

CORPORATE GOVERNANCE AND ISLAMIC SOCIAL RESPONSIBILITY DISCLOSURE IN KUWAITI SHARIAH COMPLIANT FINANCIAL INSTITUTIONS

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ABSTRACT

This study examines the relationship between corporate governance characteristics and the extent of Islamic social responsibility disclosure in Kuwait. The annual reports of 40 Shariah-compliant financial institutions listed on the Kuwait Stock Exchange in 2010 are examined. Four major corporate governance characteristics are investigated: 1) the existence of a Shariah supervisory board; 2) the number of board members; 3) the proportion of non-executive directors to the total number of directors on the board; and 4) role duality.

The extent of Islamic social responsibility disclosure is measured using a self-constructed index. The index consists of 46 Islamic information items. Multivariate regression analyses are used to examine the relationships between these characteristics and the level of Islamic social responsibility disclosure. The results show that Shariah-compliant financial institutions disclosed 18% on average of the possible voluntary disclosure items. The findings report that Islamic social responsibility disclosure increases with the presence of a Shariah supervisory board, but decreases with role duality. Other corporate governance characteristics were found not to be significant in the study.

Keywords: Islamic social responsibility disclosure, Shariah-compliant financial institutions, corporate governance characteristics, Kuwait.

JEL Classification: M41, G21, G28, G32

I. INTRODUCTION

Islamic (Shariah) principles of conduct are different from those in Western countries. The resurgence of Islam as a way of life has therefore opened up an additional dimension in financial reporting. Islam has its own laws to regulate companies and business transactions, creating the need for Shariah-compliant financial institutions. Unlike

conventional financial institutions, they do not charge and collect interest (riba), which is strictly prohibited in Islam. Abu-Majid et al. (2011) pointed out that one of the main reasons for the establishment of Islamic financial institutions is the desirability of abolishing fixed interest rates and bringing the “Islamization” of financial systems.

With the rapid growth of Shariah-compliant

financial institutions in size and complexity since the 1970s, and their increasing presence in world financial markets (Sulaiman, 2000), these institutions are deemed to have extremely high levels of accountability to protect the rights of their stakeholders (Abu-Majid et al., 2011). This poses an important challenge for these institutions: to improve all the crucial aspects of their corporate governance (Chapra, 2007). The objective of corporate governance in Shariah-compliant financial institutions is primarily to increase accountability by broadening the scope of disclosure beyond a financial focus (Abu-Majid et al., 2011).

The annual report is used by management to communicate firm performance and governance matters to stakeholders (Healy and Palepu, 2001). Thus in discharging their accountability duties, these institutions should specifically disclose Islamic social responsibility information in their annual reports. This is to enable stakeholders to exercise prudence from both economic and Islamic jurisprudence perspectives. Haniffa and Hudaib (2002) suggested that full disclosure in the annual report of relevant and reliable information would assist Muslim stakeholders in making both economic and religious decisions and assist managers in fulfilling their accountability to God and society.

The impact of corporate governance characteristics on the level of voluntary social disclosure has generated an increasing amount of attention in recent years. The focus of much of the research on this issue has been on conventional financial institutions. However, very little has been written about corporate governance and

its impact on Islamic social responsibility disclosure in Shariah-compliant financial companies. To date, no study has examined this issue in Kuwait.

Unlike East Asia countries such as Malaysia, in which Islamic regulations exist and a corporate governance code is in place, Kuwait is in the early stages of issuing a corporate governance code and Islamic practices. This study fills the gap in empirical studies on the impact of corporate governance characteristics on disclosure practices of Shariah-compliant financial companies' in Kuwait. Therefore, the purpose of this study is to investigate the extent of Islamic social responsibility disclosure in the annual reports of these financial companies and to explain why some disclose more than others do.

This study is important because it enhances understanding of corporate governance structures and Islamic social responsibility disclosures in Shariah-compliant financial institutions. Specifically, it seeks to understand the effect of corporate governance on voluntary disclosure, and why some companies disclose more Islamic information than others. This is given the absence of a corporate governance code or any Islamic regulations forcing such companies to disclose such information.

The study also explores the determinants of corporate governance that help explain voluntary Islamic disclosure. This may be useful for lawmakers, Shariah supervisory boards, preparers of financial statements, and existing and potential investors (Muslim and non-Muslim). The Capital Market Authority (CMA) lawmakers in Kuwait may use the

findings to suggest areas where efforts to improve the disclosure regulatory practices by Shariah-compliant financial companies should be concentrated. The CMA may also use this information to evaluate the current corporate governance requirements and their effects on disclosure. Given the importance of Shariah-compliant financial companies in Kuwait, the CMA should be particularly concerned with issues related to specific disclosure of Islamic information.

Furthermore, it may be useful for Shariah supervisory boards in communicating with stakeholders. This may assist in strengthening Shariah supervisory boards. This information is also useful when the preparers of financial statements strive to communicate with Muslim shareholders and investors. Stakeholders, e.g. Muslim investors, may consult the findings to better understand Shariah-compliant financial companies in Kuwait when diversifying their Islamic investment portfolios.

The remainder of the study is organized as follows. The CMA is described in Section II. Corporate governance of Shariah-compliant financial institutions in Kuwait is discussed in Section III. The relevant literature review is discussed in Section IV. Study hypotheses are put forth in Section V. How the sample was selected, the data collection methods, and how the statistical analysis was performed are presented in Section VI. The results are described and interpreted in Section VII. Conclusion, limitations, and suggestions on how the research could be extended are put forth in the final Section VIII.

II. THE CAPITAL MARKET AUTHORITY

This section discusses the establishment and role of the CMA in regulating and monitoring Shariah-compliant financial companies. As background information, Kuwait is one of the Middle Eastern Muslim countries that first realized the need for companies to comply with Shariah rules and principles. Consequently, the Kuwait Finance House became a pioneering company in Islamic finance as a Shariah-compliant financial institution. It was established in Kuwait in 1977 and provides a wide range of Shariah-compliant products and services (Kuwait Finance House, 2012).

The number of companies claiming to comply with Shariah rules and principles has since increased to 40 as of December 31, 2010, which represents 65% of all financial companies listed on the Kuwait Stock Exchange (KSE). These companies also represent 67% of total market capitalization of the financial companies listed on the KSE (KSE, 2010). It confirms the importance of these companies as a component of the overall capital market. This could also reflect the needs or preferences of investors for such companies.

Until the establishment of the CMA in Kuwait in 2010, there was no authority to ensure that companies' transactions and activities were based on Shariah rules and principles. A number of financial companies claiming to comply with Shariah law voluntarily appointed a Shariah supervisory board of Islamic scholars to verify their transactions and activities, and to limit the

divergence of interests between Muslim decision makers and management.

In February 2010, the Ministries Council issued law No. 7 of 2010 establishing the CMA. The Executive Regulations of Law No. 7 of 2010 include 15 articles establishing the Shariah Advisory Council (SAC). The law states that the Council is the reference in all decisions of the CMA relating to activities consistent with Shariah rules and principles. The SAC consists of at least five members, including experts in the jurisprudence of Islamic financial transactions, law, economics, and administrative sciences, with the majority being specialists in Shariah (CMA, 2010).

The stated aims of the SAC are to:

- 1) Function as a reference for the activities of companies licensed to work in compliance with Shariah rules and principles;
- 2) Ensure the supervisory departments of the CMA comply with Shariah rules and principles in their supervision of Shariah companies;
- 3) Advise the CMA on products and new Islamic financial instruments in the capital market;
- 4) Advise the CMA on complaints from Muslim decision makers regarding their companies' non-compliance with Shariah rules and principles;
- 5) Propose a Shariah index (of Shariah-compliant companies listed on the KSE) to the CMA.

