capable (Hermalin and Weisbach, 2012). The board's structure and the auditor type as two powerful monitor tools may influence, for better, the information environment, market makers' confidence, and disclosure level. Therefore, the present study would like to fill up the gap of this academic research in this area since there has been little evidence about the effect of auditor type and independent board as two powerful monitor tools on CEO and ownership structure and measure their results on the extent of disclosure. It would be surprising, therefore, to find a board structure that uniformly has better consequence for all firms at all times.

In relation to policy implication, this study highlights the importance of effective future public policy to understand which aspects of corporate governance have the greatest impact on the level of disclosure after considering board composition and auditor type. The recent Asian financial crisis and increasingly competitive environment in the financial industry have made the firm to pay more attention to the corporate governance and its effect on the level of disclosure (Morris *et al.*, 2004; Bazrafshan, 2015). This study contributes to the continuing debate on corporate governance and the role of board composition and auditor type by providing a timely and comprehensive investigation of the disclosure level of Iranian financial and non-financial firms. This study highlights the role that corporate governance (family ownership, ownership concentration, managerial ownership, government ownership, duality in position) at listed firms may have effected disclosure.

The previous disclosure literature has focused primarily on adapting to IASs (Nobes, 1990; Street *et al.*, 1999; Street and Bryant, 2000) and limited study has been carried relating to corporate disclosure compliance with national accounting standards (Ali *et al.*, 2004). The focus of most of the accounting research in developed nations. The presence of international accounting standards has facilitated the transformation of some developing nations from socialism to capitalism, but adoption of these standards has also generated significant conflict since the standards are many times inconsistent with the cultural values in the developing nation (Dahawy and Conover, 2007). Iran, which is categorized as a developing country, provides an interesting



culture contrast to western countries because of the new emphasis on Islamic laws and values after its political revolution in 1979 (Etemadi *et al.*, 2009).

This study will provide a description of the present status of adoption of accounting standards in Iran. It will update and expand the limited literature on accounting standards and the level of adoption and also the degree of financial disclosure in Iran in particular, and in the Middle Eastern Asian region in general. The case of Iran is an interesting sample of the achievable development of accounting information and national accounting standards in a transition economy. The research presents an insight into some of the major issues related to the process of transition in the accounting field.

The consequences of the research may also have implications for investors (foreign as well as domestic), standard setters and preparers of fiscal reports in Iran. Financial accounting information has been recognized as being of underlying importance for capital markets and for economic development. Consequently, insights into the adoption of accounting information and the level of the listed firms with the disclosure required of NASs and IASs are of interest to all countries and in particular to countries with emerging capital markets. It is essential for an emerging economy to raise capital is especially acute as it requires to attract foreign investment into the nation and to promote the confidence and understanding of stakeholders. For this purpose, fairness, efficiency and transparency of financial information are considered the main aims of those capital markets. Awareness has therefore been directed towards financial information disclosure, as a very significant element in promoting people to invest.

The prominent disclosure model, namely disclosure indices, has been used in this study as a basis for establishing the disclosure extent and identifying the company's characteristics that influence the disclosure pattern that is widely used in annual reports. A self-constructed checklist was established as part of the research process. It is among one of the earlier comprehensive checklists for the level of adoption of Iranian firms based on internal and international accounting standards disclosure requirements and issues of validity and reliability addressed (it can be

applied). The checklist will provide guidance to future researchers concerning the collection of data relevant to disclosures related to compliance of listed companies with accounting standards in Iran.

In this research, the index of disclosure will be generated and the factors affecting disclosure are anticipated to help local and foreign investors in making more informed decisions. In the Iranian economy, the adequate corporate disclosure will enhance the assurance of current and potential investors. The listed firms' managers can evaluate their current compliance level employing the index of disclosure generated by this study. This will assist the managers to make better their practices of disclosure. It will make possible the listed firms to compete at the global level and simplify free flow capital across the Iranian borders. The financial statements preparers (accountants) and auditors can also apply the index of disclosure developed in this research to evaluate the compliance level by firms.

### **1.10 Definition of Terms**

The following are among the operational definition of the of the key terms used in this study:

*Financial reporting* is the process of producing statements that disclose an organization's financial status to management, investors and the government.

*Financial statements* present the results of operations and the financial position of the company. Four statements are commonly prepared by publicly-traded companies: balance sheet, income statement, cash flow statement and statement of changes in equity.

