CORPORATE GOVERNANCE AND PROVISIONS UNDER IAS 37

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ÖZEN ECE ACAR

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Approval of the Graduate School of Social Sciences

Prof. Dr. Cengiz EROL
Director

I certify that this thesis satisfies all the requirements as a thesis for the degree of Doctor of Philosophy.

Prof. Dr. Serdar ÖZKAN
Head of Department

This is to certify that we have read this thesis and that in our opinion it is fully adequate, in scope and quality, as a thesis for the degree of Master of Science/Doctor of Philosophy.

Prof.Dr. Serdar ÖZKAN
Supervisor

Examining Committee Members

Doç.Dr. Çağnur KAYTMAZ BALSARI

Prof. Dr. F.N. Can ŞIMGA MUGAN

Prof. Dr. Mevlüt KARAKAYA

Prof. Dr. Orhan ÇELİK

Prof. Dr. Serdar ÖZKAN

ABSTRACT

CORPORATE GOVERNANCE AND PROVISIONS UNDER IAS 37

Acar, Özen Ece

PhD in Business Administration,

Department of Business Administration

Supervisor: Prof. Dr. Serdar ÖZKAN

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Provisions are liabilities with uncertain timing or amount. The uncertain nature of provisions in terms of timing and amount make them perceived as forward looking information. In recent years research on forward looking information gained valuable attention due to dynamic economic environment and recent accounting regulations worldwide. Therefore, decisions only rely on historical information would not be enough, investors are asking for forward looking information that will be helpful for giving wise decisions. Moreover, corporate governance serve as an important tool for moderating information asymmetry and agency problems hence influencing financial reporting and disclosure quality. With this regard, this thesis aims to aims to illustrate the extent of disclosure of provisions in Turkey and explore the relation between provisions and corporate governance.

Current thesis utilizes a panel data analysis methodology using a sample of 1078 firm-year observations from Borsa Istanbul (BIST) between the years 2005-2010. Overall findings indicate that, 62% of 1078 firm-year observations recognize provisions; and among the ones that recognize provisions only 32% provides IAS 37's full disclosure requirements. Moreover, firms that recognize provisions have larger board of directors and are more likely to be characterized with concentrated ownership and institutional owners comparing to firms that do not recognize provisions. Also, firms with larger board of directors, greater independence of board of directors and concentrated ownership have higher TP/TD ratios. Finally, firms that make full disclosure of provisions are more likely to have larger boards, higher ownership concentration and institutional owners and less likely to have CEO duality.

Keywords: IAS 37, Provisions, Forward Looking Information, Corporate Governance, Turkey

ÖZET

KURUMSAL YÖNETİM VE

IAS 37 KAPSAMINDA KARŞILIKLAR

Acar, Özen Ece

İşletme Doktora,

İşletme Yönetimi Bölümü

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Karşılıklar gerçekleşme zamanı ve tutarı belli olmayan yükümlülüklerdir. Karşılıkların zaman ve tutar açısından doğasında var olan bu belirsizlik onların geleceğe yönelik bilgi olarak algılanmasına neden olmaktadır. Son yıllarda dinamik ekonomik çevre ve elbette ki küresel anlamda yaşanan muhasebe düzenlemelerinin sonucu olarak ileriye dönük bilgi ile ilgili çalışmalar büyük ölçüde önem kazanmıştır. Dolayısıyla, sadece geçmişe dönük bilgi yeterli olmamakta, yatırımcılar akıllıca karar verebilmek için ileriye dönük bilgi talep etmektedirler. Diğer bir yandan, kurumsal yönetim bilgi asimetrisi ve vekâlet problemini azaltan, buna bağlı olarak finansal raporlamayı ve sunum kalitesini etkileyen bir araç olarak karşımıza çıkmaktadır. Bu bağlamda, bu tez Türkiye'de karşılıkların ne ölçüde sunulduğunu ortaya çıkarmayı ve karşılıklar ile kurumsal yönetim arasındaki ilişkiyi araştırmayı amaçlamaktadır.

Araştırmada, 2005-2010 yılları arasında Borsa İstanbul (BIST)'dan 1078 firma-yıl verisi kullanılarak panel veri analizi yöntemi uygulanmaktadır. Genel bulgular 1078 firma-yıl gözlemi içerisinde %62'sinin karşılık ayırdığını ve bunlar arasında sadece %32'sinin IAS 37'nin tam açıklama gerekliliklerini karşıladığını göstermektedir. Ayrıca, karşılık ayıran firmalar karşılık ayırmayanlar ile karşılaştırıldığında, daha büyük yönetim kurulları, daha yoğun sahiplik yapıları ve daha fazla kurumsal sahipler ile karakterize olmaktadır. Aynı zamanda, büyük yönetim kurulları, yüksek yönetim kurulu bağımsızlığı ve yoğun sahiplik yapısına sahip olan firmaların TK/TY oranı daha yüksektir. Son olarak, tam açıklama yapan firmalar daha büyük yönetim kurullarına, daha yüksek sahiplik yoğunluğuna ve kurumsal sahiplere ve daha az CEO ikiliğine sahiptirler.

Anahtar Kelimeler: IAS 37, Karşılıklar, İleriye Dönük Bilgi, Kurumsal Yönetim, Türkiye

To my family

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Özen Ece Acar

June, 2014

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LIST OF ABBREVATIONS

BIST	Borsa İstanbul
BS	Balance Sheet
CA	Current Assets
CEO	Chief Executive Officer
CMBT	Capital Markets Board of Turkey
CML	Capital Markets Law
ESI	Economic State Institutions
IAS	International Accounting Standards
IASB	the International Accounting Standards Board
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IGE	Istanbul Gold Exchange
IS	Income Statement
ISE	İstanbul Stock Exchange
LTL	Long-Term Liabilities
OECD	Organization for Economic Co-Operation and Development
SMEs	Small-Medium Sized Enterprises
STL	Short-Term Liabilities
TAS	Turkish Auditing Standards
TASB	Turkish Accounting Standards Board
TDE	Turkish Derivatives Exchange
The Standard	IAS 37 Provisions, Contingent Liabilities and Contingent Assets
TK/TY	Toplam Karşılıkların Toplam Yükümlülüklere Oranı
TP/TD	Total Provisions Over Total Debt Ratio

CHAPTER 1

INTRODUCTION

1.1. Introduction

The purpose of financial reporting is to inform both the parties inside and outside of the company by a set of documents called financial reports and disclosing any event that would have an impact on decisions. Therefore, financial reports can be regarded as an effective communication tool that provides financial information about the reporting entity which will be useful to decision makers. Some concerns has been expressed about the about the usefulness of traditional reporting model focusing on what is reported and when is reported (Francis and Shipper, 1999). Subsequently, it has been on the agenda of both academics (Francis and Shipper, 1999; Amir and Lev, 1996) and professional standard setting bodies (ICAEW,

2003) that new reporting models for businesses should be developed by enhancing traditional reporting model. The growing gap between the values shown in company balance sheets and the stock market valuations, and following accounting scandals, particularly in the US, have focused attention instead on the importance of maintaining the integrity of traditional financial reporting. Finally, in terms of proposing changes in what and when is reported, the direction has been shifted to widening what information is disclosed (Amir and Lev, 1996). Consequently, the increased role of disclosing narrative information in financial reports leads new questions.

Moreover, accounting disclosure has a strong relationship with agency theory. In agency theory literature, cooperating parties are the owners who are defined as principals and the managers are defined as agents. When these cooperating parties have different attitudes to risk, risk sharing problem occurs. Thus, agency problem arises when principals and agents have different attitudes toward risk, when there is a conflict between their goals and when it is difficult for the principal to verify that the agent has behaved appropriately (Eisenhardt, 1989). Such a conflict of interest between cooperating parties arise more in the companies where ownership is widely held (Fama and Jensen, 1983). Information disclosure is likely to be greater in widely held firms so that principals can effectively monitor that their economic interests are optimized and agents can signal that they act in the best interest of the owners (Chau and Gray, 2002).

On the other hand corporate governance has gained valuable attention in recent years with its moderating role on information asymmetry and agency problems therefore influencing the financial reporting and disclosure quality. Several regulations have been set to empower corporate governance. Worldwide regulation of corporate governance has been led by Organization for Economic Co-Operation and Development (OECD) in 2004 by issuing principles for corporate governance that covers disclosure and transparency. In the regarding principle "*the framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company*". Moreover it is indicated that *"information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure".* Following OECD, in 2003, Capital Markets Board of Turkey (CMB) issued Corporate Governance Principles (which is amended in 2005), aiming to improve shareholders rights and provide equal treatment to all; enhance financial reporting quality regarding disclosure and transparency issues; regulate the relationship between the stakeholders and company; and improve structure of board of directors.

Moreover, users of financial reports need a forward looking perspective in order to predict a company's financial future accurately. In other words users should study the information about past and present; and search for leading indicators in historical data and search for forward looking information to reach that aim. Forward-looking information covers any prediction or information that will be useful. It is clear that business reporting only focusing on the information about the past is not relevant enough for decision making. Disclosing forward looking information in the context of opportunities and risks, management plans for the future and comparing actual business performance to previously disclosed is found to be more useful by decision makers. Also the concern about the timeliness of information is reduced by the presentation of forward looking information. Therefore, there should be a balance between past and forward-looking information.

It is stated within the IASB Conceptual Framework for Financial Reporting (IASB Framework) that the objective of general purpose financial reporting is *to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity*. Following this objective, the IASB Framework ensures that if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. Moreover, the usefulness is enhanced with comparable, verifiable, timely and understandable financial information as well. On the other hand there is a debate whether to use the term “faithful representation” or “reliability”. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No.8 (2010) indicated the lack of a common understanding of the term reliability. While some focusing on verifiability or free from material error to the virtual exclusion of faithful representation, some focused on faithful representation combined with neutrality. Nevertheless reliability is defined as *“the information when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent”* (IASB, Framework for the Preparation and Presentation of Financial Statements, 2009). Besides, relevant financial information which is defined as being capable of making a difference in decisions of the users within the Framework also can be clarified in everyday terms as the information related to matter on hand and the users wish to know (Kirschenheiter, 1997).

However, the trade-off between relevancy and reliability has been argued since many years from different perspectives (Barnea et.al., 1975; Kirschenheiter, 1997; Entwistle and Phillips, 2003; Bandyopadhyay et.al., 2010). Even it is argued that the accrual process is the result of the trade-off between relevance and reliability (Ball, 1989; Watts and Zimmerman, 1986, from Dechow, 1994). In the framework of forward looking information, it would be appropriate to indicate that the trade-off is remarkable. Forward looking information covers predictions which decrease the level of reliability. Therefore, reliability is linked to the estimation process in accounting measurements ‘‘precision of an estimate’’ becomes more of an issue (Kirschenheiter, 1997). However, information depending on predictions should be disclosed as a result of relevancy. Thus such a trade-off between relevancy and reliability in the context of forward looking information and the expanded role of disclosing narrative information in financial reports lead to new issues for exploration. Consequently, considering the enhanced role of disclosing forward looking information in financial reports and significance of corporate governance in disclosure quality, this thesis initially aims to explore the relationship between corporate governance mechanisms and disclosure level of forward looking information that will be proxy for disclosure quality. Provisions in the context of *IAS 37 Provisions, Contingent Liabilities and Contingent Assets (the Standard)* lead forward looking information by covering future estimates. Therefore, the thesis mainly aims to reveal the relationship between corporate governance mechanisms and disclosure level of provisions under of IAS 37.

This thesis extends the prior literature in several ways. Initially, it makes contributions to accounting literature by studying provisions. Because provisions are one of the most debatable as well as unexplored field in accounting literature. It is indicated in the Standard that in some countries provisions are also used in the context of items such as depreciation, impairment of assets and doubtful debts. However, these are adjustments to the carrying amounts of the assets and not in the scope of the Standard (IAS 37, [7]). Turkey is one of the countries that face with this problem indicated in the Standard (Cemalcılar, 2001). Therefore, clarifying provision concept and revealing the disclosure level of provisions extends the prior forward looking information studies.

The remainder of this chapter is organized as follows. Section two explains the main objectives and identifies the research questions. Section three outlines the structure of the thesis.

1.2. Research Objectives and Research Questions

The main objective of this thesis is to explore the relation between corporate governance mechanisms and disclosure level of provisions in Turkey for BIST companies. Also, this thesis aims specifically to (i) reveal the overall disclosure level of provisions; (ii) the relation between the corporate governance mechanisms and tendency to recognize provisions; (iii) the relation between the corporate governance mechanisms and amounts of provisions.

Based on these objectives, in this thesis the following research questions were addressed;

Research Question I (RQI): What is the overall disclosure level of provisions under IAS 37 for BIST companies between the years 2005 and 2010?

Research Question II (RQII): What is the relationship between corporate governance and tendency to recognize provisions under IAS 37 for BIST companies between the years 2005 and 2010?

Research Question III (RQIII): What is the relationship between corporate governance and the amounts of provisions under IAS 37 recognized for BIST companies between the years 2005 and 2010?

Research Question IV (RQIV): To what extent BIST firms apply the disclosure requirements for provisions that are specified in IAS 37?

