Nonfinancial Information Disclosure in Saudi Capital Market

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One of the foremost objectives of corporate reporting is for the users to understand the underlying economic values of corporations. Corporate reporting plays a vital role in the efficiency and operation of capital markets, and it is a reliable “window into companies’ thoughts and priorities” to evaluate the companies’ past, to forecast their future, to decide upon their potential, performance and speculate their continuation. Corporations provide external users with information that is necessary to attract them for investing their wealth and financing their operations. Corporate reporting is not limited to the financial information. Users of corporate reports need to be well informed about an entity to make economically rational decisions. The accounting profession through corporate reporting enhances investor’s confidence and reports relevant and reliable information comprehensively and adequately.

corporate reporting | nonfinancial information disclosure | voluntary discloser | emerging markets

1. Introduction

In corporate reporting, comprehensiveness is achieved in conveying nonfinancial information to the conventional function of corporate reporting to provide financial information. Evidently, “nonfinancial performance measures enhance the value of financial measures due to the interactive effects between the two measures” (Maines et al. 2002, p. 360). Corporate reports that provide nonfinancial performance information potentially enable users to assess and forecast corporate financial performance (Behn and Riley 1999). Both types of information complement each other to enhance users’ awareness about diverse aspects of a corporation (Amir and Lev 1996; Arvidsson 2011). Nonfinancial information has value relevance to the reported financial information in the corporate reporting financial figures (Simpson 2010).

Amir and Lev (1996) call for expanding the corporate reporting function to include nonfinancial information. By including information on social and environmental aspects of a corporation, nonfinancial reporting complements the corporate economic representation that is already evoked in financial information (Perrini 2006). Reporting financial and nonfinancial information on a mandatory or voluntary basis is a fundamental characteristic of corporate reporting practices (Sarıoğlu et al. 2019).

Focused on a wide range of areas other than health, safety, and environment, nonfinancial reporting enhances the sustainability of corporate reporting (Perrini 2006). Tamas-Szora (2016) reported that environment, social, staff affairs, respecting human rights, anticorruption and antibribery are the main five reporting areas that maintain the quality of non-financial information and guide its use.

While most countries disclose the nonfinancial information in voluntary context, nonfinancial disclosure is compulsory in some regions such as the European countries. The European Commission has mandated the nonfinancial reporting by its Directive 2014/95/EU (Mion and Adaui 2020) which requires the public interest entities “with more than 500 employees to disclose non-financial and diversity information in their financial statements or in separate, independent documents” (Caputo et al. 2020, p. 1; see also Tamas-Szora 2016). Weber et al. (2018) observed that several companies in 2018 issued their annual reports according to the new regulation in the European Union (EU) by including the mandatory nonfinancial disclosures as a consequence of the new regulation. After adopting its legislation to Directive 2014/95/EU through Royal Decree-Law 18/2017, Spanish Companies repot high rates of nonfinancial disclosure (Sierra-Garcia et al. 2018). Arguably, financial reporting is anticipated to grow to match the stakeholders’ demand for more information regarding environmental, social, and governance impacts (Markota Vukić et al. 2018).

2. Nonfinancial Information Is a Segment of the Communication Function of Corporate Reporting

Different definitions have been offered for accounting. One of the most cited ones1 is the *A Statement of Basic Accounting Theory's* (ASOBAT 1966). Accounting is "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information"2 (ASOBAT 1966, p. 1). According to this definition, communicating information about economic events to users with the intent of rationalizing their investment decisions is a function that corporate accounting has assumed in a corporate economy.

The corporate model where ownership and management are separated (Berle and Means 1932) characterizes a long-lasting encounter to corporate accounting since the advent of a corporation as a model for dictating the conduct of business ([1] 2021; Al-Adeem and Fogarty 2010; Al-Hazzani and Al-Adeem 2020; Merino 1993; Previts and Merino 1998). What the contents of corporate reporting should be remains an open question to the present day.

Attempting to theorize corporate reporting, accounting academics and researchers, accounting academic organizations and accounting professional bodies have put forward theories for corporate reporting3. However, none of them has gained the necessary acceptance to become the accounting theory ([1] [2] [3] [4] [5] 2021; Al-Adeem and Fogarty 2010; Al-Hazzani and Al-Adeem 2020); *Statement on Accounting Theory and Theory Acceptance* (SATTA 1997)4; (Beaver 2002; Belkaoui 2004; Chatfield 1977; Coetsee 2010; Gaffikin 1987; Garcia 2017; King 2006; Lee 2009).

At the professional level, corporate reporting has been expanded in scope to accommodate the expanded users' needs for more information about their corporations. The impossibility of capturing economic reality to contain it in corporate financial statements (White et al. 2002) justifies such an expansion. Corporate reporting is expanded to cover business and corporate sustainability5, corporate social responsibility (see for example Rupley et al. 2017), triple-bottom line6 along with reporting intellectual capital (see for example, Guthrie 2001; Guthrie et al. 2001; Mouritsen et al. 2004; Petty and Guthrie 2000). Such a broadness in corporate reporting signifies needed information that financial statements lack.

