Chapter (1)

Introduction

1-1. Introduction:

During the few past decades, interest in corporate governance has been growing in many developed and developing economies, especially in the wake of economic collapses and financial crises witnessed by the number of countries in East Asia, Latin America, and Russia in the nineties of the twentieth century. The U.S. economy has also recently been passing through rough waters as evidenced by the repercussions of the financial collapses of a number of U.S. tycoons and international companies during 2007. These collapses can be attributed for the most part to the spread of administrative and accounting corruption in general and financial corruption in particular, taking into account that accounting corruption is in part due to the process of fraud practised by auditors through emphasis on the correctness of the financial statements and their contents (i.e. the accounting information included), which is contrary to the truth.

Some studies have indicated that the most important reasons for the collapse of the companies was the management’s lack of good practice in monitoring and supervision, lack of experience and skill, imbalance between financing structures and random expenditure, lack of transparency, lack of interest in the application of accounting principles and standards of accounting and auditing which are based on the application of principle of transparency and verification of disclosure to make accounting information actually reflect the real financial situation of the company, and other non-sound practices that have led to the inability to generate sufficient internal cash flow to pay off their obligations, hence sent them to a state of collapse. This state of collapse may result in lack of confidence in the financial markets and the withdrawal of the various investors, as well as lack of confidence in accounting and auditing firms as a result the lack of confidence in the accounting information contained in the financial statements of different companies.

Given the increasing interest in the concept of corporate governance, a number of international institutions made efforts to subject this concept to study and analysis: e.g. the International Monetary Fund (IMF), the World Bank, and the Organization for Economic
Cooperation and Development, which issued the principles of corporate governance in 1999 to help member and non-member states of the Organization to develop legal and institutional frameworks for the application of corporate governance in both public and private companies, whether current or non-current in financial markets. Here, a number of guidelines have been provided to enhance efficiency companies and financial markets and stabilize the economy as a whole. This supports the emphasis by the International Organization for Securities Commission (IOSCO) in 2002 on the importance of adopting the principles of corporate governance (Fawzy, 2003:6-7).

The concept of Corporate Governance is concerned with the creation and regularization of good applications and practices by those in charge of a company's management as to maintain the rights of shareholders, bondholders and employees of a company as well as its stakeholders and others, through the commitment to apply the standards of disclosure and transparency. Corporate Governance constitutes a set of rules that guide the behaviour of companies and shareholders, and companies managers (Al-Issawi, 2003:36-37), the government actions to promote and enforce those rules, and the increasing interest in the subject of corporate governance in recent years by researchers and those interested in international organizations (a number of conferences, seminars and workshops have been held in the developed countries, unlike developing countries, especially Arab states in general and Yemen in particular, where there is still a distinct lack in this direction).

With regard to the banking sector in the turn of the third millennium, banks worldwide face many challenges such as liberation of commerce in the financial services, the requirements of Basel Committee, the spread of money laundry operations, the technological revolution, the changes in the banking services structure. In order to face these challenges, many banks have adopted strategies such as expanding banking investment activities, presenting innovative financing activities, enhancing the use of technology, adopting the modern concept for banker marketing, developing human resources, and banker mergers.

Joint share companies, including banks, are undergoing a quantum leap in their practices. Consequent to the scandal of Enron (Agrawal & Chadha, 2005:373), Sarbanes Oxley’s law and the Standard (SAS No. 99) were issued with instructions that force many companies to change their traditional methods in practising their work and be committed to these instructions and other regulations, which would increase the burdens sustained by
auditing companies, too. Indeed, one of the new instructions which will affect most companies is that proposed by New York Stock Exchange (NYSE), which is represented by the new requirements that should be available for internal auditing function. Currently, the American companies will have to pay bigger amounts of money than earlier as auditing fees. Companies should also pay expenses for implementing the new programs to tally with the instructions of the American government and the stock exchange.

Furthermore, the changes which will occur on International Accounting And Auditing Standards will exceed the joint share companies, given that the new legislations will impact on Corporate Governance. Banks and insurance companies will also be affected by those changes, and even private companies, on the basis of being subjected to standards related to high quality businesses (Bhasin, 2009:271).

The financial crisis that hit financial markets in the United States and other countries during 2008, threatening the whole world falling into recession not seen since 1928. The main reasons for this to be a bug in the mechanisms of control and follow-up both at the corporate level or the capital markets. Which increased the importance of the belief systems of governance as a tool of control and accountability and a wall of protection from such crises (Hassanein, 2009).