The law defines Shariah-compliant companies as those whose business transactions and activities are in compliance with Shariah rules and principles. It also gives the SAC the right to classify

companies listed on the KSE as compliant or non-compliant, based on whether their activities are in compliance. Non-compliant companies are those whose activities are in contravention of Shariah rules and principles (CMA, 2010). For example, non-compliant business transactions and activities include charging interest (riba), gambling (maysir/gimar), speculation and ambiguity (gharar), and manufacture or sale of prohibited or related products or services, such as alcoholic drinks, pork, and unlawful entertainment (Maali et al., 2006).

III. CORPORATE GOVERNANCE OF SHARIAH-COMPLIANT FINANCIAL INSTITUTIONS IN KUWAIT

This section describes current corporate governance that exists in Kuwait. To date, there is no national corporate governance code. However, two governmental bodies are concerned with defining and enforcing principles of corporate governance: the Ministry of Commerce and Industry and the KSE. All types of companies (Shariah or non Shariah) must comply with these principles that stress protecting stakeholders and users of financial reporting.

The Ministry promulgated a number of corporate governance principles in Company Law No. 15 (CL15) of 1960. It contains 12 provisions on corporate governance practices. These include election of boards of directors and their terms in office, board vacancies, the minimum number of board meetings in the fiscal year, and the liability of the board to the company and shareholders. Each company must have a minimum of

three directors, with no maximum, with renewable terms of not more than three years. CL15 allows directors to hold office concurrently with any other office in the company, but does not specify the balance between executive and non-executive directors. In terms of board structure based on this role duality, the same individual may function as chairman of the board and chief executive officers (CEO).

The KSE issued the Amiri Decree (Stock Exchange Law) on August 14, 1983 and includes only two corporate governance principles. It is silent on all the CL15 provisions, requiring only that board members inform the stock exchange administration of how many shares they own within one month of being appointed to the board. However, this information is not published and only the exchange is informed. The decree also stipulates that board members may not have any direct or indirect interest in contracts and transactions with or for the company unless they have been granted authorization from the general meeting.

These CL15 provisions and KSE decree principles have not been amended since their issuance. Moreover, the Kuwait Central Bank (KCB) is silent in any corporate governance principles. However, with the absence of formal Islamic corporate governance in Kuwait, Shariah-compliant financial institutions have voluntarily used the recommendations of the Accounting and Auditing Organization for Islamic Financial institutions (AAOIFI). It was established in 1990 and is supported by 200 institutional members from 45 countries. The aims of the AAOIFI are to prepare accounting, auditing, governance, ethics and Shariah standards for

Islamic financial institutions. To date, the AAOIFI has issued 25 accounting standards, five auditing standards, two codes of ethics, and seven governance standards (AAOIFI, 2012). Although Shariah-compliant financial institutions in Kuwait have not formally adopted AAOIFI standards, they may voluntarily use a number of them such as creation of a Shariah supervisory board in Islamic companies.

IV. LITERATURE REVIEW

In many countries, religious beliefs are a private issue, influencing every aspect of life including spirituality, business, and social justice (Rice, 1999). Islam is a religion that affects the way Muslims live and do business (Graafland et al., 2006; Sulaiman, 2001). Islam's influence on business, especially accounting, is evident (Beekun, 1997; Karim, 1995; Ullah and Jamali, 2010; Wilson, 2006). From an accounting perspective, Islam influences financial disclosure practices (Baydoun and Willett, 1997; Willett and Sulaiman, 2001; Ullah and Jamali, 2010).

The Islamic perspective on disclosure consists of two requirements: (1) full disclosure and (2) social accountability (Baydoun and Willett, 2000; Haniffa, 2002). The concept of social accountability relates to the principle of full disclosure with the objective of serving Islamic society (Baydoun and Willett, 2000). Unity with God is a foundational Islamic concept. God has absolute ownership; human beings are merely trustees in this world (Maali et al., 2006). As trustees, all people are responsible to God and for Islamic society, and will be accountable for their actions in an afterlife (Baydoun and Willett, 1997; Maali et al.,

2006). Under Islam, people's accountability includes societal accountability.

In Islamic accounting, management and shareholders are accountable for their actions to all stakeholders, and to society and the public (Baydoun and Willett, 1997). Society has the right to know the operational effects of a company on its well-being, and to be advised within the requirements of Shariah whether the objectives were achieved (Baydoun and Willett, 2000). One of the ways that companies do this is by providing full disclosure to help discharge their accountability to society. Baydoun and Willett (2000) and Haniffa and Hudaib (2002) suggest that full disclosure means relevant and reliable information of importance about companies discharging their accountability to God, society and Muslim decision makers in making economic and religious decisions.

Islamic social reporting is an extension of reporting that encompasses not only conventional disclosure related to the broader expectations of society with regard to a company's role in the economy, but also a spiritual perspective (Haniffa, 2002). The objectives of Islamic social reporting show whether the company is compliant with Shariah principles and how operations affect the well-being of society pertaining to interest and unfair trading practices. They also enable Muslim decision makers to perform their religious duties (Maali et al., 2006; Sulaiman, 2001). Haniffa (2002) suggests Islamic social reporting is necessary in an Islamic society with the objectives of demonstrating accountability to God and society. This includes increasing transparency of business activities by providing relevant information conforming

to the spiritual needs of Muslim decision makers.

Despite the growth of Shariah-compliant financial companies in both size and complexity, few studies have examined voluntary Islamic disclosures in the context of these companies. Although some studies since 1986 have investigated Islamic accounting and corporate reporting of Shariah-compliant companies, they are generally normative or analytical, developing theoretical frameworks for Islamic accounting. They lack systemic, empirical analyses of corporate Islamic disclosure practices.

A seminal study by Gambling and Karim (1986) developed a theoretical foundation for analyzing Islamic accounting and its peculiarities: examining social orientation. Following them, Hamid et al. (1993) and Karim (1995) developed conceptual frameworks for Islamic accounting and disclosure requirements by investigating the influence of Islam on all areas of accounting, from practice to disclosure. Sadeqzadeh (1995) developed a theoretical framework for the Islamic perspective of social responsibilities, and contrasted it with conventional theories related to the area. Baydoun and Willett (2000) subsequently developed normative Islamic reporting as value added statements based on Islamic values, following the two principles of full disclosure and social disclosure.

Empirical studies investigating voluntary corporate disclosure by Shariah-compliant companies can be divided into two groups. The first includes studies with a measure of disclosure that is not an index. Haniffa and Hudaib (2007) measured the level of ethical

identity of seven Islamic banks' annual reports in six Gulf countries (Kuwait, Qatar, Bahrain, Oman, Saudi Arabia, and the United Arab Emirates). Based on an ideal versus the communicated ethical identity framework, they reported a wide gap between the two. Eight dimensions of ethical identity were used: (1) mission and vision statement, (2) board of directors and top management, (3) products and services, (4) Zakah - charity and benevolent funds (qard hasan), (5) commitments to employees, (6) commitment to debtors, (7) commitment to society, and (8) Shariah supervisory board.

The second group includes studies with a measure of voluntary disclosure that is a self-constructed index. Maali et al. (2006) examined voluntary Islamic social disclosure in 29 Islamic banks in 16 countries (including one Kuwaiti bank). A disclosure index consisting of 30 items measured the level of voluntary Islamic social disclosure. Findings suggest that the overall mean Islamic social disclosure index for the highest bank was 35% and the lowest was 0%, indicating that two banks did not disclose any Islamic information. The authors concluded that disclosure of Islamic social reporting falls short of expectations. Islamic banks may only disclose corporate social reporting information to construct an Islamic reality while not subscribing to that reality and its resultant obligations. However, the authors did not attempt to investigate variations of Islamic disclosure among the sample banks.

