

# Improving Corporate Stability Through Regulatory and Financial Reporting Within the Banking Sector in Saudi Arabia

**Yosra Hamza<sup>a</sup>, Abeer Atallah Aloudat<sup>b</sup>, Maher Diab Abulaila<sup>c</sup>, Sukinah Abdullah Aljishi<sup>d</sup>, Sara Qasem Al- Suwaidi<sup>e</sup>, Hala Sulaiman Alturki<sup>f</sup>**, Department of Accounting, College of Applied Studies and Community Services, Imam Abdulrahman Bin Faisal University, Dammam, Saudi Arabia.

As a country, the Saudi Arabia banking sector has experienced a lot of changes and positive development over the last few years. The development within the financial sector has been caused by the positive financial policy measures by the government, the oil economy and the developing construction and real estate industry in the region. Even though Saudi Arabia has one of the largest financial sectors within the MENA region, the banking sector has faced many challenges within the past few years. The research findings show that the banking sector has faced challenging economic times owing to the fluctuating oil prices. Another major factor which has led to the declining banking fortunes in the region is the onset of the COVID-19 pandemic which has also hit other global economies and affected the country's oil trade. However, the findings also show that the banking sector has still continued to experience positive growth as a result of many factors. Such factors include positive customer perception, increased economic activity in the region and favourable government policy in the region. There are still internal and external challenges that are likely to shape the future of banking in Saudi Arabia. Such include the challenges due to cybersecurity and technology development. Poor cultures related to the customer relationships in the banking sector have also influenced the industry in Saudi Arabia.

**Keywords:** *Corporate Stability, Regulatory and Financial Reporting, Banking Sector, Saudi Arabia*

## INTRODUCTION

The regulatory and standard financial reporting have remained key variables for development and growth since the great depression (Boshnak, 2020). The increasing regulatory models being adopted by many corporates within Saudi Arabia have forced most companies and organisations to adopt new suitable business models. Within the banking sector, the regulatory shifts have led to more corporate stability, since the sector now evaluates its business risks considerably (Nurunnabi, 2017). Thus, the sector has realigned its objectives with the need for profitability and corporate stability by minimising cases of regulatory misdemeanours. In Saudi Arabia, the majority of the regulatory changes and financial reporting standards are influenced by international best practices (Nurunnabi, 2018). The country has adopted international measures that were adopted post-financial crisis. However, Saudi Arabia's banking sector still faces the challenges of interpreting international practices to suit the needs of the local market (Boshnak, 2020). Some of the major challenges include the interpretation of the financial reporting standards and regulatory framework to suit the needs of the unique local customer base while providing the required standards of service (Hamdan, 2020). Currently, much of the regulatory and financial reporting standards in Saudi Arabia have been adopted from the US and Europe.

To date, the banking sector in Saudi Arabia faces many regulatory and financial reporting risks. Consequently, the sector has been developing unique and sustainable regulatory priorities to tackle such challenges (Nurunnabi, 2018). Such challenges have included the sustained low oil prices which affect corporate liquidity, cases of non-performing loans, financial crimes, and the need to balance the vision and future objectives of the banking sector with growth and profitability. However, the banking sector has also developed measures that would help to accelerate economic growth, while also encouraging diversification (Boshnak, 2020). The above measures have been achieved through the introduction of financial reforms through legislative procedures and amendments (Fajembola et al., 2018). The above laws are suitable for providing growth incentives for the financial sector. However, their development and sustainability depend on the management roles in implementing and enforcing such regulatory and reporting standards.

## THE STATE OF THE BANKING SECTOR IN SAUDI ARABIA

Despite its growth, the banking sector in Saudi Arabia has faced many challenges. The biggest hit to the banking sector was witnessed in 2014 as a result of the fluctuation in oil prices (Hamdan, 2020). The above occurrence led to a massive reduction in the level of profitability that had been witnessed for many years. Subsequently, there have been many financial reforms which have often led to uncertainty regarding the future growth of the banking sector (Osemy, 2020). The aggregated growth in assets was a mere 3.4% in 2015 following the fluctuation of the oil prices (Fajembola et al., 2018). There was further slower growth in 2017 with a 0.4%

asset growth value (Osemy, 2020). Despite the negative market forces, the banking sector has witnessed positive growth between 2018 and 2020 (Sarea, 2020). The positive growth of the banking sector has been achieved as a result of the oil price stabilisation and the government's development agenda through the Saudi Arabia's Vision 2030 agenda (Herath & Alsulmi, 2017).