1.3. Scope and Research Methodology of the Thesis

Current thesis aims to reveal the relation between corporate governance mechanisms and disclosure level of provisions in the framework of forward looking information. For this aim, the thesis employed on non-financial firms listed on Borsa İstanbul (BIST) for the years between 2005 and 2010. Financial institutions and holdings are out of the scope of this dissertation, since in some points their financial characteristics, ownership structure and financial reporting practices differ from non-financial firms.

The thesis employs a panel data analysis to reveal the relation between corporate governance mechanisms and disclosure level of provisions. Disclosure checklist is gathered from the Standard IAS 37 Provisions, Contingent Liabilities and Contingent Assets. The thesis employs 6 different disclosure checklist items which are explained in Chapter 4. After constructing the disclosure checklist the observations are grouped as “observations that make full disclosure” and “observations that make partial disclosure”. Later, the differences in corporate governance structure of firms that make full disclosure of provisions and that make partial disclosure of provisions are examined by employing following corporate governance variables; size of board of directors, independence of board of directors, CEO duality, ownership concentration and institutional ownership. Moreover, considering the relation between corporate governance and forward looking information observations that recognize and do not recognize provisions are determined. The differences in corporate governance structure of firms are also examined for the observations that recognize and do not recognize provisions. Furthermore, as provisions are liabilities Total Provision/Total Debt ratio is calculated for all observations. The relation between amounts of provisions recognized and corporate governance mechanisms is examined by using this ratio. During those steps independent sample t-tests and chi-square tests were employed. Furthermore, stepwise regressions were employed as further analyses.

1.4. Organization of the Thesis

The overall structure of the thesis is as follows. The introduction chapter introduces the research objectives and questions, clarifies motivation and contributions of the study. Chapter two provides an overview of Turkish accounting and accounting related legal environment. Chapter three explains the literature on disclosure, forward looking information and corporate governance. Chapter four explains the research, indicates the research objectives and research questions, develops and analyses the hypotheses and provides the findings. Finally, chapter five concludes the research and points out the limitations and directs for further studies.

CHAPTER 2

ACCOUNTING SYSTEM AND LEGAL ENVIRONMENT IN TURKEY

2.1 Introduction

The main purpose of this chapter is to provide an overview of the capital market mechanism, accounting and auditing environment and internationalized accounting regulations in Turkey. Initially, this chapter provides an understanding of the development of capital markets for Turkey in terms of both structure and operations. Moreover, this chapter clearly describes the efforts to develop the system and legal framework for the accounting and auditing profession and services in Turkey. Finally, this chapter aims at providing an understanding of the influence of globalization on Turkish accounting regulations regarding the standards, boards, committees and other related institutions.

The remainder of this chapter is as follows. Section two describes the development and operations of capital markets in Turkey. Section three provides a review of the accounting and auditing environment in Turkey. Section four explains the globalization process of accounting regulations in Turkey. Finally, section five summarizes the chapter.

2.2 Capital Markets in Turkey

The establishment of a modern securities market in Turkey dates back to early 1980's, when a macro-economic approach aimed at economic liberalization was adopted. 1980 was a turning point for the Turkish economy, when liberalization policies showed a new adjustment path with greater emphasis on export expansion and market forces. Since then, capital and market structure has experienced significant developments. In 1981, Capital Markets Board of Turkey (CMB) was established and empowered by the enactment of Capital Markets Law (CML). Following the foundation of CMB, Borsa Istanbul [(BIST) formerly Istanbul Stock Exchange (ISE)] was established in 1985 and started trade of equities and fixed income securities in 1986. Afterwards, in 1995, the establishment of

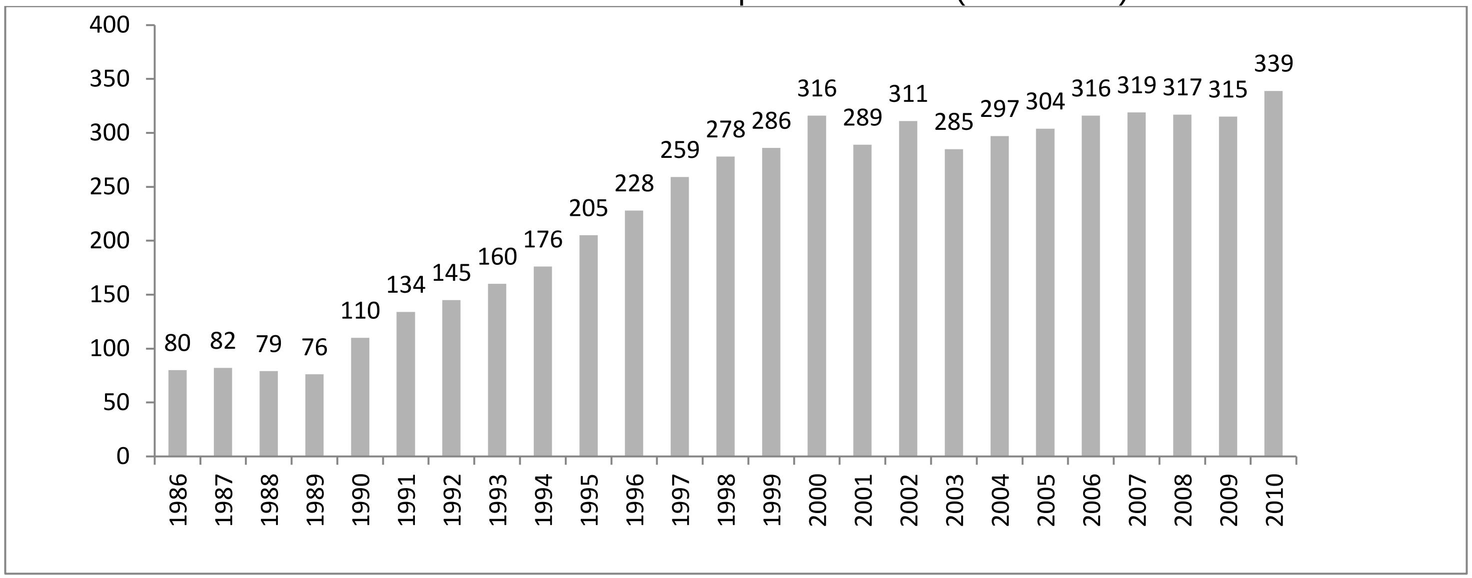
Istanbul Gold Exchange (IGE) allowed the trading precious metals under an organized market. Later, in 1995, Turkish Derivatives Exchange (TDE) was established to encourage the development of the futures and options market.

CMB is the regulatory and supervisory authority responsible for the securities and derivatives markets in Turkey through strict regulations of the capital markets, market instruments and institutions. The real purpose of CMB, reinforced by CML, is to operate stock exchange regulations and to protect rights and interests of investors. All BIST listed firms are subject to CML and regulations, and CMB Communiqués which emphasize requirements for financial reporting, accounting standards, independent auditing and rules to be traded on exchange markets.

The number of listed companies and trading volume in BIST increased significantly between 1986 and 2010. BIST began operating in 1986 with 80 companies and a trading volume of 9 thousand TL (13 million US Dollar), and reached a total of 315 companies with a trading volume of 635.9 billion TL (425.7 billion US Dollar) by 2010. As the economy experienced severe crises between 1994 and 2001, Turkish capital market, particularly BIST, suffered from this conjuncture. Specifically, the crises of November 2000 and February 2001 led to a decrease in the trading volume. However these crises were followed by major improvements and the trading volume reached to 146.6 billion TL (100.2 billion US Dollar) in 2003 with 285 listed companies, and 208.4 billion TL (147.8 billion US Dollar) in 2004 with 297 listed companies. After this period of rapid growth, the increase in trading volume and number of listed companies continued at a much slower rate. In 2005 the total trading volume in the BIST equities market was 269.9 billion TL (201.8 billion US Dollar) with 304 listed companies. The trading volume figures for the years 2006 – 2009 are as follows: 2006, 325.1 billion TL (229.6 billion US Dollar); 2007, 387.7 billion TL (300.8 billion US Dollar); 2008, 332.6 billion (261.3 billion US Dollar); 2009, 482.5 billion TL (316.3 billion US Dollar). The number of listed companies for the period 2006 – 2009 are as follows; 2006, 316 companies; 2007, 319 companies; 2008, 317 companies; 2009, 315 companies; and 2010, 339 companies. Finally, as of December 2010, there are 339 listed companies in BIST, with a market capitalization of TL 472.5 million (US$ 307.5 million) and trading volume of 635.9 billion TL (425.7 billion US Dollar), and a level of with 45% of gross domestic products (CMB, 2010).

The table below summarizes the number of companies that are listed on BIST between the years 1986 and 2010.

Table 1: Number of Listed Companies in BIST (1986-2010)



Consequently, the Turkish capital market is, with its limited number of companies, low level of market capitalization and trading volume, is one of the most promising markets in terms of internalization potential. In the wake of its considerably strengthened macroeconomic policy framework and robust financial sector supervision, there has also been considerable improvement in terms of access to international capital markets (OECD, 2010).

Furthermore, as indicated in previous chapter, CMB issued Corporate Governance principles in 2003 which was amended in 2005. The motivation lying behind those principles is clarified with the following statement: *“It is widely accepted that bad management practices have triggered the financial crises and company scandals that broke out in the recent years. This has clarified the importance of the concept of sound corporate management practices. The importance of the issue has been growing at an international level and the quality of corporate governance practices, which is deemed to be as important as financial performance in investment decisions, has become a subject of more serious consideration. High quality status of corporate governance means low capital cost, increase in financial capabilities and liquidity, ability of overcoming crises more easily and prevention of the exclusion of soundly managed companies from the capital markets” ” (CMB, Corporate Governance*

Principles). Public Disclosure and Transparency is one of the corporate governance principles issued. This principles aims to provide shareholders and investors accurate, complete, comprehensible, easy-to-analyze, unbiased, interpretable information which is also accessible at a low cost and in a timely manner via periodical financial statements and reports[1] (CMB, Corporate Governance Principles, 1.1.). Also it is determined that periodical financial statements and footnotes should be prepared in accordance with the current legislation and international accounting standards and applied accounting policies should also be included in the footnotes of the financial statements (CMB, Corporate Governance Principles, 3.1.1.).

2.3 Accounting and Auditing Environment in Turkey

Turkish accounting thought and practices have been strongly influenced by European accounting cultures since the early 19th century, particularly by German accounting culture, from the beginning of 20th century, after the establishment of close political relations. This influence was most clearly seen in the accounting organizations of the Economic State Institutions (ESI), the preparation of the Tax Reforms in 1949 and modernization of the

[1] Public Disclosure and Transparency Principles of Corporate Governance defines periodical financial statements and reports. Such a set covers company's annual report, semi-annual reports, annual and quarterly periodical financial statements, audit reports, capital adequacy tables and other reports to be prepared annually and during interim periods.

Turkish Commercial Code of 1957 (Güvemli and Selçık, 2008). As a consequence of this Continental European influence, taxation law had a significant effect on the Turkish accounting system (Balsarı et al., 2009; Elistas ve Uc, 2009).

Since the establishment of the Turkish Republic there has been a sustained effort to develop the accounting system and to set a legal framework for the accounting and auditing profession and services. The progress of this work can be seen in the following list of events:

• the establishment of Expert Accountants' Association of Turkey (1942);

• the establishment of uniform accounting system, generally accepted accounting principles and rules and management reporting system for public entities (1968-1970);

• the establishment of International Federation of Accountants (IFAC), with Turkish Association of Accounting Experts as a founding member and the adoption of its membership to International Accounting Standards Board (1977);

• the enactment of Capital Markets Law and establishment of Capital Markets Board of Turkey (1981);

• the establishment of Independent Audit Association (1988);

• the publication of Law No. 3568 on Certified Public Accountancy and Sworn-in Certified Public Accountancy, and the recognition of accounting and auditing as a profession (1989);

• the translation and publication of International Accounting Standards by Turkish Association of Accounting Experts (1991);

• the establishment of a uniform accounting system for private entities (1992);

• the establishment of Turkish Accounting and Auditing Standards Board (TAASB) for the development of accounting standards (1993);

• the establishment and commissioning of Turkish Accounting Standards Board (TASB) in order to develop, set and issue the Turkish Auditing Standards (TAS) (2002);

• the publication of The Communiqué on Independent Audit in Capital Markets (Serial: X, No: 16) in 2002 which sets external independent auditing requirements of BIST firms;

• the establishment and commissioning of an independent and autonomous Turkish Audit Standards Board (2003);

• the publication of The Communiqué on Accounting Standards in Capital Markets (Serial: XI, no: 25), effective from 1 January 2005, which requires all listed firms in BIST to use International Accounting Standards(IAS)/International Financial Reporting Standards (IFRS) (2003);

• the publication of first set of TAS adopted from IAS/IFRS (2005);

• the publication of the Communiqué on Independent Auditing Standards in Capital Markets (Serial: X, No: 22), partially effective from June 2006, and full effective from year-end of 2006, which defines the legal requirements and the independence of auditors, regulates the quality of auditing services by describing the scope of them, identifies the auditor tenure and introduces auditing standards which are in line with International Standards on Auditing (ISAs) (2006);

• the publication of the Communiqué on Financial Reporting in Capital Markets (Serial: XI, no: 29), effective from 1 January 2009, which requires listed firms in BIST to use of TASs/TFRSs (2008);

• the publication full set of TAS/TFRS fully convergent with the IAS/IFRS (2010);

• the publication Turkish Financial Reporting Standards for SMEs (TFRS for SMEs) to be effective in 2013 (TURMOB, 2010)

• Public Oversight, Accounting and Auditing Standards Authority is established in 2011 in order to issue Turkish Accounting Standards compliant with the international standards, to ensure uniformity, high quality and confidence in statutory audits, to set the auditing standards, to approve statutory auditors and audit firms and to inspect their audits, and perform public oversight in the field of statutory audits (POA, 2014).