Hassan and Harahap (2010) explored whether any discrepancy existed between the corporate social activities disclosed in annual reports of Islamic banks and a corporate social responsibility disclosure index for the Islamic business ethics

framework. They developed a disclosure index including 78 items. The study described a survey of 2006 annual reports of seven Islamic banks from seven countries (Bahrain, Bangladesh, Indonesia, Malaysia, Saudi Arabia, Kuwait, and the United Arab Emirates). They used content analysis to measure the volume of social responsibility disclosure. The results demonstrated that the overall mean social responsibility disclosure index for the highest bank was 61% and the lowest was 14%. Therefore, issues of social responsibility disclosure are not a major concern for most Islamic banks. This study did not attempt to examine why some banks disclosed more Islamic information than others.

Halil et al., (2011) investigated the level of compliance with Shariah, social responsibilities and corporate governance disclosures by a sample of 17 Islamic banks in Malaysia. Their Shariah disclosure index consists of 11 information items whereas the social responsibilities disclosure index contains 13 items. Their corporate governance disclosure index has 16 items. The findings reported that the level of compliance with Shariah and social responsibilities disclosures was 94%. The level of compliance with corporate governance disclosure was 91%. The findings also reported that the size of Islamic banks (measured by paid-up capital) affected only Shariah and social responsibilities disclosures.

Sulaiman et al. (2011) attempted to measure the extent of compliance with Shariah disclosure by a sample of 16 Islamic financial institutions in Malaysia. A disclosure index consisting of 123 items was developed using the guidelines issued by the Central

Bank of Malaysia (BNM), the standard on corporate governance promulgated by the AAOIFI, and the framework introduced by the Islamic Financial Services Board (IFSB). The results reported that the disclosure index ranges from a low of 42% to a high of 68%, with the average score 51%.

Zubairu et al. (2011) measure the extent of Islamic social disclosure by a sample of 4 Saudi Islamic banks for 2008 to 2009. They adopted the Haniffa and Hudain (2007) and Maali et al. (2003) checklists to measure the social disclosure of the 4 banks. Their checklist consists of 80 information items. They found that Saudi Islamic banks disclosed less than 50% of the items and concluded that these banks had poor Islamic disclosure, yet claimed to be in compliance with Shariah principles.

Farook et al. (2011) attempted to develop and test a theoretical model of the determinants of Islamic banks' social disclosures. They examined the relationship between corporate governance characteristics and the level of Islamic social disclosure in 47 Islamic banks in 14 countries (5 banks from Kuwait) for 2002 and 2003. The Islamic social disclosure items were collected mainly from the annual reports. The corporate governance characteristics examined were the existence of a Shariah supervisory board, number of board directors, and role duality. Company size as a control variable was also investigated. Regression analysis was used to test this relationship. The study reported that the mean of Islamic social responsibility disclosure by Islamic banks was 17%. The maximum level of Islamic social disclosure was 48%, and the minimum was 0%. According to the regression results,

the variation in the level of Islamic social disclosure was explained by all corporate governance variables. However, company size is the only insignificant variable.

This brief review of the relevant literature demonstrates that studies measuring the impact of corporate governance characteristics on voluntary Islamic disclosure are scarce and limited. To date, no study has attempted to investigate the association between corporate governance characteristics and voluntary Islamic social responsibility disclosure by Shariah-compliant financial companies in Kuwait.

V. HYPOTHESES

Prior studies have reported that a number of corporate governance characteristics may influence a company's disclosure of voluntary information in general and Islamic information items in particular. In the present study, each corporate governance characteristic had to meet four preconditions before it was included. First, there had to be a sound, theoretical reason for expecting the characteristic to be associated with voluntary Islamic social responsibility disclosure. Second, the characteristic must be relevant to the socioeconomic environment of Kuwait. Third, the characteristic must be measurable in principle. Finally, sufficient data must be available in the Shariah-compliant financial companies' annual reports or guides available from stock exchanges for the characteristic to be measured in practice.

Based on these preconditions, four corporate governance characteristics were selected for this study: (1) the existence of a Shariah supervisory board, (2) the number of

board members, (3) the proportion of non-executive directors on the board, and (4) role duality.

Existence of Shariah supervisory board

The Shariah supervisory board is an Islamic governance variable that explains voluntary Islamic disclosure (Farook et al., 2011; Halil et al., 2011). Unlike Malaysia and Brunei where a Shariah Advisory board were mandatory (Halil et al., 2011), only some Shariah-compliant financial companies in Kuwait appoint Shariah supervisory boards. These boards monitor transactions and activities and limit the divergence of interests between Muslim decision makers and management. Although it is not mandatory for a Shariah-compliant company to have its own board, a company's board of directors appoints the Shariah board to ensure Muslim decision makers are compliant with Shariah principles to meet their spiritual needs.

Generally, a board consists of top Islamic scholars specialized in Islamic jurisprudence and experts in Islamic finance practices consistent with the AAOIFI recommendations (AAOIFI, 2012). Halil et al. (2011) argued that the common backgrounds of board's members facilitate their communication and enable them to transform their knowledge faster than members of the board of directors. Demand for the services of such boards arises from the need to check accounting constantly against Shariah principles. The board investigates to what extent the company adheres to Shariah principles in all activities. The investigations include examination of a company's memoranda, articles of association, contracts, financial reports, and various other reports. The board prepares a special report regarding the results of its investigation that is published

with the annual report. However, since the appointment of this board is voluntary, a number of companies instead write a declaration in their annual reports claiming that they comply with Shariah principles.

Karim (1990) suggested that the purpose of a Shariah supervisory board was to ensure compliance with Shariah principles and might play a role in mandating or promoting voluntary Islamic disclosure by Shariah-compliant financial companies in their annual reports. Halil et al. (2011) argued that the existence of a Shariah supervisory board brings transparency, trust, ethical behaviour, and credibility values to the companies. Since Shariah-compliant financial companies appoint Shariah supervisory boards to satisfy Muslim stakeholders and fulfill their values and spiritual needs, the presence of a board is likely to encourage a company to engage in voluntary Islamic social responsibility disclosure in their annual reports. This is to assure stakeholders that they are monitoring transactions and activities and constantly checking whether accounting practices are in compliance with Shariah law and principles. As a result, one expects the existence of a Shariah supervisory board to promote the Islamic perspective of full disclosure and social accountability. Thus, it is hypothesized that:

H1: Shariah-compliant financial companies with a Shariah supervisory board are more likely to have a higher level of voluntary Islamic social responsibility disclosure.

Number of board members

The number of board members is a significant corporate governance variable in explaining voluntary disclosure in prior studies. Haniffa and Cooke (2002) suggested that an increase

in the number of directors could lead to higher voluntary disclosure because capacity for monitoring increases and agency costs decrease. Farook et al. (2011) indicated that a greater number of board members imply a greater level of compliance with Shariah principles since the board is able to allocate its monitoring functions across a larger number of directors. This allows the board to better control the opportunistic behavior of management and review more aspects of the financial companies' activities to ensure compliance with the Islamic perspective of full disclosure and social accountability.

In Kuwait, CL15 specifies that each company must have a minimum of three directors, with no maximum. It can be argued that a board with a greater number of directors may be more likely to enhance the monitoring of activities, transparency, and compliance with Shariah principles. This should increase the level of Islamic disclosure to assure Muslim shareholders and society that the company's activities are in compliance with Shariah principles and the Islamic perspective of full disclosure and social accountability. Based on these assumptions, the following hypothesis is examined:

H2: Shariah-compliant financial companies with a greater number of board members are more likely to have a higher level of voluntary Islamic social responsibility disclosure.

