The Impact of Corporate Governance on Credibility Gap of Accounting Information: The perspectives of Investors in Amman Stock Exchange

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Abstract

This study aimed at testing the perspectives of investors in Amman Stock Exchange (ASE) toward the impact of corporate governance on credibility gap. Corporate governance was proxied by the level of auditors' commitment towards implementing International Standards on Auditing and Quality Control Standards. Data were collected by using a questionnaire that was distributed on 125 respondents, but only 102 were returned. The statistical analysis shows a significant negative impact for the International Standards on Auditing and Quality Control Standards on credibility gap. Results also show that there are differences in responses refer to gender, education, and experience.

Keywords: Corporate Governance, International Standards on Auditing, and Quality Control Standards, Credibility Gap, Amman Stock Exchange.

I. Introduction

Business environment has been subject to many financial crises followed by loud votes that require auditors to provide users with true and fair financial statements for business enterprises. These votes have raised doubt about the services provided by auditors and the moral and behavioral deficiencies and weaknesses in the profession in general. In addition, they discovered the absence of tight mechanisms in the professional standards and lack of professional quality in performance (Rodrigues, 2011).

Kangarluie and Bayazidi (2011) explored that auditors are responsible for the credibility of financial reports' information. The audit profession is not intended for satisfying the company's management and board of directors, but to reassure external users such as current and prospective investors, financial analysts, and governmental authorities about the truth and fairness of financial report. Hence, the audit profession has a huge responsibility and in order to ensure its work, International Standards on Auditing (ISA) had defined a practical framework for auditor's performance.

Credibility gap is known as a disparity between claims or statements made and the evident fact of the situation or circumstances to which they relate, and for a business to go on such a gap should be narrowed and eliminated if possible (Hamdallah, 2012). From Keeffe (1975) point of view, the inability of auditor to perform his job correctly without making mistakes in judging the veracity of the financial statements is due to a larger gap in the information credibility (Responsibility Gap).

This study aims at identifying the governance role of an auditor and its impact on the credibility gap of financial information from the perspective of investors in ASE. This could be achieved through testing the impact of auditor's compliance with International Standards on Auditing and Quality Control Standards as proxies for corporate governance.

This study contributes to the knowledge through: first, employing different proxies for measuring corporate governance than those used by other researchers. Second, this study is an attempt to measure the governance role of an auditor and its influence on the credibility gap of financial information in order to minimize this gap from the perspective of investors, who realized the importance of audit work and its impact on the quality of financial reports. To fulfill that, the following questions were studied:

1- From an investors' perspective, does the auditor compliance with the International Standards on Auditing affect the credibility gap of financial information?
2- From an investors' perspective, does the auditor compliance with the Quality Control Standards affect the credibility gap of financial information?
3- Do the demographical factors of these investors (gender, age, experience and qualification) make differences in their responses toward the credibility gap of financial information?

II. Literature Review and Hypotheses Development

II.1 Corporate Governance

Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed (Shailer, 2004). Cakar and Alakavuklar (2011) defined corporate governance as the prevention of management's failure to cover some matters not covered by law. Whereas Cadbury (2000) argued that it is the way for managing and controlling any company. Ma'atoofi and Ahmadian (2011) described it as a specific mechanism enabling investors to follow and direct the administration in a satisfactory manner for both parties. Kangarluie and Bayazidi (2011) described governance as a mediatory tool among parties, and auditors are responsible for the quality of financial statements and reports issued by companies.

Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and include the rules and procedures for making decisions in corporate affairs (The Corporate Governance of Iconic Executives, 2011).

The auditor does not have direct corporate governance responsibility but rather provides a check on the information aspects of the governance system. Abdullah (2011) confirmed that the internal control system set by the company must be followed through applying the rules of governance whereas the audit committees will verify the efficiency and effectiveness of such application and present recommendations to the board of directors. Abdul-Wahab and Shihata (2007) also confirmed that governance is achieved through a collection of legal, economic, financial rules and systems as well as the instructions and directions issued by the administration to carry out and perform the work correctly in all the activities inside the company.

The various definitions of the concept and comprehension of governance have caused an increase in the number of previous studies during the past years. O'Sullivan et al. (2008) studied the importance of corporate governance as a theoretical framework through which the Australian companies should work between 2000 and 2002. The results showed a positive relation between the quality of auditing and the governance system.