The milestones above have shaped the Turkish accounting and auditing environment. Moreover, the Turkish Commercial Code has had significant effects on regulating business life, thereby the accounting and auditing environment in Turkey. The first Turkish Commercial Code in the republican era, undertaken in 1926, was derived from the French Commercial Code with the influence from both the German and Italian Commercial Codes (Balsarı et al. 2009). In 1957, it was succeeded by the renewed code, prepared by a German academician. This code was in turn replaced by a new commercial code, effective from 1 July 2012, which redefines the rules bounding commercial, financial and capital markets in Turkey.

The new Turkish Commercial Code empowers the TASB as the only and exclusive authority to set and publish TASs/TFRSs which are the identical to the IASs/IFRSs. The New Code requires that the financial reports of all the enterprises below, regardless of they are public or private, be prepared in conformity with TASs/TRFSs as of 1 January 2013;

a) Large sized equity capital companies and their subsidiaries in consolidation, affiliates and groups of companies,

b) Companies issuing marketable instruments trading in exchanges or other markets, intermediary institutions, portfolio management companies, and other companies in the scope of consolidation,

c) Banks and their subsidiaries identified under Banking Law Article 3,

d) Insurance and reinsurance companies identified under the Insurance Law,

e) Pension fund companies identified under the Individual Pension Savings and Investment System Law.

Also, the new Turkish Commercial Code requires small and medium sized entities (SMEs) to prepare their financial reports in conformity with the TASs for SMEs as of 1 January 2013. On the other hand, the new Turkish Commercial Code not only focuses on the accounting regulations, but also has some requirements for the auditing process. The new Turkish Commercial Code requires all equity capital companies to be subject to audit that will be conducted by an independent auditing firm (PWC, 2012).

2.4 GLOBALIZATION OF ACCOUNTING REGULATIONS

The fundamental driving force behind the international harmonization of accounting regulations is the economic and political pressure to globalize. Accounting rules are shaped by market economics and politics in every country. Therefore, the progressive worldwide integration of the markets and politics reveals the harmonization that serves the interests of variety of stakeholders (Ball, 1995). As a result of increased cross-border investments and transparent capital markets, the only way for Turkey was to reform its local accounting regulations to be a part of world economy and multinational investment trade and community (The New Turkish Commercial Code, 2012).

The first attempt to globalize accounting standards occurred in 1973 with the establishment of the International Accounting Standards Committee (IASC) by professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom and Ireland, and the United States. Between 1973 and 2001, the committee was responsible for issuing the International Accounting Standards (IAS) and this standard setting body became known as the IASC.

In 2001 IASC was succeeded by the International Accounting Standards Board (IASB) which had the mission of developing an organized and uniform arrangements in accounting based on a set of new and rigorous financial reporting standards, entitled International Financial Reporting Standards (IFRS). However, while implementing the IFRS, the IASB still recognizes the IAS. The new board, IASB, created as the standard setting body of the IFRS Foundation, is an independent, not-for-profit private sector organization working in the public interest. Eventually, IASB is responsible for the development and publication of IFRS, including the IFRS for SMEs; and approving interpretations of IFRS developed by the IFRS Interpretations Committee that certainly serves for international harmonization of accounting regulations.

The first step towards globalization of accounting regulations in Turkey was the establishment of Turkish Accounting and Auditing Standards Committee (TMUDESK, TAASC) in 1994 with the aim of publishing national accounting standards and the national auditing standards for auditing services. Subsequently, in 2002, TASB, an incorporated self-governing authority, was founded in order to issue TASs/TFRSs in compliance with the IASs/IFRSs. This led to the official recognition of Turkey's adoption of internationally harmonized accounting and financial reporting regulations.

Financial reporting and auditing requirements of listed firms in BIST are regulated by CMB as indicated before. CMB issued two communiqués which are considered cornerstones of Turkish accounting practice: the Communiqué on Accounting Standards in Capital Markets (Serial: XI, no: 25) and the Communiqué on Financial Reporting in Capital Markets (Serial: XI, no: 29). The former, issued in 2003, requires all listed firms in BIST to use accounting and financial reporting standards issued by CMB which are in line with IFRSs starting from 1 January 2005. The Communiqué on Financial Reporting in Capital Markets (Serial: XI, no: 29) issued in 2008, effective from 1 January 2009, requires listed firms in BIST to use only those TASs/TFRSs that are adopted from IASs/IFRSs.

2.5 SUMMARY

Since 1980s, overall structure of Turkish economy has experienced several changes. As expected, these changes resulted with the development of Turkish capital market which is still emerging and developing. The most recent progress in accounting and auditing environment is the issuance of the new Turkish Commercial Code.

As the purpose of this thesis is to reveal the relationship between provisions and corporate governance structure, an overview of Turkish legal and accounting environment was crucial for the interpretation of research findings. The following chapter will review the literature on disclosure research considering forward looking information accounting and corporate governance.

CHAPTER 3

LITERATURE REVIEW ON DISCLOSURE, CORPORATE GOVERNANCE AND FORWARD LOOKING INFORMATION

3.1. Introduction

Since the aim of this thesis is to explore corporate governance and provisions under IAS 37, it is crucial to understand the coverage of provisions by referring IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Moreover, provisions lead forward looking information by covering predictions. Therefore, discussing the provision framework comprehensively in the context of forward looking information is essential. In addition, the usage of the term “provision” is one of the most problematical issues in accounting literature both for Turkey and the rest.

Consequently, considerable importance should be given to the usage of the term provision.

The remainder of this chapter is as follows. Section two explains financial reporting disclosure in accounting literature. Section three explains forward looking information. Then, section four clarifies the definition, recognition and measurement of provisions within the scope of IAS 37. Also, section four discusses the usage of the term provision in Turkish accounting literature. Finally, section five summarizes the literature.

3.2. Disclosure Research in Accounting

Disclosure of information both in financial reports and corporate annual reports has attracted many researchers since many years. It is important to make distinguish between disclosure and recognition. Recognition is incorporating information in the financial statements; disclosure is informing investors by footnotes or annual reports without incorporation in financial statements (Ball, 2005). It is argued that common law countries which are more market-oriented hence have a proportionately larger capital markets, are more litigious, and are more likely to operate with at arm’s-length transaction are more likely to presume that investors rely on timely public disclosure and financial reporting when compared to code law countries (Ball, 2005). Similar with the behavior of common and code law countries' investors, equity investors and debt investors' reliance on information also differs. It is argued that the demand for recognition versus disclosure arises primarily from the use of financial statements in debt markets. However, equity investors emphasis on information whether provided by recognition or disclosure (Ball et.al, 2008).

There are some incentives for the management to make or to withhold disclosure. Grossman (1981) argues that managers will disclose the highest possible information[2]; on the contrary, Dye (1985) argue that managers will disclose information that has positive effect on stock price and do not disclose information that adversely affects stock price. Dye (1985) documents the reasons to management's withhold to disclose information as; (i) investors knowledge of management's information is incomplete, (ii) managers have the knowledge of private information some of which is proprietary, some nonproprietary, so they want to keep nonproprietary information in the business, (iii) it is the best way to resolve the agency problem between shareholders and managers.

Disclosure research in accounting has a wide range. Some of the research focus on the compliance level of overall disclosure requirements (Street et

[2] This can be explained by Akerloff's (1970) lemons problem; *"Sellers may know the quality of the item that they sell but it may be in their interest to withhold that information. If there is no way for buyers to learn about the sellers' quality, then this will force to sell all items at the same price. If there is no way the sellers of good quality items can distinguish themselves from sellers of low quality items, then the low quality seller will find it in their interest to hide their quality. This has been called the lemons problem".* (Dye, 1985)

al, 1999; Street and Bryant, 2000; Glaum and Street, 2003; Mutawaa and Hewaidy, 2010; Juhmani, 2012, Feyitimi, 2014). Street et.al. (1999) studied 1996 annual reports for 49 companies in 12 developed countries to determine the degree of compliance with IASs and revealed that only 41% of companies note full compliance with the tested standards. Then, Street and Bryant (2000) investigated the extent to which the disclosure requirements of the IASC are complied with or exceeded for companies claiming to use IASs by seeking to identify significant differences between those companies with U.S. listings, U.S. filings, and those with no U.S. listings or filings. Findings of Street and Bryant (2000) document that overall disclosure level is greater for companies with U.S. listings. Moreover, Street and Bryant (2000) found that companies that states their financial statements are prepared in accordance with IASs and the audit opinion that states that International Standards of Auditing (ISAs) were followed when conducting the audit are associated with greater level of disclosure. Specifically, the study of Street and Bryant (2000) U.S. listed companies provide significantly more disclosure for IAS 37[3]. German companies are investigated by Glaum and Street (2003). Their research

[3] It is stated that "*IAS 37 becomes effective for periods beginning on or after July 1, 1999. Therefore, the companies were not required to provide these disclosures in their 1998 financial statements, but the 20-F companies voluntarily provided 82 percent of the disclosures. For example, USINOR early-adopted the standard and provided all the required disclosures. The other companies without a U.S. listing voluntarily provided only 59 percent of the disclosures. IAS 37 will require disclosures such as a reconciliation of the beginning and ending balance for each class of provision and an indication of the uncertainties about the amount and timing of cash flow associated with provisions*" (Street and Bryant, 2000).

reveal that overall compliance ranges from 41.6% to 100% with an average of 83.7%, however that average was reported to be significantly low for companies that apply IAS. Moreover, Glaum and Street (2003) documented significant positive association between overall disclosure level and audit firm and listing status and no significant association between overall disclosure level and industry, country of origin, profitability, multinationality, ownership structure, firm age, and growth. Other than overall compliance, the results of Glaum and Street (2003) indicate that disclosure compliance is particularly low specifically for research and development and provisions and contingencies. Mutawaa and Hewaidy (2010) provided evidence for Kuwaiti listed companies and results indicated that overall compliance level averages 69% of the disclosures required by the standards and only company size and type of industry have positive association with disclosure. Juhmani (2012) examined compliance with mandatory IFRSs disclosure requirements for Bahrain Stock Exchange companies and resulted with an average of 80.7% compliance level and compliance level is found to be positively associated with company size and audit firm. Feyitimi (2014) examined the compliance level for Nigerian companies and resulted with an average of 60.2% overall disclosure compliance. Specifically Feyitimi (2014) documented IAS 37 complied with 60.8% of the companies in the sample[4].

[4] The results indicate the disclosure compliance in 2011. At this time IFRSs are not yet mandatory in Nigeria.

Furthermore, disclosure research studies vary from developed to developing countries. Studies in developed countries include: United States (Singhvi and Desai, 1971; Buzby, 1975; Stanga, 1976, Street et.al, 1999; Street and Bryant, 2000); New Zealand (McNally et al., 1982; Sweden (Cooke, 1989); Canada (Bujaki and McConomy,2002); Spain (Wallace et al., 1994); France (Depoers 2000); Japan (Cooke, 1992; Cooke, 1996); Germany (Glaum and Street, 2003); New Zealand (Owusu-Ansah and Yeao, 2005); United Kingdom (Iatridis, 2008; Camfferman and Cooke 2002). Studies in developing countries include India (Ahmed, 2005:), Mexico (Chow and WongBoren,1987), Nigeria (Wallace, 1988; Feyitimi 2014); Zimbabwe (Owusu-Ansah,1998); Bahrain (Juhmani, 2012); Jordan (Naser et al., 2002) and Kenya (Barako, 2007).

The above literature reveals that financial reporting disclosure has been studied from several different aspects by many researchers since many years. One of the distinctions may be whether the items used to conduct disclosure index are mandatory or voluntary; financial or non-financial and reflecting past or forward looking information. Disclosing information due to legal requirements is characterized by mandatory disclosure of information. Mandatory disclosure system is *"an administrative, institutional arrangement to ensure that information relating to the economic activities and transactions, and financial policies of a company are made available to the investors and creditors of the company*" (Owusu-Ansah 1998).

Voluntary disclosure of information which are mostly forward looking in nature (Beyer et.al, 2010) can be defined as *“disclosures in excess of requirements, representing free choices on the part of company managements to provide accounting and other decision needs of users of their annual reports”* (Meek et.al., 1995). Non-financial information disclosure is defined as the qualitative information included in company annual reports, but outside of the four financial statements and related footnotes (Robb et.al., 2001). Financial information disclosure refers to any deliberate release of financial information, whether numerical or qualitative, required or voluntary, or via formal or informal channels (Gibbins et.al., 1990). Forward-looking information is defined as any prediction or information that helps estimation which includes management's plans, assessments of opportunities and risks, and forecasted data (Jenkins Committee Report, 2000). Finally, historical information disclosure refers to disclosing information about past events.