The function of communication through corporate reporting potentially mitigates agency issue that the corporate model symbolizes. External parties are intended to be served by nonfinancial information in addition to financial information through corporate reporting. Integrating reporting on such matters in corporate reporting yields integrated reporting (see Humphrey et al. 2017; Maama and Mkhize 2020; Rezaee 2017) that best serves users of corporate accounting. Corporate disclosure encompasses financial and nonfinancial information conveyed by formal and informal channels of communication ([6] 1992). "Financial disclosure is defined as any deliberate release of financial information, whether numerical or qualitative, required or voluntary, or via formal or informal channel" (Gibbins et al. 1990, p. 122). Since nonfinancial is an unstandardized form of corporate disclosure, exploring the practice of corporate reporting is ironic. An empirical investigation revealed that users in Saudi Arabia value information conveyed in the annual reports and considers them the most important source of information (Al-Razeen and Karbhari 2004).

3. A Brief History of Nonfinancial Reporting

Since the beginning of the 19th century, the industrial revolution has affected corporate reporting's focus when corporations started to be concerned about corporate social responsibility (CSR) of women's rights and social inequalities of their employees (Markota Vukić et al. 2018). The 1970s witnessed criticism toward negative impacts of corporations on the environmental and social aspects (Bruntland 1987). An awareness toward reporting nonfinancial information to develop the sustainability and to integrate economic and ecological considerations in decision making has emerged (Bruntland 1987). In the early 1990s, corporations have been reporting nonfinancial information to illustrate their commitment toward society by producing environmental, social and sustainability reports (as cited in Kolk 2003, p. 280).

Nonfinancial reporting has increased substantially since the publication of the first separate environmental reports in 1989 (Kolk 2004). According to a study conducted by KPMG (2002)7 in 19 countries, an increase in nonfinancial reporting from 13% in 1993, to 17% in 1996, 24% in 1999, and 28% in 2002 is reported.

4. Recognizing the Need for Nonfinancial Reporting

Corporate scandals shed light on measures increasing in popularity, which include a wide range of environmental performance indicators and the way of dealing with workers to corporate governance and providing charities (Chatterji and Levine 2006). Criticizing the current corporate reporting model for not responding to changes in environment, Jenkins (1994)8 observed that the existing corporate reporting model failed to fully fulfil the needs of a wide range of users, and he suggested to go beyond the financial reporting to include nonfinancial measures (see also Nielsen and Roslender 2015).

Companies vary in the manner of defining, preparing, and reporting the nonfinancial reports (Perrini 2006). Erkens et al. (2015, p. 25) define nonfinancial reporting as
"Disclosure provided to outsiders of the organization on dimensions of performance other than the traditional assessment of financial performance from the shareholders and debt-holders' viewpoint. This definition includes, but is not limited to, items related to social and environmental accounting, CSR, and intellectual capital disclosed outside the financial statements".

Nonfinancial reporting to investors is crucial, which is widely recognized (Hirschey et al. 2001). Nonfinancial information positively impacts individual investor's investment decision (Naveed et al. 2020). Nonfinancial reporting gives the investors a better perception through providing more information about different important aspects (Landau et al. 2020). Ernest & Young (2017)9, conducted a study that showed that the nonfinancial reports are highly significant for users and that 68% of investors use the nonfinancial reports to make their investment decisions.

From a business' perspective, the nonfinancial information disclosure and the inclusion of environmental, social, and governance activities is critical for strengthening the corporate reputation with customers and contribute more to the decision-making process (Ernest & Young 2021)10. Markets do react to environmental news (Gupta and Goldar (2005). The need for engaging environmental aspects in the decision making is indispensable for sustainability development (Bruntland 1987).

Disclosing nonfinancial information along with financial information complements the corporate reporting in a consistent manner and provides the investors relevant information (Arvidsson 2011). Brazel et al. (2009) found that nonfinancial information can be used to detect the inconsistency among patterns in financial and nonfinancial information, which is a significant indicator of financial fraud.

Nonfinancial information can be a useful device to predict stock returns (see Luft 2009). Particular nonfinancial measures such as employees' satisfaction and customers' satisfaction are very useful for managers in predicting future earnings (Banker and Mashruwala 2007). In addition, the market's assessment of accounting performance is affected by nonfinancial measures such as customer satisfaction (Ittner and Larcker 1998, p. 32).

Advocates of nonfinancial information reporting promote that such information, when disclosed, provides better insights into the value creation of a firm (Landau et al. 2020). Arguably, nonfinancial information gives more focus on the factors that impact the value creation for the long term (Nielsen and Roslender 2015).

From the practitioner and researchers' viewpoint, the use of nonfinancial measures in the managerial control systems of firms has considerable influence (Banker and Mashruwala 2007). Nonfinancial performance measures are a part of a balanced scorecard system that plays a role in building long-term value for shareholders that should assist stakeholders such as customers, societies, standard setters, and potential staffs to evaluate the social performance of firm (Chatterji and Levine 2006). The use of nonfinancial measures is justified based on the assumption that these measures could be indicators for future financial performance (Banker and Mashruwala 2007).