Kangarluie and Bayazidi (2011) examined the relationship between corporate governance and social responsibility in Tehran Financial Market by distributing a questionnaire for the period from 2003 – 2009. The results showed that the more the company size and the higher the demands rates, the lower the social responsibility of governance.

Abu Ojaila and Hamdan (2009) aimed at exploring the extent of Jordanian industrial companies listed in ASE in managing profits as one of the factors that lead to the move towards the current financial crisis, as well as measuring the level of corporate governance within these companies. The most significant result is the negative relationship between profits management and corporate governance.

II. 2. International Standards on Auditing

The International Standards on Auditing (ISA) are the basic principles and practices issued by the International Committee of Auditing Practices formed by the International Federation of Auditors and expected to be followed by the professional societies. The application of standards enables auditors to perform their job efficiently and work on developing auditors abilities, so they could follow up the accelerating changes in the business environment. Roberts et al. (2004) mentioned that the auditing standards support the process of financial disclosure; hence, increasing the trust of investors and helping them to make better decisions. He further stated that the auditing standards assist in the process of following the companies' compliance with the standards of quality control and setting the policies and methods of auditing.

The study of Azira et al. (2010) confirmed the necessity to apply laws and regulations to govern any company whether internal, external or international laws. He further mentioned in his study the importance of some laws that were approved as standards under which the companies should work worldwide. The International Standards on Auditing, for example, help in disclosing the financial information in a wide range, as well as supporting and increasing the trust of investors in companies and eventually making correct decisions.

The study of Thomas et al. (2010) aimed at suggesting a set of methods that help auditor to increase the audit effectiveness by adding the unpredictability element to the auditing procedures in order to comply with all requirements of American and International Standards on Auditing for preventing and detecting fraud. The study was based on a theoretical analysis for each of the auditing standards and 17 methods were suggested to help auditor increase the effectiveness of the audit process.

Daske et al. (2008) tested the economic effects of complying with the International Financial Reporting Standards (IFRS) around the world. The study analyzed the influence of the market liquidity and cost of capital through the use of a large sample of assigned companies that apply the IFRS standards. The study found that the capital benefits only occur in the countries that provide incentives and follow tight regulations. In addition, it focused on improving the quality of financial reports. Moreover, by comparing the mandatory and voluntary enforcement of international standards, the study found that the influence of working capital is more obvious on the businesses that voluntarily applied the standards.

II. 3. Quality Control Standards

The quality control standards (QCS) identify the extent of the auditor's compliance with rules and systems of work appeared (Fraser, 2010). Abdullah (2011) highlighted that the enforcement of quality control standards increases the governance effectiveness and improves the degree of transparency and clearance. Also ethics play an important role in controlling the audit job. It represents the measures and standards of moral values and behaviors governing the professional work that will be carried out in the work environment (Stralser, 2008).

II. 4. The Credibility Gap of Information

The credibility gap of information is defined as the difference between what is expected or demanded by investors and what is supplied by management of information about the financial position and performance of the firm. Salehi and Rostami (2009) have added that the professional administration is responsible for providing users with information and auditors should give their opinions about such information. Abdullah (2011) mentioned that the auditor should establish basis for ethics inside the organizations as well as reducing the deception and misrepresentation of financial statements. Whereas the administration should improve the control process and strengthen the organization process of auditing and its standards. Keeffe (1975) stated that most of the cases had filed suit against the auditors due to their failure in assessing financial reports and statements.

Abdullah (2011) has identified the influence of governance on the information credibility gap from the auditor's point of view. The study also measured other variables such as the auditor's independence and the rules of moral behavior for the audit profession. The most significant result of the study found that corporate governance affects information credibility gap from the auditors' point of view.

Based on the previous discussion, the following hypotheses could be developed:

H1: From the perspective of investors, there is no significant impact of the auditor’s corporate governance mechanisms on credibility gap of accounting information.

This hypothesis could be divided into two sub-hypotheses as follows

H1 (A): From the perspective of investors, there is no significant impact of the auditor’s compliance with International Standards on Auditing on credibility gap of accounting information.