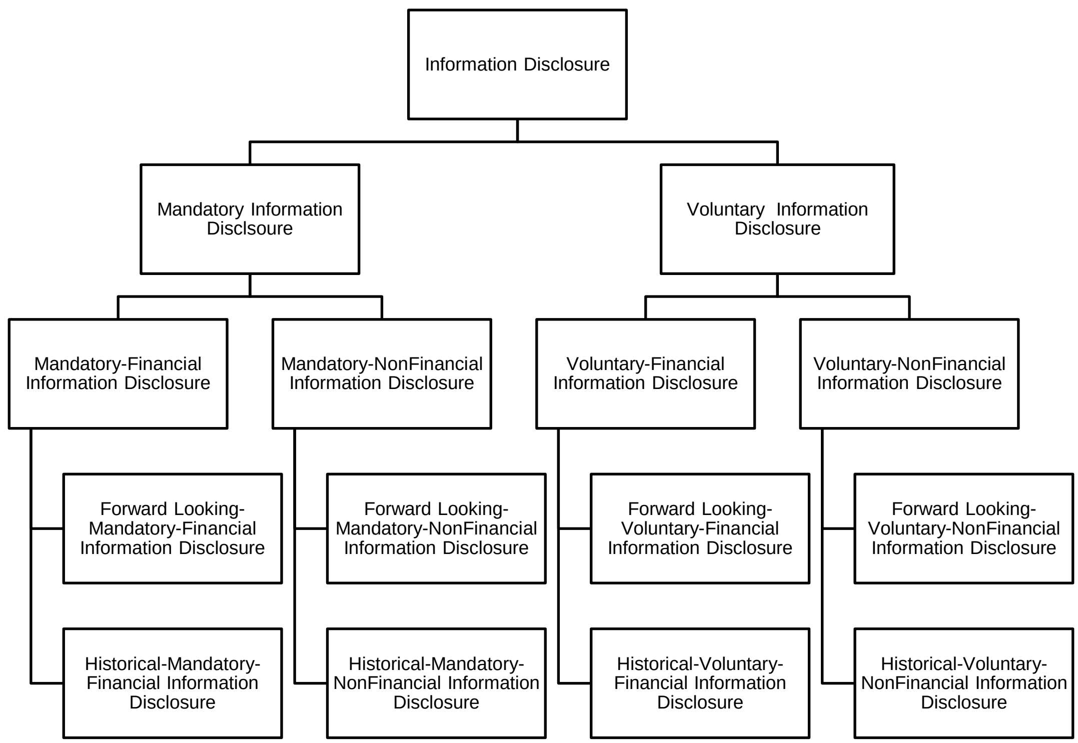
In this respect, following determination can be made to describe disclosure; disclosure is an accounting activity that releases financial and/or non-financial information whether about historical events or future estimates through financial and/or annual reports concerning legal requirements or company specific motivations.

Moreover, based on the literature about disclosure the table below developed in order to point out categories. Initially information disclosure has been classified in accordance with the obligation nature as mandatory disclosure of information and voluntary disclosure of information. Then, the second step considers whether the information disclosed is financial or non-financial. Finally, information disclosure is categorized whether the disclosed information is forward looking or historical. Consequently, depending on this classification this thesis develops a classification of information disclosure and there can be listed 8 different categorizes of information disclosure;

- Forward Looking-Mandatory-Financial Information Disclosure *(i.e. Disclosing the amount of provisions at the beginning and at the ending of the period in the footnotes to financial reports)*
- Historical-Mandatory-Financial Information Disclosure *(i.e. carrying amount and accumulated depreciation and impairment losses for each class of plant, property and equipment, IAS 16 Plant, Property and Equipment)*
- Forward Looking-Mandatory-Non-Financial Information Disclosure *(i.e. a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits in the footnotes to financial reports, IAS 37)*

- Historical-Mandatory-Non-Financial Information Disclosure *(i.e. Depreciation method used for each class of plant, property and equipment, IAS 16)*
- Forward Looking-Voluntary-Financial Information Disclosure *(i.e. Disclosing information about future earnings in annual reports)*
- Historical-Voluntary-Financial Information Disclosure *(i.e. Disclosing amounts spent for the social responsibility projects)*
- Forward Looking-Voluntary-Non-Financial Information Disclosure *(i.e. Disclosing planned investment projects for the coming year in annual reports)*
- *Historical-Voluntary-Non-Financial Information Disclosure (i.e. number of employees employed in the previous year)*

Figure 1: Disclosure Classification



3.2.1 Disclosing Forward Looking Information

In recent years, nature of the business accordingly information requirements in the business world has changed fundamentally. To serve those changes in information needs it is clear that forward looking changes in the reporting system are essential (Wallman, 1995, 1996). In such a dynamic economic environment decisions only rely on backward looking information would not be enough, hence presenting forward looking information would help investors giving wise decisions. Also, the existence of forward looking information would help reducing information asymmetry between managers and investors, thereby reduced information asymmetry would result with reduced cost of external financing. From the other point of view, in consistent with the proprietary cost hypothesis it is argued that forward-looking disclosure might provide useful information to competitors which might damage the competitive position (Healy and Palepu, 2001).

Forward looking information concerns forecasts based on current facts which allows users to evaluate a company's future performance (Menicucci, 2013). Forward looking information is best described with the words "predict", "expect", "estimate", "anticipate" and "forecast" (Aljifri and Hussainey, 2007). Presenting forward looking information is believed to improve the ability to assess future cash flows and predict future earnings hence give better investment decisions by investors (Hussainey et.al, 2003). Moreover, it is argued that forward looking information disclosure is strongly attached to legal system. Litigation has the effect of reducing forward looking information if the legal system penalizes forecasts disclosed with positive intents because of the difficulties in distinguishing unexpected forecast errors due to chance and those due to deliberate management bias (Healy and Palepu, 2001).

There have been various research that study of forward looking information from different aspects which mostly focus on voluntary disclosure of forward looking information due to its voluntary nature. Kent and Ung

(2003) studied voluntary disclosure of future earnings information for Australian companies and documented a positive significant relation between company size and disclosure of forward looking information. Moreover they found that companies with less volatile earnings tend to disclose more forward looking information probably because of larger companies having more stable earnings. Hossain et.al. (2005) document that independence of board of directors is found to be positively associated with disclosure level of forward looking information. Furthermore, Aljifri and Hussainey (2007) found that profitability has significant effect on the extent of forward looking information disclosure. Li (2009) indicated that there is a positive relation between forward looking statements existence in the MD&A and performance and size.

From another point of view, Bujaki et.al.(1999) studied nature of forward looking information disclosed in MD&As in Canadian companies and found that most of the forward-looking information is qualitative, company-specific and dominated by good news. Similarly, Clatworthy and Jones (2003) suggested that UK companies prefer to emphasize positive aspects of their performance. On the contrary, Hutton et.al (2003) examined whether managers make supplementary statements when they forecast earnings and whether that supplementary statements are related with the nature of the information for US companies. Their results indicated that managers are more likely to disclose more verifiable forward looking statements for good news forecasts, while they equally disclose good and bad news about future earnings.

Finally, Çelik et.al. (2006) examined firm characteristics affecting the level of forward looking information disclosure for ISE companies in Turkey. Their results indicate that the overall disclosure level of forward looking information is positively associated with company size and foreign offers, where a negative significant association is documented for ownership structure, profitability, level of foreign investment and the proportion of institutional investors. Moreover, Uyar and Kılıç (2012) examined the extent of forward looking information for Turkish manufacturing firms and identified the attributes of disclosure. Forward looking items regarded in their study were profits/profitability forecast, market share forecast, sales forecast, cash flow forecast, capital expenditure forecast, new investments forecast and share price estimation. Their results revealed that forward-looking disclosure level is not high among Turkish firms and majority of the disclosures are qualitative which are dominated by good news. Moreover, firm size and audit firm are important determinants of forward-looking information disclosure; where profitability, leverage, ownership structure, independent directors, listing age is found to be insignificant.

3.2.2 Disclosure and Corporate Governance

The definition of corporate governance differs according to the point of view. For instance from the aspect of suppliers of finance corporate governance is defined as the way in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer and Vishny, 1979). From a broad perspective corporate governance is a system of laws, rules and factors that control operations of a company (Gillan and Starks, 1998). However it is clear that the separation of ownership and control created the demand for corporate governance structure. Management (the agents) make the decision of in which assets to invest and how to finance them; the board of directors serve as an advisory and monitoring mechanism for the management. On the other hand, there exist the capital providers (principals) arising from firm's need to raise capital. Such a separation between capital providers and those who manage the capital created the demand for corporate governance structures (Gillan, 2006). This fact is known as the agency problem and corporate governance aims to mitigate the agency problem. Agency problem occurs between shareholders (principal) and the management (agents) in developed countries with diffused ownership of firms; where the same problem arise between minor and major shareholders in developing countries with concentrated ownership (Shleifer and Vishny, 1997). Moreover, law and its enforcement vary across countries and legal families. Code laws give investors weaker legal rights than common laws do (La Porta et.al, 1998); hence code law countries with poor investor protections indeed have significantly smaller debt and equity markets (La Porta et.al., 1997). Therefore, the crucial role of corporate governance is monitoring and controlling of management's activities (Benkel et al. 2006). It is apparent that corporate governance mitigates the conflicts between management and owners in common law countries mainly in countries with high investor protection; where it mitigates the conflicts between majority and minority shareholders in code law countries in which investor protection is poor. In this context La Porta et al. (2000) defined corporate governance as *"a set of mechanisms through which outside investors protect themselves against expropriation by the insiders"*.

Corporate governance mechanisms can be classified as internal namely institutional and external namely market-based. Internal corporate governance mechanisms are shaped by institutional and firm-specific facts; where externals are shaped by country-level rules and regulations set by the regulatory bodies or capital markets board (Dennis and McConnell, 2003). Current thesis focuses on internal corporate governance mechanisms since it investigates the relation between provisions and corporate governance for one country, Turkey in which country level rules and regulations are the same for all sample firms. Internal corporate governance mechanisms studied in the thesis are as follows: size of board of directors, independence of board of directors and CEO duality representing the structure of board of directors; ownership concentration and institutional ownership representing the ownership structure.

Accounting researchers have investigated relationships between corporate governance structure and disclosures in financial and annual reports since many years from different aspects. Therefore, in the following section initially, the components of corporate governance mechanisms will be discussed and then the research surrounding corporate governance and disclosure will be illustrated.

3.2.2.1 Structure of Board of Directors

Structure of board of directors is an important tool for strong corporate governance. The structure is shaped by the size of board of directors, independence of the board of directors and CEO duality. Size of board of directors is one of the debatable issues in corporate governance research. Different and opposing theoretical arguments exist in the literature to support either large or small board size. Even though size of board of directors is related to directors' ability to monitor and control managers (Lipton and Lorsch, 1992; Jensen, 1993), the direction of influence is unclear. While some argue that *"The greater the need for effective* *external linkage, the larger the board should be"* (Pfeffer and Salancik 1978); some support the view "*Keeping boards small can help improve their performance. When boards get beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control*" (Jensen, 1993). Several studies reveal a positive association between board size and firm performance (Chiang, 2005; Haniffa and Hudaib, 2006) and board monitoring (Anderson et al., 2004; Williams et al., 2005) supporting larger boards. Moreover, Williams et al argued that larger boards have more specialized skills and are better equipped to monitor management (Williams et al., 2005). On the other hand, some other studies found smaller boards are more efficient in discharging their responsibilities (Lipton and Lorsch, 1992; Jensen, 1993; Beasley, 1996). From this point of view, in larger boards coordination and communication problem may arise and that problem would affect the effectiveness of the board, hence financial reporting. Previous literature reveals that larger boards are positively associated with disclosure. Larger firms tend to have relatively larger boards and monitored by the various government agencies hence tend to disclose more information to avoid pressure from them (Wallace et al, 1994). Zaheer (2013) documented that larger board size positively affects the level of disclosure. It is also argued by Kent and Steward (2008) that larger boards are associated with greater level of disclosure.

Independence of board of directors is an important sign for strong corporate governance system. It is argued that appointment of independent members to the board of directors would enhance the perception of the board as an internal control mechanism (Fama, 1980), separate the decision management and control functions (Fama and Jensen, 1983), mitigate agency problem therefore create pressure for better disclosure (Forker, 1992). Independent directors are professional managers with expertise in decision control and responsible for performing tasks that involve serious agency problems between inside directors and shareholders, therefore independent directors are perceived as contributing to effective corporate governance. Moreover, independent directors have motivations to provide voluntary disclosure and minimize the risk from inside directors' poor management and from inside directors providing misleading information (Lim et al., 2007). Eng and Mak (2003) examined the impact of ownership structure and board composition on voluntary disclosure. Their results revealed lower managerial ownership and government ownership are positively associated with disclosure, however a negative association between independence of board of directors and corporate disclosure. Similarly with Eng and Mak (2003) and contrary to expectations, Patelli and Prencipe (2007) could not find significant association between independence of board of directors and forward-looking information disclosure. However, Ajinka et al. (2005) found that firms with more independent directors and greater institutional ownership are more likely to issue a forecast and are inclined to forecast more frequently. Likewise, Lim et al. (2007) examined Australian companies and found a positive association between independence of board of directors and disclosure. Their results illustrate that independent boards provide more voluntary disclosure of forward looking information. Moreover, association between independence of board of directors and disclosure level resulted with a positive association between two regardless items subject to disclosure are mandatory or voluntary (Chen and Jaggi, 2000).