Moreover, banks face another type of challenges and changes, such as establishing direct lines for the notification about cheating and fraud, and training of employees for the application of the new standards according to the requirements of Sarbanes–Oxely’s law and the Standard (SAS No. 99), given the necessity to keep abreast with the new laws and changes imposed by American government and stock exchange. Therefore, it has become necessary for the financial managers to endure new complicated burdens, in addition to their previous burdens.

Based on the above, and since year 1992, many countries have issued guidelines or principles for corporate governance. Europe was in the front, e.g. Britain, through Cadbury Report in 1992 (entitled “The financial aspects in the corporate governance”), followed by Greenbury Report in 1995, followed by Hampel Report in 1998, and finally The Practical Guidelines for Corporate Governance in 2004. Similarly, some countries from North,
Southern and Latin America as well as some Asian and African countries started on the same path. It is noticed that most of those countries depended while preparing the guidelines and principles on the principles of corporate governance issued by the Organization for Economic Co-operation and Development (OECD) in 1999, and the modified version of 2004, which defines corporate governance as “ procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decisions-making” (OECD, 2005).

Public trust and investor confidence in the nation’s economy and its capital markets are the key drivers of economic growth, prosperity, and financial stability. Investors are confident when stock prices are high, the news about future stock performance is optimistic, and financial information is perceived to be reliable. The wave of financial scandals in the late 1990 and the early 2000 coupled with the economic downturn had a substantial negative impact on investor confidence. Corporate and accounting scandals are still a major concern among investors. In May 2006, more than 71 percent of investors felt that accounting issues negatively affected the capital markets (down from 91 percent in 2002) (Zabihollah, 2007). Corporate governance reforms, including the Sarbanes-Oxley Act of 2002 (SOX), SEC-related rules, listing standards of national stock exchanges, and best practices, have been established to rebuild public trust and investor confidence in corporate America. Investors would like to see changes in the corporate governance structure that not only require compliance with these reforms but also address managerial incentives and pressures, vigilance and independence of boards of directors, quality and independence of auditors,

objectivity of financial analysts, and shareholder democracy in director elections. Public trust and investor confidence in public financial information is a complex issue that “cannot be legislated ... the investment community is requiring individual companies, one by one, to earn back market trust” (Woodward, R., J. Dittmar, and C. Munoz. 2003).

In this context, Yemeni Businessmen Club (YBC) has issued guidelines of corporate governance in March 2010, but it did not give instructions on the disclosure and transparency of corporate governance in published annual reports of banks. It does not force Yemeni companies to commit to it; it is voluntary. All Yemeni banks did not mention the reports of the boards of directors to the topic of corporate governance with the exception of Arab Bank.

In order to provide more transparency and disclosure, and encourage investment in the financial markets and institutions, and rebuild confidence, we need to ask the Yemeni financial community: Why corporate governance guidelines? Why are Yemeni banks report not published thereon within the annual reports published? What is the role of the accounting profession in Corporate Governance?

In this sense, this study is investigating a very important issue, i.e. “To study the impact of adopting International Accounting and Auditing Standards on improving corporate governance effectiveness in Yemeni banks”.

1-2. The Problem of the Study:

There is an urgent need for reassuring investors, employees, and other interested parties by undertaking steps that are necessary for the protection of their legitimate interests, and retrieving confidence in the published financial statements which are supposed to “fairly expose”. In addition, there is a need for confirmation that the financial statements are prepared according to known and generally accepted principles and a demand for stronger legislations in order to protect the public against illegal or unethical conduct of those in charge of the companies.

Here, it can be said that the competence of financial markets can be affected if investors cannot trust the financial statements offered to them, since financial statements are official regular means for the delivery of information. We are in need for the establishment of a benchmark for fair presentation to administer justice with regard to those in charge of money, and stakeholders and other interested parties.
Therefore, at the beginning of the third millennium, the accounting profession is facing many problems, the most important of which is the retrieval of confidence in the financial statements. In other words, we need to see its role in corporate governance, considering the financial scandals of giant international companies, including American, Dutch, and Italian corporations, due to lack of commitment to company laws and Securities and Exchange Commission (SEC), in addition to the lack of upholding high level standards of ethical and professional conduct.

From this perspective, there has been a loud call for better governance of organizations over the past ten years or so. The call has concentrated on major public joint-stock companies especially the banks, and it also expanded onto a wide coverage scale of organizations, for the following reasons:

1. The emergence of several cases of financial fraud and bankruptcy in public joint-stock companies, giving rise to such questions as: Where is the board of director? Where are the auditors? Where are the internal auditors and the supervisors? Where are the organizers and the legislators?