Proportion of non-executive board members

The proportion of non-executives to the total number of board members is a significant variable in explaining voluntary disclosure in previous studies. Weir and

Laing (2001) and Al-Shammari and Al-Sultan (2010) indicated that boards include executive (insider) and non-executive (outsider) directors. The former are full-time employees of the company with clearly defined roles and responsibilities for day-to-day operations, whereas non-executive directors are not affiliated with the company in any way.

A larger proportion of non-executive members may enhance both the board's effectiveness and compliance with Shariah principles and help to alleviate the agency problem by monitoring and controlling the opportunistic behavior of management (Jensen and Meckling, 1976; Rosenstein and Wyatt, 1990). Consequently, companies are expected to voluntarily disclose more information (Leftwich et al., 1981; Fama and Jensen, 1983; Ho and Wong, 2001). One can argue that non-executive directors provide the necessary checks to enhance board effectiveness and monitoring of financial disclosure quality to ensure compliance with Shariah principles. This is because they are less tied to management and thus may encourage companies to disclose Islamic information to Muslim shareholders to fulfill their spiritual needs. On the other hand, Leftwich et al. (1981) suggested that when executive managers dominate the board, control becomes ineffective and collusion can occur between executive directors and management to further their own interests. The result may be that withholding of information may increase.

In Kuwait, CL15 left it up to the board to determine the proportion of non-executive directors, as there is no regulation governing this. It can be argued that a board with a higher proportion of non-executive directors

may be more likely to enhance monitoring and ensure compliance with Shariah principles. This should lead the company to operate from the Islamic perspective of full disclosure and social accountability. This should also increase the level of Islamic disclosure to assure Muslim shareholders and the public that the company's activities are in compliance with Shariah principles. Based on these assumptions, the following hypothesis is examined:

H3: *Shariah-compliant financial companies with a higher proportion of non-executive members are more likely to have a higher level of voluntary Islamic social responsibility disclosure.*

Role duality

With role duality, a single individual serves as both the chief executive officer (CEO) and chairman of the board, creating a unified leadership structure. According to agency theory, the combined functions can significantly impair the board's monitoring, disciplining, and compensating of senior managers (Molz, 1988). It also enables the CEO to engage in opportunistic behavior because of his/her dominance over the board. Individuals who hold both roles are aligned more with management than with shareholders. Hence they tend to withhold unfavorable information in general and Islamic disclosure in particular from shareholders (Farook et al., 2011). It can be argued that a dominant personality in both roles poses a threat to monitoring and compliance with Shariah principles and therefore is detrimental to disclosure.

In Kuwait, since CL15 allows role duality, a number of Shariah-compliant financial companies are managed by one individual

with two positions. It can be expected these companies with role duality are more likely to disclose less Islamic information in their annual reports. This is because their managers may tend to withhold information from shareholders in order to serve their own interests. As a consequence, role duality is more likely to impair accountability. Accordingly, it is hypothesized that:

H4: *Shariah-compliant financial companies that appoint a dominant CEO as board chairman are more likely to have a lower level of voluntary Islamic social responsibility disclosure.*

Control variables

Prior studies have documented the influence of company-specific characteristics on voluntary disclosure (e.g., Haniffa and Cooke, 2002; Ho and Wong, 2001; Leung and Horwitz, 2004; Al-Shammari, 2008; Al-Shammari and Al-Sultan, 2010; Farook et al., 2011). Four company-specific characteristics (company size, profitability, ownership structure and auditor type) were included in the regression model to control for other potential influences of voluntary disclosure. Most prior corporate governance studies have included these variables as control variables (e.g., Haniffa and Cooke, 2002; Chau and Gray, 2002; Ho and Wong, 2001; Luo et al., 2006; Huafang and Jianguo, 2007; Akhtaruddin et al., 2009 Al-Shammari and Al-Sultan, 2010; Farook, et al., 2011).

Agency theory suggests that agency costs are associated with the separation of management from ownership, which are likely to be greater in large companies (Jensen and Meckling, 1976). Larger companies are more politically visible than smaller ones and subject to more regulation, including

price controls, threat of nationalization, and social responsibility requirements. These companies have an incentive to disclose more information in their annual reports than smaller companies to enhance their reputations and public image and to lessen public criticism or the threat of government intervention (Watts and Zimmerman, 1978). For example, Al-Shammari and Al-Sultan (2010) and Haniffa and Cooke (2002) have found a positive association between company size and voluntary disclosure.

Based on the Islamic perspective of social accountability and full disclosure, larger companies are more likely to become involved with society. They therefore disclose more information in their annual reports to discharge their accountability to their stakeholders, particularly Muslim stakeholders. In Kuwait, a number of larger companies have contributed to society by building hospitals, parks, and roads or by providing hospitals with equipment. It can be argued that from the Islamic perspective, Shariah-compliant financial companies may disclose more information about how they are meeting their perceived responsibilities to society to enhance their public image and reduce political costs.

Agency theory suggests that managers of larger profitable companies may wish to disclose more information to obtain personal advantages, like continuation of their management positions and compensation (Inchausti, 1997). Applying signaling theory (Akerlof, 1970), larger profitable companies may disclose more information than less profitable companies because their managers are more likely to wish to signal their success and strength to potential investors and market participants (Singhvi

and Desai, 1971; Inchausti, 1997). For example, prior studies (Haniffa and Cooke; 2002; Ho and Wong, 2001; Akhtaruddin et al.; 2009) reported a positive relationship between profitability and voluntary disclosure. Based on the Islamic perspective of social accountability and full disclosure, a company should be willing to provide full disclosure regardless of whether it is making a profit. This is because management is accountable for its actions to all stakeholders, and to society and the public (Baydoun and Willett, 1997; Haniffa, 2002).

Agency theory also suggests that companies with more outside ownership are more likely to disclose more information than companies with less outside ownership. This is because when there are more outsiders, the demand for publicly available information is likely to increase. Detailed disclosure in annual reports may enable outsiders to monitor their interests more efficiently, thereby reducing agency costs (Leftwich et al., 1981; Fama and Jensen, 1983; Makhija and Patton, 2004). Previous studies found that outside ownership structure was positively associated with voluntary disclosure (e.g., Haniffa and Cooke, 2002; Akhtaruddin et al., 2009)

Based on the Islamic perspective of full disclosure and social accountability, management and shareholders are accountable for their actions to all stakeholders, and to society and the public. Society has the right to understand a company's operational effects on its well-being and to know whether the company is compliant with Shariah principles irrespective of the proportion of outside ownership. Full disclosure by companies could provide all stakeholders and

society with detailed information, thereby enabling companies to demonstrate their accountability to society.

Jensen and Meckling (1976) argued that large audit firms act as a mechanism to reduce agency costs and exert more of a monitoring role by limiting opportunistic behavior by managers. They argued that larger audit firms are less likely to be associated with clients that disclose lower levels of information in their annual reports. For instance, Luo et al. (2006) and Huafang and Jianguo (2007) found a positive relationship between auditor type and voluntary disclosure. Based on the Islamic perspective, accountability includes societal accountability. Consequently, larger audit firms are more likely to act responsibly toward shareholders and society by exerting more of a monitoring role to uncover any opportunistic behavior by managers. Therefore, larger audit firms are more likely to encourage their Shariah-compliant clients to provide full disclosure to enable them to discharge their accountability to God and society and to enable Muslim decision makers in their economic and religious decisions.

VI. DATA COLLECTION AND RESEARCH METHODOLOGY

This section describes the research methods of the study, including sample description, data collection, how the dependent and independent variables are operationalized, and the analyses used to test the four hypotheses.