The other component of structure of board of directors is the Chief Executive Officer (CEO) duality or sometimes referred as role duality. CEO duality refers to the situation where CEO is also the chairman of board of directors. It is suggested that the role of the CEO and chairman should be separated in order to avoid power concentration and increase the ability of controlling and monitoring the management's activities (Jensen, 1993). Previous literature provides evidence for CEO duality and disclosure level. Firms with CEO duality tend to provide lower voluntary disclosure; where firms without CEO duality tend to provide higher voluntary disclosure. Also the negative association between CEO duality and disclosure is weaker for firms with higher board independence (Gul and Leung, 2004).

3.2.2.2 Ownership Structure

Ownership structure comprises ownership concentration and institutional ownership in this thesis. Ownership concentration is defined as *"the extent to which a small number of shareholders own a large proportion of share capital"* (JeanJean et al., 2008). In developing economies ownership is heavily concentrated (La Porta et al, 1998) and also countries greater ownership concentration are characterized by poor investor protection (La Porta et.al., 1999). The literature about ownership concentration supports two opposite views. One is that concentrated ownership serves as a controlling mechanism on management and hence mitigates agency problems (Grossman and Hart, 1988); contrariwise concentrated ownership would serve agency problem if the interest of majority shareholders do not align with minority shareholders (Claessens et al., 2002). Chau and Gray (2002) examined the association between ownership structure and voluntary disclosure for Hong Kong and Singapore. Their results revealed a positive association between extent of outside ownership with voluntary disclosures. Additionally, they found that the level of information disclosure is likely to be less in family businesses.

Institutional ownership refers to the situation where the largest shareholder is an institution or not. As institutional owners are more sophisticated, and experienced with access to relevant information (Balsam et al., 2002), it is suggested that they would be more effective in controlling and monitoring management's activities (Siregar and Utama, 2008). Therefore, it is argued that substantial shares hold by institutional investors may lead higher disclosure of information to decrease information asymmetry (Diamond and Verrecchia, 1991).

As clearly identified in the literature above, previous research studied disclosure and corporate governance relation from different aspects. While some examined voluntary disclosure and corporate governance association; some studied mandatory disclosure and corporate governance association. Since current thesis focuses on provisions and corporate governance relation, and meanwhile provisions are future oriented items, it is obvious that forward looking information disclosure is considered. In this context, after the identifying the literature in disclosure of information in accounting research from a general sense and then providing the research focused on the relation between disclosure and corporate governance, the following section explains the provisions which are proxied for forward looking information.

3.3 Provisions as a Proxy for Forward Looking Information

3.3.1 International Harmonization of Accounting Regulations

The fundamental driving force behind the international harmonization of accounting regulations is the economic and political pressure to globalize. Accounting rules are shaped by market economics and politics in every country. Therefore, the progressive worldwide integration of the markets and politics reveals the harmonization that serves the interests of variety of stakeholders (Ball, 1995).

The attempt to globalize accounting standards actually arises in 1973 with the establishment of the International Accounting Standards Committee (IASC) by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom and Ireland, and the United States. Between 1973 and 2001, the committee was responsible for issuing the International Accounting Standards (IAS) and the standard setting body was known as the IASC Board. In 2001 International Accounting Standards Board (IASB) was formed as the successor of IASC Board, with the aim of developing organized and uniform arrangements in accounting by a set of high quality financial reporting standards with the new name International Financial Reporting

Standards (IFRS) though it continues to recognize the IAS. The new Board (IASB) was formed as the standard-setting body of IFRS Foundation that is an independent, not-for-profit private sector organization working in the public interest. Eventually, IASB is responsible for the development and publication of IFRS, including the IFRS for SMEs; and approving interpretations of IFRS that developed by the IFRS Interpretations Committee that certainly serves for international harmonization of accounting regulations.

3.3.2 IAS 37 Provisions, Contingent Liabilities and Contingent Assets

The Standard is issued at September 1998 by IASC and effective since 1 July 1999. Thereafter, in April 2001 the IASB adopted the Standard, which had originally been issued by the IASC in September 1998. The objective of the Standard is to provide that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and ensure that adequate information is disclosed in the notes to enable users to understand the nature, timing and amount of the concepts. In addition to recognition and measurement of provisions and contingencies, the Standard particularly explains obligatory event, past event, probable outflow, discusses specific applications for provisions, difference between provisions and other liabilities, as well as the relationship between provisions and contingent liabilities. Since the aim of the thesis is to focus on provisions the following sections will describe the Standard from the context of provisions.

3.3.2.1 Recognition and Measurement of Provisions

The Standard defines a provision as a liability of uncertain timing or amount (IAS 37, [10]). The term liability is defined in the Conceptual Framework for Financial Reporting as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (Conceptual Framework, 4.4.[b]). Therefore, a provision is a present obligation belonging to an entity with uncertain timing or amount and expected to result in an outflow from the entity of resources embodying economic benefits. As provision is said to be a present obligation, the concept of obligation should be clarified. A past event that leads to a present obligation is called an obligating event. The Standard determines if an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation then this situation should be called as an obligating event (IAS 37, [10]). As indicated in the definition, an obligation has two phases whether being legal or constructive. A legal obligation is an obligation resulting from a contract, legislation or other operation of law. On the other hand, a constructive obligation is an obligation resulting from an entity's actions where the following two cases exist;

- an established pattern of past practice, published policies or sufficiently specific current statement, the entity has indicated to other parties that it will except certain responsibilities, and

- the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities (IAS 37, [10]).

To recognize a provision not only the occurrence of present obligation is enough, but also the probability of an outflow of resources embodying economic benefits to settle that obligation should exist. The Standard declares that if the probability that the event will occur is greater than the probability that it will not, then that the event is said to be probable (IAS 37, [23]).

After ensuring that there is a present obligation arising from past events and settlement of that obligation will result in an outflow from the entity of resources embodying economic benefits, it should be questioned whether the amount of outflow can be estimated reliably or not. The standard indicates that use of estimates is an essential part of financial statements specifically for the items that are mostly uncertain in nature and these estimations do not affect their reliability (IAS37, [25]). However, the Standard also requires the best estimate of the expenditure to settle the present obligation which is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. In this process, judgment of the management of the entity which is supplemented by experience of similar transactions and reports from independent experts is required by considering, the risks and uncertainties that inevitably surround many events and circumstances. However, considering the conditions of uncertainty does not justify understatement of income or assets and overstatement expenses or liabilities as well as uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities (IAS 37, [36]).

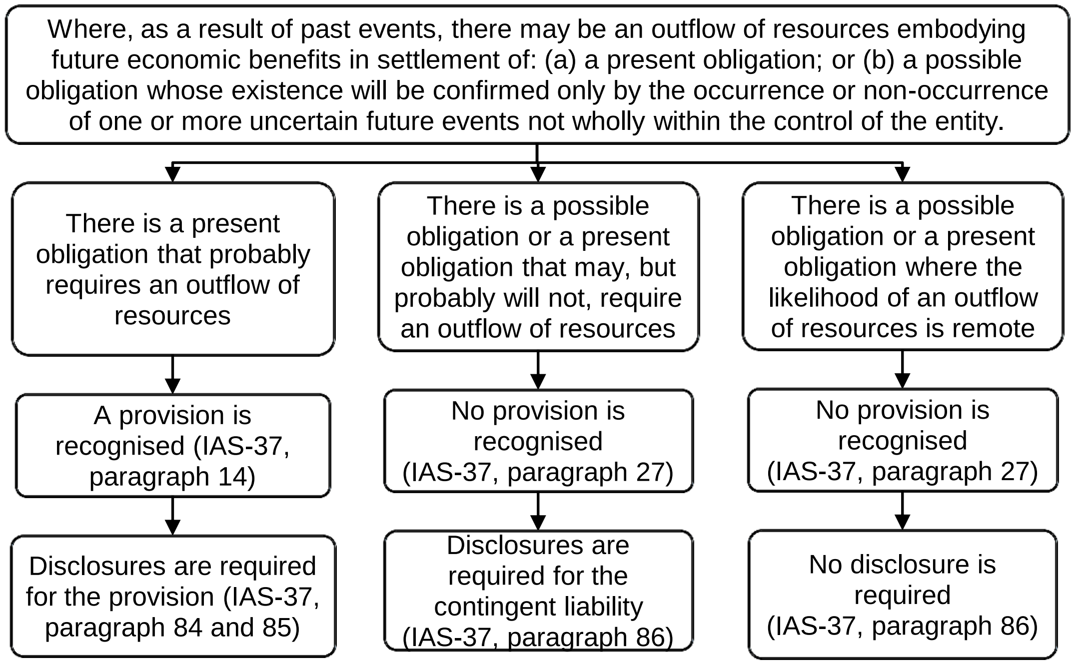
Furthermore, time value of money should be considered while estimating the amount of the expenditure to settle the present obligation. For the cases in which time value of money is material, the amount of provision shall be the present value of the expenditures expected to be required to settle the obligation. Therefore, provision amounts are discounted where the effect of time value of money is material (IAS 37, [45]).

At the end of each period entities shall review the provisions and if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision shall be reversed. However, if the obligation still exists entities shall make any necessary adjustments to reflect the current best estimate (IAS 37, [59]).

On the other hand to make the distinction between provisions and contingent liabilities is crucial. The Standard points out that all provisions are contingent because of their uncertain nature in terms of timing and amount. However, the Standard defines contingent liabilities for the non-recognized obligations because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Therefore, provisions are recognized as liabilities but contingent liabilities are not recognized as liabilities in the financial statements but they must be disclosed in the notes to financial statements (IAS 37, [12]).

Here below the Figure 2 summarizes the recognition of provisions and distinction between provisions and contingent liabilities;

Figure 2: Provisions and Contingent Liabilities



Source: IFRS Foundation, A Guide through IFRS: As at 1 July 2011/Part B

Furthermore, once a provision is recognized and then measured reliably, it should be disclosed in the footnotes to the financial statements also. The Standard requires the following information illustrated in Table 2 to be disclosed for each class of provisions;

Table 2: Disclosure Requirements for Provisions

For each class of provision, an entity shall disclose:	
IAS37:84(a)	the carrying amount at the beginning and end of the period;
IAS37:84(b)	additional provisions made in the period, including increases to existing provisions;
IAS37:84(c)	amounts used (ie incurred and charged against the provision) during the period;
IAS37:84(d)	unused amounts reversed during the period; and
IAS37:84(e)	the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.
An entity shall disclose the following for each class of provision:	
IAS37:85(a)	a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
IAS37:85(b)	an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48; and
IAS37:85(c)	the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.

Source: IASB, International Accounting Standards Board (2011), International Accounting Standard 37 (IAS-37) Provisions, Contingent Liabilities and Contingent Assets.

Finally the case below provides an example for the recognition and disclosure of provisions.

Case: Healty Food Inc. is a catering firm that serves lunch to several plants in their area. In 2013, twenty people died after a lunch at one of the plants which they serve possibly as a result of food poisoning. Legal procedures have been started seeking damages from the Healty Food Inc. At the end of the year the during the preparation of the financial statements the lawyers of the entity advised that, owing to developments in the case, it is probable that the entity will be found liable as a result of this court case.

Questions to be asked to evaluate the case in accordance with IAS 37:

1. Is there any present obligation as a result of a past obligating event? Yes, there is a present obligation as a result of a past obligating event which is ongoing court case that has a probability to end with the entity's liability, giving rise to a legal obligation.

2. Is there any probability of an outflow of resources embodying economic benefits in settlement of the court case? Yes, the settlement of court case will result with an outflow of economic resources embodying economic benefits; the entity will probably pay compensatory damage to the families.

3. Can a reliable estimate be made of the amount of the obligation? Yes, a reliable estimate of the amount of obligation can be made.

Result: A provision definitely provision for litigation should be recognized for the best estimate of the amount to settle the obligation.