H1 (B): From the perspective of investors, there is no significant impact of the auditor’s compliance with the quality control standards on credibility gap of accounting information.

H2: There are no statistical significant differences in the investors’ responses due to demographical factors (gender, age, experience and qualification).

III. Methodology

This section describes the sample characteristics, data collection process, the study tool reliability test, and statistical methods used to analyze data.

III. 1. Sampling

The target population for this study consists of securities investors who trade in Amman Stock Exchange (ASE). In order to generalize the results of this study, a target random sample of 250 respondents was taken from the different brokerage firms working in ASE. Only 102 respondents were able to express their opinions through answering the questionnaire, resulting in an acceptance rate of 40.8%. But all the 102 respondents returned the answered questionnaires at the same time they receive it.

III. 2. Data Collection

The study was conducted using a questionnaire (see Annexure A) that included 18 questions divided as follows:

- Questions (1 – 4) measure the compliance with ISA.
- Questions (5 – 10) measure the compliance with QCS.
- Questions (11 – 18) measure the Credibility Gap.

Data were analyzed using PASW statistics 18 software.

III. 3. The Reliability of Study Tool

In order to specify the extent of internal consistency among the variables and accuracy of the questionnaire, the reliability coefficient (Cronbach Alpha) was calculated. As a result, alpha value was 89.8% which is high and acceptable for scientific research purposes. The results further indicate the reliability of the study tool with its objective; hence, strengthen the results and increase the degree of its credibility.

III. 4. Measurement

A multi-dimensional measure was used to explore the views of the respondents. This measure included (18) Likert scale questions (as described above in data collection section) of which the scale points were labeled as follows: 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree. (See Annexure A). The higher the respondent's score for each question, the more he/she is agreeing about the question. Composite scores were calculated for the questions by averaging the respondents' answers across each section.

IV. Results

IV. 1. Descriptive Statistics

The questionnaire contained a section concerning respondents' profile to use the respondents' characteristics including gender, age, qualifications, and work experience as factors that might influence their perceptions.

As shown in table 1, the sample was dominated by male respondents (61%) over females (33%). On the age side, it could be noticed that more than half of respondents were very young (30 years or less), also, more than 88% of respondents were below 40 years old. The sample was clearly dominated by the bachelor degree holders. On the work experience side, table 1 showed that the majority of both samples had an experience ranged between zero and 10 years (75.5%), we can interpret this result in a way that most of the respondents that were able to express their opinion were newly graduated, new entrants, more familiar with new changes in standards.

Table (1): Demographical Characteristics

Demographic Variable	Variable Categories	Value	Percentage %
Gender	Male	61	60
	Female	41	40
Age	30 years or Less	53	52
	31-35	19	18.6
	36-40	18	17.6
	More than 40 years	12	11.8
Qualification	Diploma	18	17.6
	Bachelor	78	76.5
	Master	6	5.9
Experience	≤ 5 Years	40	39.2
	6-10	37	36.3
	11-15	20	19.6
	> 15 Years	5	4.9

Mean and standard deviation were calculated for each group of questions described in 3.2 above. It was found that QCS scored higher mean than ISA, since QCS scored 4.089 compared to 3.861 for ISA. Thus, the answers of respondents were prone to approving the questions of quality control standards rather than those of International Standards on Auditing as mentioned in Table 2. Regarding the dependent variable, it was noticed that the mean was 4.322, which indicates that respondents were strongly agreed with the credibility gap questions, but one should take into consideration that this section's paragraphs were negatively drafted. This means that the respondents agreed that the credibility gap is low.

Table (2): The Descriptive Analysis

Variable	Mean	Standard Deviation	Degree
ISA	3.861	0.562	High
QCS	4.089	0.634	High
Credibility Gap	4.322	0.676	High

Regarding the relationship between ISA and QCS as proxies of governance and credibility gap of accounting information, table 3 indicated the Pearson correlation coefficient showed a strong significant relationship between independent variables and dependent variable.

Table (3): Pearson Correlation Coefficient

Variable	ISA	QCS
Credibility Gap	0.809	0.799
	*0.000	*0.000

* Statistically significant at ($\alpha \leq 1\%$)

IV. 2. Testing of Hypotheses

H1 (A): From the perspective of investors, there is no significant impact of the auditor's compliance with International Standards on Auditing on credibility gap of accounting information.