2. In the last few years, the activities of investors and shareholders have become more candid and demanding in relation to governance issues, and concentrated on many modern requests for the necessity of improving governance since good governance is based on:
   - Reduction of organization dangers.
   - Reduction of capital cost for the organization.
   - Increase of rights and guarantee for contributor in the end.

Therefore, this study is an attempt to study the influence of the adoption of international accounting and auditing standards on improving corporate governance effectiveness in Yemeni banks.

This study tries to achieve its aims by answering the following inquiries:

1. What is the impact of the adoption of international accounting standards’ requirements on improving corporate governance effectiveness in Yemeni banks?
2. What is the impact of the adoption of international auditing standards’ requirements on improving corporate governance effectiveness in Yemeni banks?

3. What is the impact of the adoption of internal professional auditing standards’ requirements on improving corporate governance effectiveness in Yemeni banks?

4. What is the impact of the adoption of requirements of rules of professional and ethical conduct for accountants on improving corporate governance effectiveness in Yemeni banks?

5. What is the impact of commitments to laws and regulations (company law, banks law, and instructions of the central bank) on improving corporate governance effectiveness in Yemeni banks?

1-3. Importance of the Study:

Corporate Governance has developed alongside financial market development, accompanied by the existence of an active body to monitor money market and supervise its transparency. In addition, the development in the American accounting and auditing professions has also played an important role (Wahiduddin, 2003). The importance of this study stems from its presenting visualizations and solutions for consolidating the principles of corporate governance in Yemen in order to play its role as the safety valve for companies from bankruptcy and collapse through uplifting the profession of accounting and auditing in general and working on expanding the area of disclosure and transparency in particular. Besides, the importance of this study arises from up datedness of the subject both in the theoretical and applied aspects.

It is no doubt that in the current era of economic globalization companies, and even countries, where there is no or little application of the concept of governance, are more prone to serious consequences, far outweighing mere scandals and financial crises, such as financial collapse of companies and bankruptcy.

Events have proved that lack of corporate governance makes it possible for those in charge of companies from the inside (whether the board of directors, managers or employees) to manipulate the company’s money at the expense of shareholders, suppliers, customers and other stakeholders.
This study gains an additional importance by looking into a very important topic in the area of accounting and management, i.e. corporate governance, particularly after the emergence of this research problem in a number of researches and studies in developed countries such as Britain, Australia, the United States of America, Spain, Germany, Japan and China, as well as a number of Asian countries. Moreover, another dimension of the importance of the study stems from being the first study of its kind in the Republic of Yemen to the knowledge of the researcher.

The steady increase in the spread of companies, national and foreign banks, multinational corporations, and various legal forms operating and involved in several activities in Yemen makes this study quite relevant, considering that the accounting and auditing profession has hardly received any serious attention, especially corporate governance. Such point increases the importance of this study.

The Yemeni government has been trying to encourage foreign investment, changing the investment law several times, and attempting to provide facilities and incentives which would lead to increase and diversity of users of accounting information and contrast their culture and behaviour which calls for the use of accounting standards and auditing and methods and principles of corporate governance at the international level.

1-4. **Objectives of the Study:**

This study is an attempt to investigate the following aspects:

1. The impact of the adoption of international accounting standards’ requirements on improving corporate governance effectiveness in Yemeni banks.

2. The impact of the adoption of international auditing standards’ requirements on improving corporate governance effectiveness in Yemeni banks.

3. The impact of the adoption of internal professional auditing standards’ requirements on improving corporate governance effectiveness in Yemeni banks.

4. The impact of the application of requirements of rules of professional and ethical conduct for accountants on improving corporate governance effectiveness in Yemeni banks.
5. The effect of the commitment to laws and regulations (company law, banks law, and instructions of the central bank) on improving corporate governance effectiveness in Yemeni banks.

1-5. Variables of the Study:

Figure (1) Variables of the Study

<table>
<thead>
<tr>
<th>Dependent Variables</th>
<th>Independent Variables</th>
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<tr>
<td>Adopting International Financial Reporting Standards (IFRS)</td>
<td>Corporate Governance Effectiveness in Yemeni Banks</td>
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<td>Adopting International Standards of Auditing (ISA)</td>
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<td>Adopting International Internal Auditing Standards</td>
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<td>Adopting Rules of Professional and Ethical Conduct</td>
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<td>Commitment to Laws and Regulations of Yemen</td>
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1-6. **Hypotheses of the Study:**

Based on the elements of the problem of study, hypotheses are examined to find out the extent of their suitability and correctness.