Nonfinancial information indicates the future profitability and enhances the level of social performance when the stakeholders prefer the firms that are more socially responsible and have the ability to reward it (Chatterji and Levine 2006). Moreover, several nonfinancial indicators are considered as highly value relevant such as the growth proxy and operating performance measures (Amir and Lev 1996). Nonfinancial information is considered as essential incremental information over financial ratios when predicting value drivers: growth, profitability, and risk (Laitinen 2004).

5. Corporate Reporting in the Saudi Capital Market: Closely Looked

Since its establishment in 1985, the Saudi capital market has been emerging and is at a relatively early stage of its development (Al-Razeen and Karbhari 2004; Al-Adeem and Al-Sogair 2019). The Minister of Commerce issued the Ministerial Resolution No. 692, on 11/11/1985. Later, a professional accounting body, i.e., the Saudi Organization for Auditors and Accountants11, was founded in 1993 (Al-Razeen and Karbhari 2004) for professionally organizing the accounting profession and the audit function in Saudi Arabia. The Saudi capital market shows evidence against the Efficient Market Hypothesis (Lamouchi 2020). However, researchers assume that such a market operates a weak form of the market efficiency (Alabaas 2008; Al-Adeem 2017d; Al-Adeem and Al-Sogair 2019; Al-Salman 2007; Alzahrani 2010). The issuance of financial statements by publicly held corporations is mandatory, standardized and regulated in the Saudi capital market. Their contents are considered as publicly available information.

In the Saudi capital market, three main market regulatory bodies exist, namely, the Capital Market Authority (CMA), the Ministry of Commerce and Investment, and the Saudi Central Bank. CMA is in charge of regulating capital markets, including the Saudi Exchange12, known as Tadawul. On 19 March 2007, the Saudi Stock Exchange (Tadawul) was established as the official stock exchange in Saudi Arabia (Lamouchi 2020). Moreover, the Ministry of Commerce and Investment is responsible for company law, regulating trade, expanding the private sector, and all relevant laws and rules. The Central Bank regulates the banking, insurance, and other finance sectors in Saudi Arabia.

The Saudi capital market differs from those of developed countries. Generally, emerging markets have possibility of high growth, relatively weak regulatory environment, weak corporate governance leading to expropriation of minority shareholders, and low level of information disclosure, causing a high information gap among firms and investors (Alturki 2014). Saudi Arabia is "one of the pioneers in corporate governance in the Middle East" (Al-Aali et al. 2014, p. 1332). Projections toward the Saudi economy have been virtually positive. Forecasted in 2017, Saudi Arabia was to have growth in the year of 2020. Specifically, Saudi Arabia is one of the world's fastest-growing nations, with per-capita income expected to rise from USD 25,000 in 2012 to USD 33,500 by 2020.13 Contemporarily, the economy seems to be recovering from COVID-19. The General Authority for Statistics (GASTAT) declared that "Saudi Arabia recorded a positive growth rate for the first time since the start of COVID-19 pandemic by 1.5% in Q2/2021 compared to Q2/2020"14.

In the Saudi capital market, the annual corporate report is considered the only official source of information about companies' performance (Al-Razeen and Karbhari 2004). However, by assessing the magnitudes of disclosure in the annual reports of specific Saudi firms, Alsaeed (2006) demonstrated that the average level of disclosure in the annual reports of non-financial Saudi firms is low, an indication of the need for more disclosures to fill the gap between information available about companies and the information needed by the investors. Alsaeed (2006) further brought attention to the need for more research on emerging markets exists due to its imperative role in developing the weak transparency and disclosure situation by attracting the attention of regulatory authority and corporations.

In the context of nonfinancial reporting, Alturki (2014) demonstrated that voluntary non-financial disclosure level of publicly traded firms in Saudi Arabia is considered moderate and the choice to disclose is left to the discretion of management. The average voluntary disclosure in Saudi Arabia is 18.38%, which is the lowest rate of the countries studied, compared to 26.08% in Tunisia and 75.76% in Bahrain (Habbash et al. 2016). Such a rate is not commensurate with the size of the Saudi market and economy (Habbash et al. 2016). For 2012 and 2013 annual reports, Abdulhaq et al. (2015) reported that 36% of nonfinancial information is disclosed. Boshnak (2021) analyzed half of the Saudi listed firms' annual reports over the period 2016–2018 and reported a higher level of 68% of voluntary disclosure of social and environmental information. Boshnak (2021) articulated that such an improvement might be attributed to the implementation of international financial reporting standards (IFRS) by Saudi listed firms. In fact, publicly held corporations have been mandated to prepare their financial statements in accordance with IFRS starting 1 January 2017. Acknowledging the variation of reported level of nonfinancial information of Saudi corporate reporting, it was investigated that 2019 annual reports for the voluntary disclosure of nonfinancial information in three sectors: energy, materials, and utilities.

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