*Disclosure* is the appearance of quantitative or qualitative economic information relating to a business enterprise in the annual reports.

*Mandatory* disclosure refers to the information companies are obliged to disclose by the accounting standards setting body.

*Voluntary* disclosure refers to the discretionary release of financial information over and above the mandatory disclosure.

*Corporate governance* is defined as the system by which companies are directed and controlled. According to (OECD, 2004), corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders.

*Corporate attributes* are company characteristics that can influence corporate disclosure.

*Accounting Standards* are policy documents or rules that guide the preparation and presentation of financial information.

*International Accounting Standards Board (IASB)* is the international standard setting body responsible for issuing International Financial Reporting Standards.

*International Accounting Standards (IAS)* is a body of accounting standard issued by the International Accounting Standards Committee (IASC) now known as IASB.

*International Financial Reporting Standards (IFRS)* is a set of accounting and financial reporting standard promulgated by the IASB; it includes standards and interpretations adopted by the IASB.

*Local GAAP* refers to domestic accounting standards used by a country before converting to IFRS.

*Convergence* refers to the process of narrowing differences between IFRS and the accounting standards of countries that retain their own standards.

*The Audit Organization* is responsible for compiling and determining principles and rules of auditing and accounting and also the official and legal venue responsible for standard setting in Iran.

*The emerging nation* is a country that is on its way to becoming an industrialized nation. An emerging nation is a developing country that has achieved some industrial capacity.

*Developing country* is defined by the World Bank as one whose average per capita income did not exceed U.S. \$ 9266 in 1999.

*Financial leverage* is the amount of debt that an entity uses to buy more assets. Leverage is employed to avoid using too much equity to fund operations. An excessive amount of financial leverage increases the risk of failure, since it becomes more difficult to repay debt.

*Profitability* is the ability of a business to earn a profit. A profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue, such as producing a product, and other expenses related to the conduct of the business activities.

*Liquidity* is a measure of the ability of a debtor to pay their debts as and when they fall due. It is usually expressed as a ratio or a percentage of current liabilities.

*An independent board* is a corporate board that has a majority of outside directors who are not affiliated with the top executives of the firm and have minimal or no business dealings with the company to avoid potential conflicts of interests.

*A family-owned company* may be defined as any firm in which two or more family members are involved and the majority of ownership or control lies within a family.

*Ownership concentration* refers to the group who has the most influence among the equity owners.

*Managerial ownership*, it means the percentage of equity owned by insiders and block holders, where insiders are defined as the officers and directors of a firm.

*Government ownership* (also called public ownership and state ownership) refers to property interests that are vested in the state or a public body representing a community as opposed to an individual or private party.

*Duality in position* (Role duality) exists when the Chief Executive Officer (CEO) is also the chairman of the board at the same time.

*Assets in place* is the property (the securities, real estate, and other property) in which a firm has already invested.

## **1.11 Organization of Thesis**

This chapter offered an overview of this thesis. In this chapter, the problem statement was indicated, aims were mentioned, questions, objectives, research framework, scope, and the importance of the research were discussed. Definitions of key terms were also introduced. Chapter two reviews the accounting history in Iran and a brief introduction for IASs/IFRSs and relevant literature about the level of corporate accounting information disclosure in developed and developing countries and examines the variables that could influence the disclosure level of information by firms in a country, with special emphasis on developing countries and also develops the hypothesis in this study. This chapter also provides a brief overview of the Iranian economic and legal environment, with a particular emphasis on the accounting and disclosure regulatory framework. Chapter three specifies the research methodology. It discusses the research process, research paradigm, research design, method of data analysis, data collection tools, descriptive statistics, population and sampling, research instrument, validity and reliability, the validity of the instrument, regression model, and method of analysis.

As for the chapter four, it reports on the empirical findings of the model tested. The chapter present the results of a dynamic panel generalized method of moments (GMM) to control for dynamic endogeneity, unobservable heterogeneity, and simultaneity for analyzing statistical models. This chapter aims to identify the effect of corporate governance and attributes factors on corporate financial disclosure of Iranian listed firms by interaction of independent board and the audit firm. Finally, the chapter five discusses the statistical results, whereby it outlines the contributions that this

research makes to the study of corporate governance, and attributes factors on corporate financial disclosure of Iranian listed firms. Thereafter, it discusses some limitations to the research and makes some suggestion for future study.

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