\( H_01: \) There is no impact of the adoption of international accounting standards’ requirements (IAS No 1, 24, and IFRS No 7) on improving corporate governance effectiveness in Yemeni banks.

\( H_02: \) There is no impact of the adoption of international auditing standards’ requirements (ISA No 240, 260, 570) on improving corporate governance effectiveness in Yemeni banks.

\( H_03: \) There is no effect of adopting of internal professional auditing standards’ requirements on improving corporate governance effectiveness in Yemeni banks.

\( H_04: \) There is no impact of the adoption of requirements of rules of professional and ethical conduct for accountants on improving corporate governance effectiveness in Yemeni banks.

\( H_05: \) There is no effect of commitment to laws and regulations related to ensuring the basis for an effective corporate governance framework on improving corporate governance effectiveness in Yemeni banks.

\( H_06: \) There is no effect of commitment to laws and regulations related to the rights of shareholders and key ownership functions on improving corporate governance effectiveness in Yemeni banks.

\( H_07: \) There is no effect of commitment to laws and regulations related to the equitable treatment of shareholders on improving corporate governance effectiveness in Yemeni banks.

\( H_08: \) There is no effect of commitment to laws and regulations related to the role of stakeholders in corporate governance on improving corporate governance effectiveness in Yemeni banks.

\( H_09: \) There is no effect of commitment to laws and regulations related to disclosure and transparency on improving corporate governance effectiveness in Yemeni banks.

\( H_10: \) There is no effect of commitment to laws and regulations related to the responsibilities of the board on improving corporate governance effectiveness in Yemeni banks.
1-7. Definitions and Key Terms:

There are several concepts in the study, including independent and dependent variables. On this basis, the researcher used the indicated concepts in front of each variable for the purposes of this study, as follows:

- **The supervisory sides**: This refers to the sides which are in charge of supervision on Yemeni banks, including the supervision of companies, and the Central Bank.

- **The occupational sides**: This refers to the sides which issue the accepted accounting and auditing standards in Yemen as per the organizing laws of the profession, including International Accounting Standards Board (IASB), International Federation of Accountants (IFAC), and Institute of Internal Auditors (IIA).

- **Corporate governance**: It is a system for administration and supervision based on setting up a structure and frame for distribution of duties and responsibilities among participants in an organization (e.g. board of directors, managers, shareholders, and stakeholders), and the rules and the measures of decision-making on matters related to the establishment, and, hence, corporate governance provides a suitable structure through which the establishment can set its goals and the methods needed for realizing these goals, and can supervise performance.

- **Stakeholders**: They are those concerned with bank matters, and are divided into two main major sections, i.e.: internal stakeholders (such as, board of directors, managers, shareholders, employees) and external stakeholders (like depositors, borrowers, lawyers, capital markets, competitors and others).

- **Financial Reports**: This refers to the annual reports issued by Yemeni banks.

- **International Financial Reporting Standards**: These include the Introduction of International Accounting Standards, and the Accounting Standards no. (1), (7), and (24) related to the presentation of financial statements and disclosure in the financial statements for banks and similar financial organizations.

- **Internal Auditing Standards**: This refers to the new frame for the practice of the profession of the internal auditing in the light of the global developments that accompany corporate governance.
International Auditing Standards: This refers to the standards related to corporate governance and includes Standard no. (240) concerning Fraud, Standard no. (260) concerning communication, and Standard no. (570) concerning Going Concern.

Rules of Professional Conduct for the Accountants: These are the rules issued by (IFAC) and approved by the Yemeni Association of Certified public Accountants.

1-8. Organization of the Thesis:

The study contains seven chapters. Chapter I serves as an introduction of the study; Chapter II contains the research methodology and literature review; Chapter III presents corporate governance and its the role of disclosure; Chapter IV presents the role of professional and ethical factors in improving corporate governance; Chapter V offers an evaluation of Yemeni legislations in the light (OECD) standards; Chapter VI deals with the field survey of Yemeni banks; and Chapter VII provides the summary, conclusions and suggestions of the study.

1-9. Chapter Scheme

1- Introduction
2- Research Methodology & Literature Review.
3- Corporate Governance and its Role of Disclosure.
4- Factors Professional, Ethical, and corporate governance.
5- Evaluating Yemeni legislations in the light of (OECD) standards.
6- Field Study of Banks in Yemen.
7- Summary, Conclusions and Suggestions.

*Bibliography
*Appendix
References