To test this hypothesis, simple regression was used to identify the influence of ISA as one of the corporate governance proxies on credibility gap of accounting information. It was found that the independent variable explains 65.4% of the dependent variable according to r-squared, as well as an increase in the value of (F) at the significance level (0.000) provided that it is statistically significant at 1% level as showed in tables 4 and 5.

Table (4): ANOVA for ISA

	df	Total Squares	Mean of Squares	F Value	Sig.	Adjusted R2
Regression	1	27.941	27.941	183.091	*0.000	0.654
Residual	100	19.204	0.176			

* Statistically significant at ($\alpha \leq 1\%$)

Table (5): Results of Regression – Hypothesis H1 (A)

Variable	B	Beta	Standard Error	T	Sig.
ISA	0.735	0.697	0.054	13.090	*0.000

* Statistically significant at ($\alpha \leq 1\%$)

The table above indicates the influence of International Standards on Auditing (ISA) as one of the corporate governance proxies on the credibility gap of accounting information from the perspective of investors as t-value appeared.

H1 (B): From the perspective of investors, there is no significant impact of the auditor's compliance with the quality control standards on credibility gap of accounting information.

To test this hypothesis, simple regression was used to identify the influence of QCS as one of the corporate governance proxies on credibility gap of accounting information. It was found that the independent variable explains 63.8% of the dependent variable according to r-squared, as well as an increase in the value of (F) at the significance level (0.000) provided that it is statistically significant at 1% level as showed in tables 6 and 7.

Table (6): ANOVA for QCS

	df	Total Squares	Mean of Squares	F Value	Sig.	Adjusted R2
Regression	1	29.287	29.287	170.873	*0.000	0.638
Residual	100	0.169	16.465			

* Statistically significant at ($\alpha \leq 1\%$)

Table (7): Results of Regression – Hypothesis H1 (B)

Variable	B	Beta	Standard Error	T	Sig.
QCS	0.779	0.785	0.058	12.984	*0.000

* Statistically significant at ($\alpha \leq 1\%$)

Table (8): ANOVA for Testing Hypothesis H2

Variable	Categories	Mean	F-Value	Sig.
Gender	Male	4.613	7.614	**0.008
	Female	3.925		
Age	Less than 30	4.211	1.512	0.312
	31-35	4.124		
	36-40	3.680		
	41-45	4.750		
Qualification	Diploma	3.521	4.982	**0.007
	Bachelor	4.210		
	Master	4.100		
Experience	< 5 Years	4.102	3.215	*0.021
	6-10	3.964		
	11-15	3.843		
	> 15 Years	4.543		

* Statistically significant at ($\alpha \leq 5\%$) ** Statistically significant at ($\alpha \leq 1\%$)

Table 7 shows the influence of quality control standards (QCS) as one of the corporate governance proxies on the credibility gap of accounting information from the perspective of investors as t-value appeared.

H2: There are no statistical significant differences in the investors' responses due to demographical factors (gender, age, experience and qualification).

In order to identify the significant differences in the means of the sample responses, and referring these differences to the demographical characteristics of the sample, this study employed ANOVA. Table 8 showed the results of this analysis. According to F Statistics, table 8 showed that the values of gender, qualification, and experience were all significant. This indicates that there is significant difference between the categories in each demographical characteristic with regard to their responses at 1 per cent level. Regarding the age, the f-statistic was insignificant, indicating that differences in age categories did not create differences in the responses of the sample.

V. Conclusion

This study aimed at testing the impact of corporate governance on credibility gap of accounting information. Corporate governance was proxied using International Standards on Auditing (ISA) and Quality Control Standards (QCS). By using a questionnaire, the study found that both ISA and QCS negatively affect credibility gap, this means that the auditor's compliance with both standards reduce credibility gap of accounting information.

Also, the awareness of investors towards the impact of corporate governance on credibility gap of accounting information is affected by their demographical characteristics.

In response to these results, this study recommends that the auditor should always be aware of any updates in ISA and QCS to perform his task properly. Also, it is necessary that the audit profession assure the auditor's compliance with QCS by checking the independence of internal auditor and the ability of the company to fulfill the legal or contractual requirements.

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