In 2019 alone, the total asset value for the top five largest banks in Saudi Arabia was SR 1.7 trillion after witnessing a 16% growth. Consequently, the five said banks collectively achieved a 30% profit margin, an indication of the improving market environment (Osemy, 2020). Despite the recovery of the banking sector in 2019, the occurrences in the year 2020 are likely to negatively affect the positive growth that had been achieved by the Kingdom (Sarea, 2020). The onset of the COVI-19 pandemic has had a great impact on the financial performance and regulatory frameworks for the banking sector in the year 2019 (Osemy, 2020). The pandemic has increased market uncertainty as it has led to lower oil prices (Ghosh, 2018). An evaluation of the banking sector performance by April 2020 indicated that there was uncertainty on the future of the sector as the effect of the pandemic could not be clearly quantified (Sarea, 2020). However, the Kingdom of Saudi Arabia has put in place measures that would help to reduce the impact of the pandemic on the banking and other economic sectors. Such measures have included a monetary package of SR50 billion for the banks and SMEs to caution them from the adverse effects of the COVID-19 pandemic (Hamdan, 2020).

## **REGULATORY FRAMEWORK FOR THE BANKING SECTOR IN SAUDI ARABIA**

One of the major regulatory issues that influences that stability of the banking sector in Saudi Arabia is the portfolio behaviour for banks (Nurunnabi, 2017). Currently, the regulatory framework provides for the control of the bank portfolios in Saudi Arabia through a mix of factors. First, the regulatory framework provides that financing of assets is undertaken by low-cost demand deposits (Herath & Alsulmi, 2017). The other major factor which shapes portfolio in Saudi Arabia is the predominant dependence on oil by the economy (Ghosh, 2018). The above dependence makes it harder for banks to diversify their investments as the economy mainly relies on oil (Hemrit, 2019). The third factor is the institutionalisation of lending laws and regulations (Nurunnabi, 2018). Saudi Arabia has a stringent arrangement on lending limits and international lending approvals and legal caps on persons.

The entire financial system in Saudi Arabia is under the control of the Saudi Arabian Monetary Authority (SAMA) (Nurunnabi, 2018). SAMA plays the major roles of promoting regulatory compliance among the commercial banks in the country and also ensuring that the foreign exchange dealers also adhere to the laid down laws (Fajembola et al., 2018). However, the regulatory roles of controlling banking legislation are also shared by the country's Ministry of Finance which ensures that licensing and approval of banking operations are undertaken (Nurunnabi, 2018). Another major component for banking regulatory compliance lies with the

banking supervision approaches adopted in Saudi Arabia (Ben Rejeb Attia Lassoued & Sassi, 2019). Currently, the Besel Committee acts as the basis for conducting stringent supervisory moves which improve compliance (Osemy, 2020). The SAMA charter developed in 1957 also provides a clear supervisory strategy that can be adopted by the banking sector players (Nurunnabi, 2017). Banks have also developed internal administrative guidelines that enhance better supervisory roles and guidelines (Nurunnabi, 2018). Despite the need for a standard supervisory guideline, supervisory independence still remains a major issue for most of the Saudi Arabian banks.

The adoption of risk culture is currently being developed and has been included as a regulatory approach for the banking sector (Herath & Alsulmi, 2017). Some of the past failures of the banking sector within Saudi Arabia have been linked to poor culture formation, especially among the top management teams (Nurunnabi, 2018). The current legislation mainly focuses on the development of personal accountability for bank managers and employees, focusing on responsive risk culture, while also maintaining high standards of business morals and ethics (Nurunnabi, 2017). One of the biggest focuses, therefore, has been to undertake a cultural review and ensure that the newly adopted system conforms to the changing regulatory approach by most Saudi Arabian and global banks (Ben Rejeb Attia Lassoued & Sassi, 2019). The change in risk culture approach is meant to eliminate the prospects of failure associated with the issues that may arise within the banking institutions (Hemrit, 2019). Regulatory-based culture is one of the biggest factors that has been used by the banking sector players to promote positive change. Such a culture provides managers and banking leaders with the correct tools and direction for cultural change (Osemy, 2020). Saudi Arabian financial and banking regulatory authorities are, therefore, more likely to focus on developing new sustainable cultures based on regulatory direction.

The banking sector in Saudi Arabia has also developed comprehensive risk assessment models that are part of the regulatory frameworks that seek to promote corporate stability. The above regulatory framework aids in the identification and categorisation of existing banking risks within Saudi Arabia (Ariff et al., 2018). The regulations have also been designed to prevent any incidences of banking fraud and collusion between the banking staff and the customers. The frameworks also help in reducing incidences of corruption within the banking sector in Saudi Arabia. Such actions can be achieved by examining the links between the different banking stakeholders such as the customers, the employees and the government (Javaid & Alalawi, 2018). Since online and mobile banking has also been used to increase the level of corruption within banks, analysis and identification of suspicious mobile based transactions could help to reduce the level of fraud. The major way of reducing the above kind of risk is through the introduction of technological intervention. Intelligent automation has been adopted as the most important approach that helps to promote technological stability for banks.