3.3.2.2 Provisions in Turkish Accounting Literature

The Standard highlights the distinction between provisions with other liabilities. It is indicated that provisions should not be mixed up with other liabilities such as trade payables and accruals. Trade payables and accruals do not have uncertainty about timing or amount, though provisions have that uncertain nature (IAS 37, [11]). Difference between provisions and contingent liabilities are also explained within the scope of the Standard. Moreover, the Standard indicates that in some countries the term “provision” is also used in the context of items such as depreciation, impairment of assets and doubtful debts. However, these are adjustments to the carrying amounts of the assets and not in the scope of the Standard (IAS 37, [7]). Therefore, provisions have a nature to be mixed up with other liabilities. In Turkey, the term “provision” covers allowances, reserves as well as provisions for estimated liabilities in Turkey because of interpretation issues (Cemalcılar, 2001). In Turkey The Uniform Chart of Accounts came into force on 1 January 1994 with the aim of regulating the procedures and principles of accounting in Turkey for legal and real entities that keep accounting records on balance sheet basis. In the regarding Chart, there are 21 different accounts addressing provisions. However, in Turkish accounting literature these different 21 provisions actually refers different situations with the same term. In this respect, it should be stated that the term “provision” is used for several different situations which all have different structures in Turkey. Below the table (Table 3) summarizes the details about provisions covered by the Chart considering their groups, definitions and the nature of the situations. The accounts and their descriptions are directly gathered from Uniform Chart of Accounts.

Table 3: Provisions in The Uniform Chart of Accounts

Financial Statement/Group of the Account	Name of the Account	Definition/Coverage
BS/CA, Marketable Securities	Provision for Diminution in Value of Marketable Securities (-)	Provisions for losses arising from significant or continuous diminution in market values of marketable securities are followed up in this account in order to offset the effect of the losses.
BS/CA, Trade Receivables	Provision for Doubtful Trade Receivables (-)	This account consists of provisions for doubtful trade receivables. Provision for doubtful trade receivables are calculated by referring to the previous periods.
BS/CA, Other Receivables	Provision for Other Doubtful Receivables (-)	This account includes provisions made for doubtful notes receivable and doubtful receivables regarded as irrecoverable.
BS/CA, Stocks	Provision for Diminution in Value of Stocks (-)	This account is used for recording the provisions set-up for physical or economic losses incurred in the value of stocks due to natural disasters or other reasons that reduce the value of the market price of the goods.
BS/CA, Other CA	Provision for Other CA (-)	If the amounts of shortages on cash, stock and fixed asset counts which cannot be transferred to their related permanent accounts are more than the excess of counts, then the provision for this difference is followed up in this account.
BS/Non-CA, Trade Receivables	Provision for Doubtful Receivables (-)	This account consists of provisions for long-term doubtful receivables.
BS/Non-CA, Other Receivables	Provision for Other Doubtful Receivables (-)	This includes provisions made for long-term doubtful notes receivable and doubtful receivables regarded as irrecoverable.

BS/Non-CA, Financial Non-CA	Provision for Diminution in Value of Long-Term Securities (-)	When long-term marketable securities significantly or continuously diminish in market value, provisions for the arising losses are recorded in this account.
BS/Non-CA, Financial Non-CA	Provision for Diminution in Value of Subsidiaries (-)	A significant or continuous diminution in the market value of participation shares is followed up in this account.
BS/Non-CA, Financial Non-CA	Provision for Diminution in Value of Affiliated Companies (-)	A continuous or significant diminution in the market value of the participation shares of affiliated companies are followed up in this account.
BS/Non-CA, Financial Non-CA	Provision for Other Non-Current Financial Assets (-)	Continuous or significant diminution in value of other financial assets is followed up in this account.
BS/Non-CA, Other Non-CA	Provision for diminution in value of stocks (-)	To avoid the risk of any significant reductions in physical or economical values of stocks due to natural disasters like fire, earthquake, flood or deteriorating, decaying, spoiling, breaking or reductions in the market prices of the stocks due to technological improvements or changes in fashion, this provision account is used.
BS/STL, Provisions for Liabilities and Expenses	Provisions for Tax and Other Liabilities Relating to Profit of the Period	This account consists of provisions for corporate taxes payable on current year profit, other taxes and deductions, funds and other payables.
BS/STL, Provisions for Liabilities and Expenses	Provisions for Severance Payments	This account is used to record the provisions for severance payments which are payable within one year.
BS/STL, Provisions for Liabilities and Expenses	Provision for expenses relating to costing	This account is used to record the provisions for the estimated depreciation, repairs and maintenance, bonuses, financial and other such expenses during the course of determining monthly costs or allocating the expenses on a monthly basis which will be accrued during the following months or at the year-end.
BS/STL, Provisions for Liabilities and Expenses	Provisions for Other Liabilities and Expenses	This is the account in which the provision for STL and expenses is recorded.

BS/LTL, Provisions for Liabilities and Expenses	Provisions for Severance Payments (Long-Term)	This account is used to record the provisions for severance payments which are payable in the long-term.
BS/LTL, Provisions for Liabilities and Expenses	Provisions for Other Liabilities and Expenses (Long-Term)	Provisions for LTL and expenses are stated in this account.
IS/Income and Profit from Other Operations	Provisions No Longer Required	The cancelled portion of provisions provided for asset accounts are followed up in this account.
IS/Expenses and Loss from Other Operations	Provision Expenses (-)	Expenses relating to the provisions provided for the asset accounts are followed up in this account.
IS/Net Profit (Loss) for the Perios	Provisions for Taxation and Other Legal Liabilities	This account is used to record the provisions taxes and legal liabilities computed on the profit for the period in accordance with the related legislation.

Source: The Uniform Chart of Accounts (the documents of www.istanbulsmmmodasi.org.tr)

3.4 Summary

This chapter identifies the previous literature for the disclosure research in accounting, forward looking information disclosure and corporate governance. Definitions about disclosure and classification of information disclosed via financial and annual reports are illustrated. As this thesis focuses on forward looking information disclosure by studying provisions, research especially about forward looking information has been provided. With regard to corporate governance literature, definitions of corporate governance have been provided and coverage of corporate governance mechanisms is demonstrated. Meanwhile, corporate governance literature linked with disclosure research, hence the literature surrounding corporate governance and disclosure has been explained.

Furthermore, the third section of this chapter directly explained provisions regarding the Standard. Initially a general review about the international globalization of accounting standards has been provided. Then, directly considering the Standard definition of provisions, recognition and measurement of provisions via examples were illustrated. Since this thesis focuses on disclosure of provisions, the disclosure items are explained as well. Finally, provisions in Turkish accounting literature were discussed.

CHAPTER 4

RESEARCH DESIGN AND HYPOTHESES DEVELOPMENT

4.1 Introduction

This chapter aims to report the development of research questions, hypotheses, sample and data selection and description, and research design. The primary research question is to reveal the overall disclosure level of provisions in the scope of IAS 37 for BIST companies between the years 2005 and 2010. Secondly, this thesis examines the relationship between corporate governance and recognition of provisions. The remainder of this chapter is organized as follows. Section two briefly highlights the research objectives and research questions. Section three documents the hypotheses development. Section four clarifies the research emphasizing the sample and data specification process, disclosure level measure, and corporate governance measure. Section five presents the findings. Finally section six summarizes the chapter.

4.2 Research Objectives and Research Questions

Initially, the aim is to reveal to what extent provisions are disclosed in financial reports and its relationship with corporate governance structure of the firms. As extensively discussed in previous chapters, a provision is a liability of uncertain timing or amount that requires a reliable estimate of the amount of the obligation. The definition of provisions directly addresses that they can be considered as one of the forward looking information items in the financial reports. The Standard prescribes recognition and measurement of provisions and points out the disclosure requirements for the firms. Furthermore, The Standard indicates that in some countries provisions are also used in the context of items such as depreciation, impairment of assets and doubtful debts. However, these are adjustments to the carrying amounts of the assets and not in the scope of the Standard (IAS 37, paragraph 7). Turkey is one of the countries that face with this indicated problem (Cemalcılar, 2001). On the other hand, corporate governance is defined as a mechanism dealing to reduce agency problem and hence information asymmetry through some policies. Disclosure and transparency is one of those policies that cope with the information problem. Not only disclosure and transparency about historical information is required, but also disclosure and transparency for the forward looking information is discussed to be crucial for reducing information asymmetry between principals and agents (Bujaki et al. 1999). Therefore, this thesis aims to illustrate the effects of corporate governance structure on disclosure level of provisions which is one of the forward looking items in financial reports. For that purpose, first of all provisions regarding The Standard are examined in detail and the data are classified into subgroups. Therefore, a classification for provisions is illustrated since the standard does not address any specific type or group. Moreover, it is aimed to demonstrate the relationship between the corporate governance structure and the tendency of firms to recognize provisions or not. Lastly, the thesis examines the effects of corporate governance mechanisms on the amounts of provisions that are disclosed. Based on these research objectives and the prior literature, the following research questions were addressed;

Research Question I (RQI): What is the overall disclosure level of provisions in the context of IAS 37 for BIST companies between the years 2005 and 2010?

Research Question II (RQII): What is the relationship between corporate governance structure and tendency to recognize provisions under of IAS 37 for BIST companies between the years 2005 and 2010?

Research Question III (RQIII): What is the relationship between corporate governance structure and the amounts of provisions under of IAS 37 recognized for BIST companies between the years 2005 and 2010?

Research Question IV (RQIV): To what extent BIST firms apply the disclosure requirements for provisions that are specified in IAS 37?

4.3 Hypotheses Development

4.3.1 Provisions and Corporate Governance

Financial reporting serves as the measurement basis of the performance and therefore is considered as a bridge between users and companies. It is argued that the relevance and integrity of financial reporting depends on the parties involved in the financial reporting systems namely directors, management and auditors (Norwani et al, 2011). An effective financial reporting system requires an effective information system which of course requires an effective corporate governance structure (Baker and Wallage, 2000). Also, Corporate Governance principles indicate that *"The board of directors shall be held responsible for the preparation and presentation of the company's periodical financial statements in accordance with the current legislation and international accounting standards and the reliability and accuracy thereof"* (CMB, Corporate Governance Principles, 2.13). Thus, it is obvious that strong corporate governance structure effects financial reporting. Moreover, corporate governance has gained valuable importance in recent years by mitigating role on information asymmetry and agency problems and consequently influencing the financial reporting and disclosure quality. The information and agency frameworks raise a number of important questions for financial reporting and disclosure research such as the role of disclosure and financial reporting regulations in moderating information and agency problems from different aspects. A strong corporate governance structure in terms of board of directors and ownership structure aims to reduce the information asymmetry by providing users enhanced financial reports.

Furthermore, decision makers require information about the amounts, timing and uncertainty of the company's future economic inflows and outflows, namely they need a forward looking perspective in order to predict a company's financial future accurately (Berndt and Leibfried, 2007). Therefore, one way of providing useful financial reports to decision makers is enhancing the reports with forward looking information. Forward looking information covers any predictions that would help estimation consequently decision making. The Standard defines a provision as a liability of uncertain timing or amount. The uncertain nature of the timing and amount of future expenditures results from the forward looking characteristic of provisions. Therefore, provisions are used as a proxy for forward looking information in the thesis.

As indicated above, decision makers need enhanced financial reports to make wise decisions. One of the options to provide enhanced information to users is to disclose any information not only about past events but also for future probabilities. Therefore it is expected that corporate governance structure of firms and tendency to recognize forward looking items in financial reports have a relation.

This expectation is also supported by the previous literature. Ajinkya et al. (2005) report that firms with more independent boards and greater institutional ownership are more likely to issue a management earnings forecast and to forecast more frequently. Similarly Karamanou and Vafeas (2005) find that the likelihood of making a management earnings forecast is positively associated with stronger corporate governance in the form of more outside directors on the board, a lower level of managerial share ownership, a higher level of institutional share ownership and a smaller audit committee. However the distinction between “good” and “bad” corporate governance mechanisms is debatable. For instance for the size of board of directors, while some argue that *“The greater the need for effective external linkage, the larger the board should be”* (Pfeffer and Salancik 1978); some support the view “*Keeping boards small can help improve their performance. When boards get beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control*" (Jensen, 1993). For the ownership concentration again there are opposing views. One is that concentrated ownership serves as a controlling mechanism on management and hence mitigates agency problems (Grossman and Hart, 1988); contrariwise concentrated ownership would serve agency problem if the interest of majority shareholders do not align with minority shareholders (Claessens et al., 2002). However, higher independence of board of directors, the absence of CEO duality and higher institutional ownership structure are characterized with strong corporate governance structure. It is argued that appointment of independent members to the board of directors would enhance the perception of the board as an internal control mechanism (Fama, 1980), separate the decision management and control functions (Fama and Jensen, 1983), mitigate agency problem therefore create pressure for better disclosure (Forker, 1992). Moreover, it is suggested that the role of the CEO and chairman should be separated in order to avoid power concentration and increase the ability of controlling and monitoring the management's activities (Jensen, 1993). Finally, as institutional owners are more sophisticated, and experienced with access to relevant information (Balsam et al., 2002), it is suggested that they would be more effective in controlling and monitoring management's activities (Siregar and Utama, 2008). Therefore considering the relation of financial reporting and corporate governance, it is expected that the extent of forward looking information in the financial reports will differ according to the corporate governance structure. On the other hand, as determined earlier, provisions are used as a proxy for forward looking information and they are liabilities with uncertain timing and amount. Therefore, in order to test the relation between amounts of provisions recognized Total Provision/Total Debt ratio is calculated.