Sample and data collection

At the time of data collection, there was no authority to identify Shariah-compliant

companies in Kuwait. (As of January 1, 2012, Shariah-compliant companies are now identified by the SAC of the CMA.) This study selected all the Shariah-compliant financial companies listed on the KSE because they are the largest companies and are expected to be more accountable in terms of reporting their activities in conformance with Shariah rules and principles. Using large companies is supported by prior studies (Maali et al., 2006; Hassan and Harahap, 2010; Othman and Thani, 2010). Since there was no authority identifying Shariah-compliant financial companies at the time of data collection, it was decided to collect all financial companies' annual reports and read them in their entirety to identify whether or not the companies were in compliance with Shariah. A company was considered in compliance with Shariah if it has a Shariah supervisory board or it publishes a statement in the annual report that it complies with Shariah rules and principles.

The 2010 Companies Guide published by the KSE revealed that as of December 31, 2010, 198 companies were listed on the KSE. Only sixty-six financial companies were listed on the KSE. Based on KSE classifications, these companies are from two sectors: banking and investment and finance sectors. The Companies Guide was consulted to obtain the Web addresses of the 66 financial companies. Search engines (www.google.com and www.yahoo.com) were also used if addresses were not available from the Companies Guide. Fifty-three companies' annual reports were collected from their homepages. For the remaining 13 companies, the Companies Guide was consulted to obtain the names and addresses of the general managers or chief executive officers. A letter requesting the English

version of the 2010 annual reports was addressed to the general manager or CEO of each of the 13 remaining companies. After follow-up letters were sent, nine companies responded to the request for their annual reports. This may reflect the willingness of Kuwaiti companies to supply their annual reports to non-shareholders.

Overall, 62 annual reports were collected. After reading all annual reports, it was revealed that 40 companies (65%) were Shariah compliant. The sample consists of 4 Shariah-compliant banks and 36 Shariah-compliant investment and finance companies. Twenty-two companies had a Shariah supervisory board (55%), whereas the remaining 18 companies (45%) only reported that they were in compliance with Shariah law. The 2010 annual reports were selected because they were the most recent available for the listed companies at the start of the study.

The dependent variable

The level of Islamic social responsibility disclosure is measured by a disclosure index, which is the dependent variable. A properly constructed disclosure index is seen as a reliable measurement device for corporate disclosure (Marston and Shrivess, 1991). Consequently, it has been used by prior Shariah disclosure studies (Halil et al. 2011; Sulaiman, et al. 2011; Farook et al., 2011; Hassan and Harahap, 2010).

The initial step in constructing the index was to develop an Islamic social responsibility disclosure checklist. Haniffa and Hudaib (2002) argued that information disclosure should assist Muslim decision makers in making religious decisions. An extensive review of prior studies was undertaken

to develop a list of relevant Islamic information items that should be disclosed by Shariah-compliant financial institutions. For an item to be included, it must have been used in previous studies. However, only a few empirical studies were found on the development and use of a disclosure index with Islamic disclosure (Maali et al., 2006; Othamn et al., 2009; Hassan and Harahap, 2010; Halil et al., 2011; Zubairu et al. 2011, Farook et al., 2011). These studies also partially rely on the AAOIFI standards for developing the disclosure index. Two academics specializing in the area of disclosure and financial reporting refined the checklist to ensure its validity. The final checklist instrument consisted of 46 Islamic disclosure items. The checklist is described in the appendix.

The Islamic social responsibility disclosure consists of five themes as follows:

1) Social responsibility

This category contains information items about prohibited activities, zakat and charity (sadaqah), waqf, current value balance sheets, value added statements, and other social activity information items. Specifically, zakat is an obligation of individuals and businesses and one of the pillars of Islam: an annual tax based on wealth. Zakat is obligatory only for individuals; Shariah-compliant companies are not obligated to pay zakat on behalf of shareholders. However, in Kuwait, many Shariah-compliant financial companies do pay it on behalf of their shareholders. Therefore, such companies should disclose in the annual report the sources and uses of the zakat. They should also disclose any balance of the zakat fund not yet distributed, and the reasons for the delay in distribution.

Unlike zakat, charity (sadaqah) is voluntary and encouraged by Islam. Waqf is an inalienable religious endowment in Shariah law, typically denoting a building or plot of land for Muslim religious or charitable purposes (Maali et al., 2006). A company may donate waqf, and therefore it should disclose qualitative and quantitative information related to the Waqf in its annual report.

In Islam, accountability includes accountability to the society. Thus, disclosure of qualitative and quantitative information related to charitable activities could enable Muslim decision makers understand the company's contribution to the society. This is because both the management and the shareholders are accountable for their actions to all the stakeholders of the company. Shariah-compliant companies should not engage in activities that violate Shariah rules, such as charging interest (riba). Therefore, companies must disclose these activities. Such information could enable the users to understand how the operations of the company have affected the well-being of the society in terms of interest (riba) and prohibited practices. It also enables Muslim decision makers to perform their religious duties.

2) *Employee information*

Social justice is emphasized in Islam. Accordingly, employees must be dealt with justly. Muslim decision makers need to know if the company deals justly with its employees (Othman and Thani, 2010). Therefore, exploitation and discrimination are prohibited by Shariah rules and principles (Maali et al., 2006). Information related to salaries, nature of work, working hours, and holidays leads to social justice.

Moreover, education and training are essential because of Islam's emphasis on the search for knowledge (Othman and Thani, 2010). Disclosure of such information could enable users to know whether the company violates social justice for employees as described in the Shariah rules and principles (Haniffa, 2002).

3) *Environment*

This category contains information regarding environmental protection programs or activities undertaken. Shariah-compliant companies are expected to disclose information about programs and activities undertaken to discharge their accountability and transparency to society (Ousama and Fatima, 2010). Disclosure of this information could assist users in determining whether company activities have an impact on the environment, and, if so, how the company deals with protecting the environment.

4) *Corporate governance*

This category contains information about the reports of the board of directors and the Shariah supervisory board. Shariah-compliant companies should declare their compliance with the Shariah rules in the report of board of directors. In addition, the board should also explain the reasons and nature of any prohibited transactions undertaken, along with the revenues and expenses related to such transactions. Moreover, the board of directors must provide information on forbidden activities such as monopolistic practices, price manipulation, gambling, and fraudulent business practices (Sulaiman, 2005).

Truth is a very important issue in the Islam context and it applied not only to individuals but also to businesses. This issue is related

to fairness, which is stressed in Islam (Obaidullah, 2001). Fairness means all individuals and businesses are entitled to equality of opportunity, whereby all parties are entitled to equal access to information relevant to asset valuation (Obaidullah, 2001). Thus, Shariah-compliant companies should disclose such activities to enable Muslim decision makers to understand the company's activities and the reasons for such activities. Such disclosures could affect Muslim investment decisions in such companies.

Disclosure of information about the Shariah supervisory board is important for Muslim decision makers because this board ensures the company is in compliance with the Shariah rules and principles (Abdullah et al., 2011). The Shariah supervisory board issues a report containing its reviewing and monitoring results. Specifically, the report of the board shows whether the company is in compliance and whether the company undertakes prohibited transactions. The report also shows validity of zakat computations in accordance with Islam (Abdullah et al., 2011). However, since a number of Shariah-compliant companies do not have Shariah supervisory boards, these companies are not expected to have such a report. Muslim decision makers are interested in the report of the Shariah supervisory board because it is issued by a third party. A Shariah-compliant company should also disclose information about the Shariah supervisory board's members such as their names, age, and qualifications. Muslim decision makers could be interested in these details to assure whether the board members are among the top Islamic scholars.

5) Ownership structure

This category consists two information

items: number of Muslim shareholders and amount of shares owned by Muslim shareholders. Shariah-compliant companies should disclose such information to demonstrate transparency and full disclosure in accordance with the Islamic perspective.