## SHARIA COMPLIANT FINANCING IN SAUDI ARABIA

The banking sector in Saudi Arabia has also adopted regulatory frameworks for maintaining a Sharia compliant banking system. In the last ten years, Sharia banking has continued to grow within Saudi Arabia. Currently, all the different financial institutions in Saudi Arabia have adopted Sharia banking approaches (Javaid & Alalawi, 2018). However, each bank had come up with a different approach to the management of Sharia banking. Furthermore, Saudi Arabia currently has Al-Rajhi Banking and Investment Corporation which is considered the biggest global bank that offers absolute Sharia banking products (Yamani & Almasarwah, 2019). Further, the regulatory framework has provided freedom for banks to adopt varying approaches to implementing their Sharia banking products. Most banks have therefore considered offering Sharia compliant banking through dedicated banking branches (Razak et al., 2016). However, the regulatory framework provides that Sharia compliant banking has to be undertaken through internally formed Sharia advisory boards for each bank. Banks in Saudi Arabia have mainly undertaken Sharia compliant investments through the adoption of deferred sales. By the end of 2018, about 30% of the total as assets related to Sharia-compliant banking were associated with the differed sales products (Ariff et al., 2018).

Despite the establishment of a regulatory Sharia banking compliance mechanism, there are still cases and danger of non-compliance (Razak et al., 2016). The compliance risks for Sharia banking in Saudi Arabia have an effect on the economic development of Saudi Arabia. Such risks include the dangers of market conduct, poor dispute resolution approaches, and lack of legal documentation (Habtoor et al., 2017). Despite the existing regulatory compliance issues, there are measures that have been implemented to implement positive compliance approaches. The adoption of knowledge agents for internal regulatory management is one of the main approaches. Such bodies include review units for Sharia law and the Shari'a Supervisory Boards (SSB) (Ariff et al., 2018). The regulatory frameworks for Sharia banking are also managed through the leadership of persons who possess Sharia-based knowledge. The internal review units for Sharia compliance have ensured that the banking sector in Saudi Arabia provide Sharia banking services that are in compliance with international financial standards.

There are many external issues that also offer assurance over Sharia compliance. One of the biggest issues that has been raised is on the need for external reviews for Sharia compliance and the associated independence (Fallatah et al., 2019). One of the main issues that must be upheld to maintain high standards financial reporting and accountability is external audit. Since external audit is well- regulated, the banking sector and the Sharia banking sections must be managed through robust auditing practices (Habtoor et al., 2017). To conduct successful audit work, the external audit teams must ensure that they have adequate Sharia banking laws and knowledge. Such knowledge and guidelines must be consistent with those provided by the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) (Fallatah et al., 2019). Based on the compliance levels adopted under the Sharia banking system in Saudi

Arabia, external ratings have improved. International rating agencies have been important in providing assurance regarding the application of Sharia banking practices.

## **ADOPTING TECHNOLOGY IN MAINTAINING REGULATORY AND FINANCIAL REPORTING IN SAUDI ARABIA**

Technology adoption within the financial industry has been increasing around the globe. In Saudi Arabia, the emergence of new technologies in the banking sector has provided many opportunities and a space for development (Razak et al., 2016). Technology increase within the Saudi Arabian banks have increased the level of customer experience, developed new or advanced payment methods, come up with modernised regulatory changes, and improved the level and speed of service delivery (Miyajima, 2020) (Alzeban, 2019). Technology has also been used to improve the services and functions undertaken by the back office in the banking halls (Javaid & Alalawi, 2018). Most traditional Saudi Arabian banks have been forced to meet the reality of the increased fintech evolution by phasing out outdated business practices. For example, the financial reporting functions of banks has been improved through the adoption of technology-assisted accounting systems for banks. The systems have also made audit work simpler and more open (Javaid & Alalawi, 2018). Transparent financial accountability, tax filling and public awareness has been created through the use of technology in the banks.