Eventually, based on the discussions above it is expected that firms with higher independence of board of directors, lower CEO duality and higher institutional ownership structure are more likely to recognize provisions in their financial reports. For the board size and ownership concentration, while it is expected a difference among firms, as their role is to enhance corporate governance changes based on some other factors (e.g. the country level corporate governance structure, the allignment or entrenchment effect, group behaviors), the direction of the difference may not be anticipated.

Consequently, the following hypotheses are developed to test the relation between provisions and corporate governance structure;

H1: There is a difference in corporate governance structure of firms that recognize provisions.

H2: TP/TD ratio will differ according to corporate governance structure of firms.

4.3.2 Disclosure and Corporate Governance

Dennis and McConnel (2003) characterize corporate governance mechanisms as external which are external market for corporate control and legal system and internal which are board of directors and ownership structure. As this thesis focuses on one country Turkey, external corporate governance mechanisms will not change for the firms. Therefore, internal corporate governance mechanisms are considered which are structure of board of directors and ownership structure. Structure of board of directors is formed by the board size, board independence and CEO duality. Board size is one of the crucial components of an effective corporate board and larger boards are associated with greater level of disclosure (Kent and Steward, 2008). Moreover, larger firms tend to have larger boards and monitored by the various government agencies hence tend to disclose more information to avoid pressure from them (Wallace et al, 1994).

It is also argued that an effective board of directors would largely include outside members. Also effective corporate boards are the ones which succeed in the separation of decision management and decision control (Fama and Jensen, 1983). Forker(1992) argued that independent directors are more responsive to investors and their appointment on corporate boards would improve the compliance with disclosure requirements, thereby; enhance the disclosure quality in financial reports. This argument is also supported by empirical research that finds significant positive relation between the level of disclosure and the proportion of independent directors on the board (Leftwich et al., 1981; Chen and Jaggi, 2000; Leung and Horwitz, 2004; Ajinkya et al., 2005). Therefore, it is expected that inclusion of independent members in the board of directors would not only increase the information disclosure but also be useful for monitoring boards' activities, and improving the transparency of corporate boards (Chen and Jaggi, 2000).

Moreover, one of the strong corporate governance signals is separation of the roles which is associated by not assigning the CEO as the chair of the board of directors. In order to mitigate agency problem, it is proposed that firms should provide timely and adequate disclosure of financial information. However, CEO duality would lead hiding unfavorable information from outsiders (Ho and Wong, 2001). Occupation of two positions by the same individual reveals the existence of "dominant personality" in the firm which would pose a threat to information disclosure by reducing monitoring quality and withholding information. Also, previous literature theoretically proves that dominance in the firm namely CEO duality, has been found to be negatively associated with poor disclosure (Forker, 1992).

Ownership structure and type of equity owners are crucial components to clarify the differences in extent of disclosure for firms (Haniffa and Cooke, 2002). Agency theory argues that separation of “ownership” and “control” would lead a potential for agency costs as a result of conflicts of interest between agents and principals. It is argued that the magnitude of the agency costs vary from firm to firm and may increase or decrease based on the extent of separation and control within a corporation. Since widely-held share ownership could result to greater conflicts between the owners’ and managers’, managers disclose more information than closely-held organizations. In this respect, to reduce the agency costs it is suggested that firms will disclose more information in the presence of a diffused ownership environment (Jensen and Meckling, 1976; Fama and Jensen, 1983). Besides, substantial shares hold by institutional investors may lead higher disclosure of information to decrease information asymmetry (Diamond and Verrecchia, 1991). Also there are studies that find a positive relationship between disclosure and the number of independent directors on the board (Leftwich et al. 1981; Forker 1992; Hossain et al. 2005), and a higher level of institutional ownership (Bushee and Noe 2000).

Particularly, since the absence of CEO duality, higher independence of the board and the existence of institutional ownership are signals for strong corporate governance mechanisms, it is expected that firms that make full disclosure of provisions are characterized by lower CEO duality, greater board independence and institutional ownership. As discussed in the previous part strong corporate governance mechanisms cannot be defined clearly for the board size and ownership concentration. Again a difference is expected among firms the direction of the difference may not be anticipated.

Based on the discussions above the following hypothesis is developed to test the relation between disclosure and corporate governance structure;

H3: There is a difference in corporate governance structure of firms that make full disclosure of provisions.

4.4 Research Methodology

This section initially determines the sample and data that will be used during the test of hypotheses. Afterwards, disclosure level measure, and corporate governance measures will be explained respectively. Finally, the analysis to test the hypotheses will be presented.

4.4.1 Sample and Data Specification

The thesis uses both the quantitative and qualitative data of non-financial firms listed on BIST between the years 2005 and 2010. The data used in the thesis are twofold. Initially to score disclosure checklist the data are drawn from financial reports of the sample firms, then, for corporate governance measure annual reports and Corporate Governance Principles Compliance Reports are examined. For BIST firms there is no available database either for the compliance with the standards or corporate governance. Therefore, the disclosure and corporate governance data were hand-collected both from the financial reports and annual reports from BIST website and Public Disclosure Platform website.

Firms that have different reporting periods other than January, 1 - December, 31 were excluded. As well financial firms were excluded. The final sample for the test of hypotheses comprises of 1078 firm-year observations. Below the table provides the sample composition classifying them according to the industry.

Table 4: Data Composition

INDUSTRY/YEAR	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Total**
Basic Metal Industries	12	12	12	12	11	12	71
Chemicals, Petroleum Rubber and Plastic Products	21	21	21	21	21	21	126
Construction and Public Works	2	2	2	2	2	2	12
Consumer Trade	4	5	6	6	6	7	34
Defense	1	1	1	1	1	1	6
Education, Health, Sports and Other Social Services	1	2	2	2	2	2	11
Electricity,Gas and Steam	3	3	3	2	3	4	18
Fabricated Metal Products, Machinery and Equipment	24	25	24	24	25	25	147
Food, Beverage and Tobacco	19	19	20	20	20	22	120
Information Technology	8	10	11	11	11	12	63
Mining	1	1	1	1	1	2	7
Non-Metallic Mineral Products	26	26	26	26	26	26	156
Other Manufacturing Industry	3	3	3	2	2	2	15
Paper and Paper Products, Printing and Publishing	13	13	13	13	13	14	79
Restaurant and Hotels	3	3	3	4	4	5	22
Telecommunication	1	1	1	2	2	2	9
Textile, Wearing Apparel and Leather	25	23	24	24	22	21	139
Transportation	1	2	2	2	4	5	16
Wholesale Trade	3	4	3	3	3	4	20
Wood Products including Furniture			1	2	2	2	7
Total	**171**	**176**	**179**	**180**	**181**	**191**	**1078**

4.4.2 Disclosure Level Measure

This section basically determines the disclosure level measure used in the thesis referring to disclosure index literature. Disclosure indices are extensive lists of selected items, which may be disclosed in company report (Marston and Shrives, 1991). Early studies of disclosure indices were pioneered by Cerf (1961) and afterwards, many researchers (Singhvi, 1968; Singhvi and Desai, 1971; Buzby 1975; Stanga 1976; Cooke 1989) have contributed to disclosure literature from various contexts and formalized the concept of "disclosure index".

Mostly used method in disclosure literature is calculating a firm-based disclosure score, applying a multivariate linear regression and associating with financial or non-financial firm characteristics (Chavent et.al., 2006). However one of the featured debates about this methodological approach is determining the disclosure index in other words scoring the disclosure items. Mainly, the debate is about item weighting concerning the sum of disclosed items whether to be weighted or unweighted. Various studies use unweighted index mostly referring as Cooke index (Cooke et al., 1989,Cooke 1992; Wallace et al., 1994; Meek et al. 1995; Raffournier, 1995; Wallace and Nasser, 1995; Patton and Zelenka 1997; Owusu and Ansah 1998; Chen and Jaggi, 2000; Jaggi and Low, 2000; Chau and Gray, 2002; Ferguson et al., 2002; Haniffa and Cooke, 2002; Archambault and Archambault, 2002; Chavent et al., 2006), where some others specially early ones use weighted index (Singhvi, 1968; Singhvi and Desai, 1971; Buzby, 1975; Stanga, 1976; McNally et al.,1982; Firth, 1984; Malone et al., 1993; Giner, 1997; Ho and Wong, 2001). The weighted approach is based on the assumption that the users of the reports attribute different importance to the different items in the index. This approach is criticized for creating the subjectivity problem that introduces a bias towards a particular user-orientation. On the contrary, the unweighted approach attach equal importance to all disclosure items considering the major argument of Cooke (1989) *“one class of user will attach different weights to an item than another class and that the subjective weights of user groups will average each other out”.* The approach has been credited for accruing less measurement error (Adrem 1999).

Moreover, the degree of researcher involvement in the construction of a disclosure index varies from “full-involvement” namely “self-constructed index”, to “no involvement” namely “pre-developed index”. Self-constructed index is fully constructed by the researcher in which the researcher includes selected and appropriate items of information. On the contrary, “pre-determined index” is an index that was developed in prior studies or by professional organizations (Hassan and Marston, 2010). In literature there are both examples for “self-constructed index” (Cooke 1989; Camfferman and Cooke 2002) and for “pre-determined index” (Patel et al, 2002; Ali et al., 2007; Barron et al, 1999; Hope, 2003a; 2003b; Richardson and Welker, 2001). Using a pre-developed index provides the researcher to have a chance of direct comparisons with previous evidence (Marston and Shrives, 1991).

This thesis uses an unweighted approach attach equal importance to all disclosure items. However, after scoring the disclosure items instead of calculating an index, observations are classified as "full disclosure" and "partial disclosure". The details of the construction of the checklist are explained below.

Disclosure checklist used in the thesis has been gathered from the disclosure section of The Standard. Disclosure requirement of The Standard comprises 8 different items for each class of provision. First five items are the amounts that are explicit and do not require judgment of the collector; however, following 3 items are controversial and requires the judgment of the collector (i.e. IAS 37:85(a) requires disclosure about a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits; IAS 37:85(b) requires disclosure about an indication of the uncertainties about the amount or timing of those outflows; IAS 37:85(c) requires disclosure about the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement). Therefore while building the disclosure checklist used in the thesis first 5 disclosure items are considered. However, first disclosure item [IAS 37:84(a)] requires the carrying amount of the provision at the beginning of the period and at the end of the period. That statement involves two different types of information. Consequently, this first disclosure item is regarded as two different items; so total disclosure index is formed for 6 disclosure items.

Construction of the disclosure checklist progressed as follows;

- Financial reports of the sample firms are hand collected from BIST website and Public Disclosure Platform website.
- Initially amounts of provisions are collected for the sample firms.
- Then, footnotes in the financial reports are examined in detail to build the disclosure checklist. An item-based disclosure index is used, in which a dichotomous procedure applied where an item scores “1” if it is disclosed and “0” otherwise. To assign the “0” score the applicability of the item each firm is considered. If the item is not applicable for that firm, it is coded as “not applicable” (NA) instead of “0”.
- Afterwards, firms with provisions are coded as “1” and, firms without provisions are coded as “0”.
- Finally, from the whole sample firms with provisions are sorted. The total score of those firms for the disclosure index is calculated. If the score is equal to 6, which is the total possible disclosure score, then this demonstrates that those firms made full disclosure of provisions for that year. There for it is coded as”1” which points out full disclosure. On the contrary, if the total

disclosure score is less than 6, it is coded as "0" which points out that those firms made partial disclosure of provisions for that year.

Disclosure items used in the thesis are illustrated with the table below;

Table 5: Disclosure Items

Disclosure Items	Codes	Item Description
Disclosure Item #1	IAS 37:84(a)	the carrying amount at the beginning of the period
Disclosure Item #2	IAS 37:84(a)	the carrying amount at the end of the period
Disclosure Item #3	IAS 37:84(b)	additional provisions made in the period, including increases to existing provisions
Disclosure Item #4	IAS 37:84(c)	amounts used during the period
Disclosure Item #5	IAS 37:84(d)	unused amounts reversed during the period
Disclosure Item #6	IAS 37:84(e)	the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate

4.4.2.1. Classification of Provisions

The construction process of the disclosure checklist has been explained in detail just above. Financial reports of the sample firms are studied and any information about provisions has been collected. Initial examination emerged 49 different types of provisions (i.e. Environmental Liability Provisions, Provisions for Restructuring Expenses, Short Term Warranty Provisions, Long Term Warranty Provisions, Labor Litigation Provisions, Other Litigation Provisions and etc.).

In order to clarify the provision concept used in the thesis and to refine the dataset, provisions reported under IAS-37 are classified initially into eight classes, according to their characteristics. However, after excluding outliers from the initial sample there remained only a few observations for provisions for risks. Thus, final classification of provisions comprise seven classes; Provisions for Litigation, Warranty Provisions, Provisions for Penalty, Legal Provisions, Provisions for Rehabilitation Costs, Provisions for Returns and Allowances, and Provisions for Customer Loyalty.

The description of the classes and their coverage are presented in Table 6.