Scoring the disclosure items and index

Each disclosure item was given equal weight in the index, consistent with prior disclosure studies. Information items could have been weighted based on their perceived importance. However, equal weighting was preferred to avoid the subjectivity involved in assigning items' weights of importance for different user groups (Cooke, 1991; Wallace and Naser, 1995; Barako et al., 2006; Al-Shammari, 2008; Othman and Thani, 2010). In addition, prior studies have argued that the results of the equal weighting procedure tend to be similar to those of other weighting systems (Firth, 1979; Chow and Wong-Boren, 1987; Zarzeski, 1996; Prencipe, 2004).

Each disclosure item scored one if disclosed and zero if not, although no penalty was imposed if the item was considered irrelevant. To ensure that the judgment of relevancy was not biased, the following procedure was undertaken. First, the entire annual report was read carefully before scoring to enable the researcher to understand the nature and complexity of each company's operations and to form an opinion on whether undisclosed items obviously applied to the company. Second, an independent faculty member coded the checklists. Inter-rater agreement was 97% and all disagreements were resolved via discussion between the two coders. This is consistent with prior voluntary disclosure studies. The scores for each item were then added to derive the

final score for each company. The voluntary Islamic social responsibility disclosure index (ISRDI) for each company was then calculated as the ratio of total actual items disclosed to the maximum possible item score applicable to that company. This approach has been followed by the majority of disclosure studies. Specifically, consistent with Sulaiman et al. (2011) and Halil et al. (2011), the following formula was used to compute the disclosure score:

$$\text{ISRDI} = \frac{\text{Total actual items disclosed by the financial institution}}{\text{Maximum possible score applicable to the institution}}$$

The independent variables

Data for all independent variables were obtained from the annual reports and the

2010 Companies Guide published by the KSE. Table 1 below summarizes the independent variables and their proxies. Corporate governance variables were measured consistent with prior corporate governance literature (Farook et al. 2011; Rouf, 2011; Huafangm and Jianguo, 2007; Ho and Wong, 2001).

This study used total assets to measure company size because it is a common measure in prior studies (e.g., Haniffa and Cooke, 2002; Luo, et al., 2006; Farook et al., 2011; Rouf, 2011). For auditor type, a dummy variable (Big 4 audit international firms vs. non Big 4 audit international firms) is used consistent with the majority of previous studies (e.g., Al-Shammari and Al-Sultan, 2010; Makhija and Patton, 2004; Haniffa and Cooke, 2002; Inchausti, 1997).

Table 1: Summary of the independent variables and their proxies

Variable	Acronym	Proxy
Shariah supervisory board	SSB	Dummy variable coded 1 if a company has a Shariah supervisory board and 0 otherwise
Number of board members	BMEM	Number of board members
Non-executive directors on the board	NONEX	The proportion of non-executive members to total number of members on the board
Role duality	DUAL	Dummy variable coded 1 if the chairman is also the CEO and 0 otherwise
Company size	CSIZE	Natural log of total assets
Profitability	PROFIT	Return on equity = net profit/total shareholders' equity
Ownership structure	OWNER	Number of shares owned by shareholders that own less than 5% of the shares/number of outstanding shares at year end
Auditor	AUDIT	Dummy variable coded 1 if a company has a local auditor with international affiliation (Big Four) and 0 if a company has a local auditor without international affiliation

This study measured profitability as return on equity consistent with prior studies (Luo et al., 2006; Al-Shayeb; 2003; Naser et al., 2002; Malone et al., 1993).

Measure of ownership structure is constrained by available information. In Kuwait, according to KSE Law No. 2 of 1999, shareholders in listed companies are required to publish their share ownership when it reaches at least 5% of the outstanding shares of a company. It appears that three shareholders groups typically have substantial ownership in companies listed on the KSE (Al-Shammari et al., 2008). These groups are the government and its agencies, institutional investors, and dominant families. These groups are considered insiders because they usually have representatives on the companies' boards of directors; thereby, they have better access to internal information (Al-Shammari et al., 2008). Kuwaiti listed companies only reveal the identity and proportion of shares held by these groups. Therefore, the number of shares owned by shareholders that own less than 5% (outsiders) can be calculated by eliminating the number of shares owned by these groups.

Statistical method

This study uses a multivariate regression model because the model can examine the effects of all independent variables simultaneously on the dependent variable. Therefore, it has been used by prior disclosure studies. The following model jointly tested the study's hypotheses:

$$ISRD_j = B_0 + B_1SSB_j + B_2BMEM_j + B_3NONEX_j + B_4Dual + B_5CSIZE_j + B_6PROFIT_j + B_7OWNER_j + B_8AUDIT_j + \epsilon_j$$

where ISRD = the Islamic social

responsibility disclosure index scores for sampled companies and $j = j$ th company.

VII. RESULTS

Descriptive statistics

Descriptive statistics for the Islamic social responsibility disclosure index is reported in Table 2 below. The table indicates that the average level of Islamic social responsibility disclosure in Shariah-compliant financial companies is 18% (that is, companies disclose on average 18% of possible voluntary disclosure items). This is higher than found by Farook *et al.* (2011) (17%) and Maali *et al.* (2003) (13%). The Islamic disclosure of this study is higher than that in prior studies because the sample is from one country, whereas the samples of the other studies were from different countries. It is lower than found by Halil *et al.* (2011) (94%) and Sulaiman *et al.* (2011) (51%). This is due to the fact that these studies investigated compliance with Islamic disclosure in Malaysia in which Islamic disclosure is mandatory based on guidelines issued by the BNM, the standard on corporate governance promulgated by the AAOIFI, and the framework introduced by the IFSB. However, the mean level of Islamic social responsibility disclosure in Kuwait is low because over 80% of the items that could be disclosed voluntarily remain undisclosed. The low amount of disclosure in this study could be because there is no Islamic disclosure requirement in place and regulators and the public do not encourage or create pressure for more Islamic disclosure.

Based on these findings, the Islamic perspective of full disclosure and social accountability was

Table 2: Descriptive statistics for dependent and independent variables

Dependent Variable	Mean	Std. Dev.	Min	Max
Islamic social responsibility disclosure (ISRD)	0.18	0.09	0.04	0.52
Independent variables				
Shariah supervisory board (SSB)	0.55	0.50	0.00	1.00
Number of board members (BMEM)	5.00	0.20	3.00	11.00
Non-executive directors on the board (NONEX)	0.82	0.11	0.09	1.00
Role duality (DUAL)	0.42	0.50	0.00	1.00
Company size (CSIZE) (KD million)*	231.00	389.00	77.41	3176.40
Profitability (PROFIT)	0.30	0.19	-0.08	0.70
Ownership structure (OWNER)	0.31	0.21	0.29	0.59
Auditor (Audit)	0.60	0.48	0.00	1.00

*One \$US = 0.305 Kuwait Dinar (KD). The voluntary Islamic social responsibility disclosure index was calculated as the ratio of the total actual items disclosed divided by the maximum possible item score applicable to that company. For definition of the independent variables, see Table 1.

not fulfilled and the society may not be able to know the operational effects of a company on societal well-being, or to judge whether a company is compliant with Shariah principles. Muslim decision makers may be unable to properly assess the compliance of a company with Shariah principles, therefore affecting their spiritual needs and religious duties. Lack of voluntary disclosure by companies could be attributed to the absence of encouragement and pressure from both the public and shareholders.