Whereas fintech has created a positive revolution within the financial and banking sector within Saudi Arabia, there are many debates regarding the disadvantages of technology introduction. Currently, most banks have been reviewing their protocols and procedures towards the adoption of technology (Habtoor et al., 2017). The banks in Saudi Arabia have been partnering with international fintech companies with the view of creating specific measures that seek to protect the interests of banks and customers. Additionally, the Saudi Arabian banks are also involved with the discussions on how to use fintech companies to improve customer service and dedication. Such measures seek to increase service efficiencies and success (Ariff et al., 2018). The banks are now redesigning their digital strategies by providing solutions to the challenges faced. In line with the vision 2030 for Saudi Arabia, the banking sector in the kingdom has adopted technology-based customer verification processes and the introduction of digital signatures. The use of technology has also exposed the banking sector to the dangers of financial loss. Currently, Saudi Arabian banks have been targeted by hackers, both locally and internationally. However, the banking sector has been undertaking continuous reviews and changes that seek to counter the hacking incidences and online fraud (Yamani & Almasarwah, 2019). The major security issues have been aimed at providing real-time monitoring and intervention of hacking attempts online fraud (Fallatah et al., 2019). Technology has also been used by banks to keep customer deposits and financial transactions safe.



## **CYBER SECURITY ISSUES FOR BANKS IN SAUDI ARABIA**

Banks process, transfer, store and share sensitive information related to their customers, internal transactions and those of other stakeholders. The security of such data and information is important as they should not leak or pass this information to unauthorised persons. The level of data sensitivity varies based on their use. However, the above data, though important, has been targeted by malicious individuals and persons (Fallatah et al., 2019). Currently, cybercrime is increasingly become one of the largest illegals and most dangerous threats to the banking industry, not only in Saudi Arabia but across the globe. However, the government of Saudi Arabia, other stakeholders and the general public have initiated measures aimed at reducing the effects of cybercrime and improving performance. Banks are quickly installing a resilient cybersecurity structure whose main aim is to provide tools for cybercrime detection, quick response and protection. The above move is aimed at improving investor confidence, while also promoting customer satisfaction and economic stability. The Saudi Arabian Monetary Agency (SAMA) has played an important role in the development, creation and promotion of a suitable working environment for the banking sector (Yamani & Almasarwah, 2019). SAMA has been instrumental in creating awareness about cybersecurity, promoting secure banking options and creating options for the prevention of cybersecurity.

By 2017, SAMA had developed a comprehensive cybersecurity framework that was adopted by its members (Miyajima, 2020) (Alzeban, 2019). The framework was aimed at providing security options, enhancing regulation and identifying cyber-related talents (Ariff et al., 2018). Currently, SAMA is creating a more open environment for members to seek professional cybersecurity services. The body has come up with many experts and conducts training for cybersecurity related issues. The cybersecurity program by the company has been running for many years. The adopted programs have been designed to provide adequate training and work-based experience on how to deal with cybersecurity threats (Fallatah et al., 2019). The body also offers connections and visits by members to international cybersecurity firms to allow them learn about modern and advanced ways of handling cybersecurity threats. The Financial Entities Ethical Red-teaming (FEER) Framework was one of the major documents which was published by SAMA in June 2019 (Ariff et al., 2018). The above document detailed the approach that can be used by the banking sector to deal with emerging cybersecurity threats and issues. Some of the major issues captured under the new document include the approaches to handling controlled attacks and securing sensitive information against malicious intruders. The framework issues by SAMA is considered one of the only six such guidelines that have been issued globally on the state of cybersecurity around the globe (Miyajima, 2020) (Alzeban, 2019). Currently, SAMA and the Saudi Arabian-based banks have established a strong link and working relationship that seeks to improve a governance structure that would promote safe banking practices devoid of cybercrime issues.



## **RELATIONSHIP BETWEEN CORPORATE STABILIST AND PUBLIC TRUST AMONG BANKS IN SAUDI ARABIA**

Regulatory changes and governance issues have significantly changed within the banking industry in Saudi Arabia. Despite the above changes, there are many issues which still occur that are related to corporate stability, and which impact public trust in the industry. Different issues related to customer trust that result from management incompetence still face some banks in the region. One of the major emerging trends is that the employees within the banking sector dictate the level of customer satisfaction (Nurunnabi, 2017). Despite the existence of frameworks for customer service, such guidelines are sometimes ignored. The banking sector must seek to provide standard measures and approaches that would promote uniformity in the handling of customers, shareholders and all the other stakeholders.

Drawing from the 2007-2008 financial crisis, the banking sector in Saudi Arabia has been undertaking new measures aimed at earning more customer support (Ariff et al., 2018). Since one of the secondary causes of the financial crisis was due to the lack of transparency and trust due on the contracts, banks have to work hard to gain the trust of their customers and shareholders. In Saudi Arabia, regulatory requirements have been instituted to ensure that such occurrences do not happen in the future (Nurunnabi, 2017). Most banks are required to provide customer service and improve service delivery based on stringent financial regulations and law. Many banks in the region have been fined as a result of failing to adhere to some of the regulations.

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