Table 2 shows the minimum and maximum percentages of Islamic disclosure. The minimum and maximum for Islamic disclosure items were 4% and 52%, respectively. Only one company disclosed the minimum, and only two companies disclosed the maximum. There was one Islamic item disclosed frequently by all the

Shariah-compliant financial companies: a statement of compliance with Shariah principles. This study also found Islamic items not disclosed, including *Gharar* and value-added statements. These differences in the levels of voluntary Islamic social responsibility disclosure could be attributed to corporate governance characteristics.

With respect to the independent variables, there is a wide range of variation within the sample, as indicated by the minimum and maximum values in Table 2. The study found that Shariah supervisory boards existed in 22 companies (55%), whereas other companies in the sample only declared a statement of compliance with Shariah principles. This may suggest that Shariah-compliant financial companies rely on Shariah supervisory boards to assess compliance with Shariah law.

The mean for the number of board members was 5 members with a minimum of 3 and a maximum of 11 members. For the proportion of non-executive directors on the board, the mean was 82% with a minimum of 9% and a maximum of 100%. This indicates that boards seem to include more non-executive directors than executives. The percentage of 100% indicates that all members on the board are non-executives. For role duality, the results show that the mean was 42%, indicating that 16 companies have role duality.

For continuous control variables in Table 2, total assets (company size measure), for example, has considerable dispersion in the scores, as represented by the minimum, maximum, and standard deviation. For the categorical control variables, 24 Shariah-compliant financial companies were audited by a local audit firm affiliated with one of the Big Four international audit firms, and 16 were clients of local audit firms not affiliated with one of the Big Four.

Before conducting regression analysis, multicollinearity was tested. One reason for doing this is to indicate whether multicollinearity could cause estimation problems. Table 3 below contains a Pearson correlation matrix for the continuous variables. The table also shows that the highest correlation coefficient was 0.222 (between number of board members and ownership structure). As a result, it is not sufficient to impair the regression results since the pair-wise correlation coefficients are less than 0.80 (Gujarati, 2003).

However, another method widely used to detect multicollinearity is the variance inflation factor (VIF). This is reported in Table 4 in the next subsection. Since VIF did not exceed 10 for any variable in any model, it was concluded that collinearity was not a serious problem (Neter *et al.*, 1983).

Table 3: Pearson correlation coefficients of continuous independent variables

	BMEM	NONEX	CSIZE	PROFIT
NONEX	0.154**			
CSIZE	0.092	-0.078		
PROFIT	0.207**	0.124	0.213**	
OWNER	0.222**	0.114**	0.211	0.035

** Significant at the 0.01 level (two-tailed). For definitions of the independent variables, see Table 1.

Analysis of regression results

This study is concerned with the association between a number of corporate governance characteristics and the extent of Islamic social responsibility disclosure in the annual reports of 40 Shariah-compliant financial companies listed on the KSE in 2010. Table 4 below presents the regression results.

The model is statistically significant at the 1% level and the adjusted R squared (Adj R^2) suggests that 31% of the Islamic social responsibility disclosure variation is explained by the independent variables. However, this indicates that variables not included in the model may explain the variation in Islamic disclosure. The R^2 (adj.) was lower than in some prior studies: 39% was found by Farook *et al.* (2011) and higher than 25% was found by Ousama and Fatima (2010). The results showed that the level of

Table 4: Regression Results

Independent variable (expected sign)	Islamic disclosure		
	Coefficient		VIF
Shariah supervisory board SSB (+)	0.094	+++	1.912
Number of board members BMEM (+)	0.051		1.129
Non-executive directors on the board NONEX (+)	-0.012		1.112
Role duality DUAL (-)	-0.010	+	1.192
Company size CSIZE (+)	0.140	+++	1.431
Profitability PROFIT (+)	0.081	++	1.264
Ownership structure OWNER (+)	-0.021		1.357
Auditor AUDIT (+)	0.016		1.607
Constant	0.278	**	
Adjusted R^2	0.311		
F	4.159		
Prob. (F)	< 0.001		
No. of companies	40		

+++ t test (one-tailed) significant $p < 0.01$; ++ t test (one-tailed) significant $p < 0.05$; + t test (one-tailed) significant $p < 0.10$, ** t test (two-tailed) significant $p < 0.05$. For definitions of the independent variables, see Table 1.

Islamic social responsibility disclosure was associated with the existence of a Shariah supervisory board, role duality, company size, and profitability. The remaining independent variables (number of board members, proportion of non-executive directors, ownership structure, and auditor) were not significant. These findings lend support to hypotheses H1 and H4.

The results also show that a Shariah supervisory board was positively associated with the level of Islamic social responsibility disclosure. These results are consistent with Farook *et al.* (2011) and Halil *et al.* (2011). This study provides evidence that the Shariah supervisory board explains voluntary Islamic disclosure and plays a role in promoting voluntary Islamic disclosure in the annual reports of Shariah-compliant financial companies. This in turn assures Muslim shareholders and society that the board has monitored transactions and activities and

checked whether they were in compliance with Shariah law. It is also possible that the existence of the Shariah supervisory board fulfills the Islamic ideal of full disclosure by putting pressure on management to disclose information to enable Muslim shareholders and society to make religious decisions.

Role duality was negatively associated with the level of Islamic social responsibility disclosure. A possible interpretation of this result is that a single individual acting as both the CEO and chairman of the board impairs the board's monitoring and leads to opportunistic behavior on the part of the CEO. Consequently, the CEO would tend to withhold unfavorable information in general and Islamic disclosure in particular from shareholders. It can be concluded that the Islamic ideal of full disclosure and social accountability may not be fulfilled with the existence of role duality.

Company size was positively associated with voluntary Islamic disclosure. This suggests that larger Shariah-compliant financial companies disclose more Islamic information than smaller companies because they may become more involved with society and want to discharge their accountability to society and stakeholders, particularly Muslim stakeholders. The findings are consistent with Farook *et al.* (2011) and Ousama and Fatima (2010).

Profitability was also positively associated with the level of Islamic disclosure. A possible interpretation for this result is that managers of larger profitable Shariah-compliant financial companies disclose more voluntary information to display their actions and signal their success to all shareholders and society. Those managers wish to show society and the public that their transactions and activities are in compliance with Shariah principles.

VIII. SUMMARY AND CONCLUSIONS

This study sought to examine in an empirical way the relationship between a number of corporate governance characteristics and the extent of voluntary Islamic social responsibility disclosure. The data source was the annual reports of 40 Shariah-compliant financial companies listed on the KSE in 2010. The extent of voluntary Islamic social responsibility disclosure was measured in cross-section using a self-disclosure index. This index consists of 46 Islamic information items. A multivariate regression analysis was employed to test the associations between the level of voluntary Islamic social responsibility disclosure and the corporate governance characteristics.

Results showed that voluntary Islamic social responsibility disclosure by Shariah-compliant financial companies is 18%. This is higher than that found by Farook *et al.* (2011) (17%) and Maali *et al.* (2003) (13%) but lower than that found by Halil *et al.* (2011) (94%) and Sulaiman *et al.* (2011) (51%). However, the mean level of Islamic social responsibility disclosure in Kuwait is low; over 80% of the items that could be disclosed voluntarily remain undisclosed. The low amount of disclosure in this study could be because there is no Islamic disclosure requirement in place and regulators and the public do not encourage or create pressure for more Islamic disclosure. This finding suggests that the Islamic ideal of full disclosure and social accountability was not fulfilled, the operational effects of a company on societal well-being are not clear, and society is unable to judge whether a company was compliant with Shariah principles. Muslim decision makers could be unable to assess a company's compliance with Shariah principles, thereby affecting their spiritual needs and religious duties.

The results of multivariate analysis indicate that the level of Islamic social responsibility disclosure was positively associated with the existence of a Shariah supervisory board, company size, and profitability, but negatively with role duality. Other variables were insignificant. The Shariah supervisory board was positively associated because companies with such boards may have done more monitoring of transactions and activities and checking of whether they were in compliance with Shariah law. Role duality was negatively associated because a single individual in charge impairs the board's monitoring and leads to opportunistic behavior on the part of CEOs. They in turn

tend to withhold unfavorable information in general and Islamic disclosure in particular from shareholders.

Company size was positively associated with voluntary Islamic disclosure. This suggests that larger Shariah-compliant financial companies disclose more Islamic information than smaller ones because they may become more involved with society and want to demonstrate their accountability to society and stakeholders, particularly Muslim ones. Profitability was also positively associated with the level of Islamic disclosure. Managers of larger profitable Shariah-compliant financial companies disclose more voluntary information to demonstrate their actions to all shareholders and society. These managers wish to show that their transactions and activities are in compliance with Shariah principles.

This study extends the limited Kuwaiti literature in the area of corporate governance and voluntary Islamic disclosure by Shariah-compliant financial companies. It also fills a gap for empirical studies on the impact of corporate governance on Shariah-compliant financial companies' disclosure practices. This study is important for enhancing our understanding of corporate disclosure by Shariah-compliant companies in Islamic nations in general and Kuwait in particular. It seeks to explain why some Shariah-complaint financial companies disclose more Islamic information than others, given the absence of any Islamic regulation compelling companies to disclose such information. It also explores the determinants of corporate governance that enable the explanation of voluntary Islamic disclosure.

Several limitations should be noted. First, this study is limited to a single period data. It uses only annual reports from 2010. Future research could extent this study over longer period data. Such studies may help to validate the conclusions of this study and overcome the possibility that a single period data set may bias the results. In spite of this limitation, the results of this study provide a useful insight into the social responsibility disclosure by Shariah-compliant financial companies in Kuwait and provided a starting point for future research.

Second, the model explained 31% of Islamic disclosure variation with independent variables. Although this explained a significant part of the variation, there is still a material part unexplained, which represents the “noise” in the model. Data availability limited the ability to study some factors that have been found to be important theoretically or empirically in other disclosure studies (e.g. share ownership by Muslims and educational qualifications of members of the board). As additional information regarding Kuwaiti Shariah-compliant financial companies becomes available, the effects of such factors should be investigated.

Third, this study is limited to only one source of information: annual reports. Other disclosures that companies provide were beyond the scope of this study. Future studies should investigate the level of voluntary Islamic social responsibility disclosure through alternative media, such as the financial press, analyst meetings, stock market announcements, conference calls, and the Internet.

Fourth, this study assumes that disclosure items have the same weight, and that Shariah-compliant financial companies are disclosing the most important information selected. A survey focusing on various annual report user groups might provide further insight into the reliability of this assumption, especially in the case of Kuwait.

Fifth, this study was undertaken before the establishment of the SAC of the CMA on January 1, 2012. Future studies should replicate this study to assess any differences after the existence of the Council.

Finally, in the field of corporate disclosure in the Middle East, research should extend this study over a longer period, or alternatively involve comparative studies with other Arab countries such as Gulf Co-Operation Council (GCC) member states. Such studies should investigate changes in corporate voluntary disclosure across time, and compare potential variations in nations with disparate social, political, and economic systems. This will help validate the conclusions of this study and overcome the possibility that a small, single-period study biases results.

The findings of this study have important implications for lawmakers, preparers of financial statements, and existing and potential investors (Muslim and non-Muslim). The findings provide evidence that Shariah-complaint companies lack meaningful voluntary disclosure, especially for Islamic disclosure information. As a result, the CMA (lawmakers) may use the findings to suggest areas for further concentrated efforts. The aims would be to ensure information adequacy and increased efficiency of rapidly developing capital

markets and improvement of the disclosure regulatory practices by Shariah-compliant financial companies in Kuwait.

The CMA may also use this information to evaluate the current corporate governance requirements and their effects on disclosure. The CMA should not allow companies to have role duality. Given the importance of Shariah-compliant financial companies, the CMA should be particularly concerned with issues related to disclosure, specifically of Islamic information. More specifically, the CMA should be more concerned with the disclosure needs of users of financial companies with no Shariah supervisory board in place, companies with role duality, and smaller, less profitable Shariah-compliant financial companies.

The Shariah supervisory boards in companies may use the findings to better communicate with stakeholders. This may assist in strengthening these boards in Kuwait. The findings are also useful when the preparers of financial statements strive to communicate with Muslim shareholders and investors. Stakeholders, e.g. Muslim investors may use the findings to better understand the disclosure behavior of Shariah-compliant companies in Kuwait. Such findings may assist them in diversifying their investment portfolios. The findings and limitations also have important implications for academicians and researchers in future studies.

Appendix
Disclosure index checklist

No	Category
	1- Social responsibility
	1-1 information on Riba and Gharar
1	<i>Riba</i> (interest) activities
2	Amounts of expenses/revenue from <i>riba</i> transactions
3	Qualitative information on the prohibited transactions/activities
4	Amounts of profits or losses from the prohibited transactions other than <i>riba</i> (interest)
5	Qualitative information on <i>Gharar</i>
6	Quantitative information on <i>Gharar</i>
	1-2 information on Zakat
7	Information on computation of <i>Zakat</i>
8	Amount of <i>zakat</i> fund
9	sources of <i>zakat</i> fund
10	Beneficiaries of <i>zakat</i>
11	The balance of <i>zakat</i> fund, and reasons for non-distribution
	1-3 information on Saddaqa
12	Qualitative information on <i>Saddaqa</i> /Charitable donations
13	Quantitative of <i>Saddaqa</i> /Charitable donations
	1-4 information on Waqf
14	Qualitative information on <i>Waqf</i>
15	Quantitative of <i>Waqf</i>
	1-5 information on other social responsibility
16	Current Value Balance Sheet (CVBS)
17	Value Added Statement (VAS)
18	How such amounts are to disposed off
19	Qualitative information on debts written off
20	Quantitative information on debts written off
	1-6 information on activities towards the society
21	Qualitative information on the contribution towards the society programs
22	Amounts of the contribution towards the society programs
	2- Employee information
23	Corporate policy on equal opportunities
24	Employment of other special-needs-group (i.e. handicapped)
25	Employment of other special-interest-group (i.e. ex-convicts, former drug-addicts)
26	Qualitative of benevolent loan to employees (<i>qard hasan</i>)
27	Quantitative of benevolent loan to employees (<i>qard hasan</i>)
28	Higher echelons in the company perform the congregational prayers with lower and middle level managers
29	Muslim employees are allowed to perform their obligatory prayers during specific times and fasting during Ramadhan on their working day
30	Proper place of worship for the employees
	3- Corporate governance
	3-1 Report of the board of directors
31	Declaration about compliance with Shariah rules and principles
32	Board's opinion about the necessity and nature of prohibited transactions undertaken

33	Reasons for engagement in prohibited transactions
34	The amount of revenue or expenses from prohibited transactions
35	Information on forbidden activities: monopolistic practice, hoarding necessary goods, price manipulation, fraudulent business practice, and gambling
36	Anti-corruption policies
	3-2 Shariah supervisory board
37	Report of Shariah supervisory board
38	Name of the Shariah supervisory board
39	Age of the Shariah supervisory board
40	Educational qualifications
	Experience of the Shariah supervisory board
41	Other company's supervisory board held by member board of the Shariah supervisory
42	The Shariah supervisory board's remuneration
43	The Shariah supervisory Board's view about the necessity of prohibited transactions/ activities
44	The Shariah supervisory Board's opinion regarding validity of zakat's computation
	4- Ownership structure
45	Number of Muslim shareholders
46	Amount of shares owned by Muslim Shareholders

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