Table 6: Provision Classes[5]

Provision Classes	Description and Coverage
Provisions for Litigation	referring to provisions for juridical, labor, commercial and administrative litigations filed against the company i.e. Labor Litigation Provisions, Rent Litigation Provisions, Short Term Litigation Provisions and etc.
Warranty Provisions	referring to provisions that a company recognizes the estimated liability to repair or replace products under warranty i.e. Short Term Warranty Provisions, Long Term Warranty Provisions and etc.
Provisions for Penalty	referring to provisions for penalties resulting mostly from legal and governmental regulations i.e. Penalty Provisions for Tax Exposures, Provisions for Overdue Interest Charge of Unpaid Taxes, Provisions for Obligatory Employment Shortage of Disabled People, Ex-convicts and Terror Victims and etc.
Legal Provisions	referring to legal provisions resulting from legal and governmental regulations, i.e. Adequate Pay Expense Provisions, Provisions for DHMI Agreement Shares, Provisions for Government Limestone Usage Compensation and etc.
Provisions for Rehabilitation Costs	referring to provisions for restructuring costs i.e. Environmental Liability Provisions, Provisions for Restructuring Expenses, Provisions for Land Restructuring, Provision for Asset Retirement Obligation, Rehabilitation of the Mine Sites and Shut Down of Mine, Provisions for Site Restorations and etc.
Provisions for Returns and Allowances	referring to provisions for any probable return of products from customers.
Provisions for Customer Loyalty	referring to provisions for premiums, bonus and similar special offers to customers i.e. Provisions for Promotions, Provisions For Customer Loyalty Program, Volume Rebate Provisions and etc.

[5] A similar classification can also be found in the study of Feleaga et al, 2010. They used provisions as aproxy for accounting conservatism and investigated the effects of national culture on recognition of provisions for 17 European countries. Their results indicate that conservative countries assign a significantly higher degree of uncertainty to their total amount of liabilities. Provision classes emerged in their study is as follows; Provisions for Litigation, Restructuring, Warranties, Environmental, Onerous contracts, Properties, Personnel costs, Abandonment, Marketing. However description and covergae of those classes are not provided.

4.4.3 Corporate Governance Measure

Corporate governance measure used in the thesis can be classified into two groups; structure of board of directors and ownership structure namely internal corporate governance mechanisms. Corporate governance mechanisms can be classified as internal (institutional) and external (market-based) mechanisms. Since the thesis examines the relationship between provisions and corporate governance for Turkey, namely just for one country, external corporate governance regulations does not change for the sample firms. This is why internal corporate governance mechanisms are regarded as corporate governance measure in the thesis.

Board of directors is characterized by the independence of the board, size of the board and CEO duality. Independence of the board is measured as the proportion of the independent directors to the total number of directors on the board (Ho and Wong, 2001). Measuring board of directors' independence is complicated if it is not obviously expressed by the firm. Therefore, the data for board of directors' independence were gathered initially from Corporate Governance Principles Compliance Reports, and then controlled from the website of Public Disclosure Platform and from the websites of the firms by using a retrospective approach. Besides, Corporate Governance Principles issued by Capital Markets Board of Turkey (CMBT) applies the following requirements for a board member to be qualified as an independent member;

- *"Not to have any direct or indirect relationship of interest in terms of employment, capital or trade and commerce between the company, its subsidiaries, affiliates or any other group company and himself/herself, his/her spouse and his/her blood or affinity relatives by up to the third degree within the last two years*,
- *Not to be previously elected to the board of directors as a representative of a certain group of shareholders,*
- *Not to be employed in a company, primarily for the audit and consultant firm, which undertakes full or partial activity or organization of the company under a contract and not to be have a managing position therein within the last two years,*
- *Not to be previously employed by the external auditor of the company or not to have been included in the external audit process within the last two years,*
- *Not to be previously employed by a firm providing significant amounts of services and products to the company and not to have a managing position therein within the last two years,*
- *For his/her spouse or any of his/her relatives by blood and affinity up to the third degree, not to have a managing position or be a shareholder holding more than 5% of the total capital or the controlling shareholder by all means, or not to hold a managerial position or not to be effective in the control of the company,*

- *not to receive any compensation other than the board membership compensation and attendance fee; to hold shares of less than 1% if he/she is a shareholder due to his/her duty, provided that such shares are not preferred shares" (CMBT, Corporate Governance Principles, part 3, substance 3.3.5)*

Consequently, in the thesis, considering these requirements, a board member is classified as independent when he/she meets all the criteria above.

Moreover, size of the board was measured as the number of members in the board. CEO duality refers to the situations where CEO is also the chair of the board of directors (Haniffa and Cooke, 2002). To measure CEO duality a dichotomous procedure was used where "1" is coded when the CEO and chair of the board is the same person and "0" otherwise.

Second phase of corporate governance measure is ownership structure which is characterized by institutional ownership and ownership concentration. Institutional ownership refers to the situation where the largest shareholder is an institution or not. While measuring institutional ownership a dichotomous procedure is used. If the largest shareholder is an institution "1" is coded and "0" otherwise to measure institutional ownership.

Ownership concentration is *“the extent to which a small number of shareholders own a large proportion of share capital”* (JeanJean et al., 2010). Basically, ownership concentration concentrates on the distribution of shares among investors. In the thesis, ownership concentration is measured with the percentage of shares held by the largest shareholder(s).

4.5 Results

4.5.1 Descriptive Statistics

Table 7 presents descriptive statistics for all firm year observations covering mean, median, standard deviation, minimum and maximum values of corporate governance and control variables. Mean and median of board of directors’ size (BOARD_SIZE) are 6.413 and 6, respectively; revealing that the firms in the sample have 6 directors on average ranging between 3 and 14 in the board of directors. When compared to US, UK and other European firms this number demonstrates small sized board of directors (Allegrini and Greco, 2013). Likewise, mean and median of board independence (BOARD_IND) are 0.48 % and 0 (zero), respectively, representing a quite low level of board independence relative to that of European firms reporting 0.77 (Desender et al, 2013), and US firms reporting 0.58 (Klein, 2002) mean values for board independence. Mean and median of CEO duality (CEO_D) is 0.163 and 0 (zero) respectively. The mean value of CEO duality implies that approximately 16.3% of observations in the sample have CEO duality where the remaining does not. Mean and median values of ownership concentration (OWN_CONC) are 48.86 and 49.11, respectively, illustrating that approximately 48% of sample firms' shares are held by big shareholders. Mean and median values for institutional ownership (INST_OWN) are 0.80 and 1, respectively, which implies that 80% of firms in the sample have an institutional owner. Furthermore, mean values of sum of provisions are 2117185.439 for litigation (PROV_LITIGATION), 2475279.557 for warranty (PROV_WARRANTY), 269771.2143 for customer loyalty (PROV_LOYALTY), 206341.9267 for penalty (PROV_PENALTY), 246508.0353 for rehabilitation costs (PROV_REHAB), 23676.00093 for returns and allowances (PROV_RETURN), and 29721.9666 for legal (PROV_LEGAL). These values reveal that the highest means belong to provisions for warranty initially, and then provisions for litigation. By disregarding the classification of provisions, mean value for sum of all provisions (PROV_TOTAL) is 5368484.139. Also the mean value of existence of a provision (PROV_EXIST) is 0.62 illustrating that 62% of firm year observations have at least one class of provision. Mean value of disclosure of provisions (PROV_DISC) is 0.32 figuring out among the observations that have at least one class of provision only 32% fully disclosed the requirements of the standard.

Table 7: Descriptive Statistics for All Firm-Year Observations

ALL VARIABLES					
Variables	**Mean**	**Median**	**Std. Dev.**	**Min**	**Max**
BOARD_SIZE	6.413	6	1.910	3	14
BOARD_IND	0.048	0	0.111	0	0.66
CEO_D	0.163	0	0.369	0	1
OWN_CONC	48.86	49.11	22.56	0.78	99.28
INST_OWN	0.80	1	0.399	0	1
PROV_LITIGATION	2117185.439	21424.5	13723133.14	0	252978000
PROV_WARRANTY	2475279.557	0	15227071.43	0	246192000
PROV_LOYALTY	269771.2143	0	2765721.172	0	41976000
PROV_PENALTY	206341.9267	0	1152739.065	0	16813000
PROV_REHAB	246508.0353	0	3024874.283	0	86023000
PROV_RETURN	23676.00093	0	333313.4544	0	7321412
PROV_LEGAL	29721.9666	0	366257.8314	0	7559094
PROV_TOTAL	5368484.139	143337.5	23104536.57	0	288168000
PROV_EXIST	0.62	0	0.484	0	1
PROV_DISC	0.32	0	0.469	0	1

n=1078 firm-year observations between the years 2005-2010. BOARD_SIZE is the Size of the Board of Directors; BOARD_IND is the Independence of the Board of Directors; CEO_D is CEO Duality; OWN_CONC is Ownership Concentration; INST_OWN is the Institutional Ownership; PROV_LITIGATION is the Sum of Provisions for Litigation; PROV_WARRANTY is the Sum of Provisions for Warranty; PROV_LOYALTY is the sum of Provisions for Customer Loyalty; PROV_PENALTY is the of Sum of Provisions for Penalty; PROV_REHAB is the of Sum of Provisions for Rehabilitation Costs; PROV_RETURN is the of Sum of Provisions for Returns and Allowances; PROV_LEGAL is the of Sum of Legal Provisions; PROV_TOTAL is the of Sum of All Provision Types; PROV_EXIST is the Existence of a Provision; PROV_DISC is the Disclosure of Provisions.

Table 8 documents the Pearson correlation matrix across all variables. The correlation coefficients assure that multicollinearity is not a serious problem for the variables since the correlation coefficients do not exceed 0.50 for most of the variables. Initially, there is a positive association between board size (BOARD_SIZE) and board independence (BOARD_IND). As the firm size gets larger, board size also gets larger, thus it is more likely to appoint independent members to the board. On the other hand, it is not surprising that CEO duality (CEO_D) and board independence (BOARD_IND) are negatively associated which implies that as CEO duality increases board independency decreases. The occupation of CEO position and the chairman position by the same person would probably decrease the board independency as that person would have significant influence on the appointment of independent members to the board of directors. Moreover, there is a positive correlation between ownership concentration (OWN_CONC) and board independence (BOARD_IND). This positive correlation illustrates that as the ownership concentration increases board independence also increases. This positive correlation is quite surprising since a negative correlation between board independence and ownership concentration is expected.

Furthermore, there is a significant negative relation between board size (BOARD_SIZE) and CEO duality (CEO_D). This result reveals that as the board gets larger in size, CEO duality tend to decrease. Also the significant positive relation between board size (BOARD_SIZE) and institutional ownership (INST_OWN) illustrates that firms with institutional owners are more likely to have larger boards.

In addition, CEO duality (CEO_D) has significant correlation between ownership concentration (OWN_CONC) and institutional ownership (INST_OWN). These negative correlations show that the firms with concentrated ownership and institutional owners are less likely to have CEO duality.

Institutional ownership (INST_OWN) is significantly positively associated with board size (BOARD_SIZE), CEO duality (CEO_D), and ownership concentration (OWN_CONC). These positive results indicate that institutional owners are more likely to be the big shareholder. Moreover, as institutional ownership increases, board size also increases.

Other than corporate governance variables and control variables, the correlation matrix clarifies the association between provisions and other variables. First of all provisions for litigation (PROV_LTG) is significantly positively correlated with board size (BOARD_SIZE) and institutional ownership (INST_OWN) which mean that firms with larger board size and higher institutional owners are more likely to have provisions for litigation. Provisions for warranty is significantly positively correlated with board size

(BOARD_SIZE), CEO duality (CEO_D) and institutional ownership (INST_OWN) which mean that firms larger board size, higher CEO duality and higher institutional owners are more likely to have provisions warranty. Provisions for loyalty (PROV_LYLTL), provisions for penalty (PROV_PNLYT) and provisions for returns and allowances (PROV_RET) are significantly positively correlated with board size (BOARD_SIZE). Those results imply larger boards are more likely to have provisions for loyalty, provisions for penalty provisions for returns and allowances. Similarly, the positive correlation between board size (BOARD_SIZE) and sum of all provision classes (PROV_SUM) supports the correlations above.

Table 8: Correlation Matrix

	BOARD_ SIZE	BOARD_ IND	CEO_D	OWN_ CONC	INST_ OWN	PROV_ LTG	PROV_ WRNTY	PROV_ LYLTL	PROV_ PNLYT	PROV_ REHAB	PROV_ RET	PROV_ LGL
BOARD_ IND	0.0775*											
CEO_D	-0.2061*	-0.0891*										
OWN_ CONC	0.0091	0.0554	-0.0646*									
INST_ OWN	0.2259*	0.0296	-0.2269*	0.5412*								
PROV_ LTG	0.1234*	-0.0021	-0.0547	0.0333	0.0659*							
PROV_ WRNTY	0.1947*	-0.0109	-0.0643*	0.0173	0.0808*	-0.0171						
PROV_ LYLTL	0.1255*	-0.0412	-0.0356	-0.0034	0.0484	-0.0133	0.8422*					
PROV_ PNLYT	0.0640*	-0.0073	-0.0409	0.0066	0.0594	0.0331	0.0108	-0.0126				
PROV_ REHAB	0.0271	0.0097	-0.0067	0.0109	0.0406	0.3947*	-0.0131	-0.008	0.022			
PROV_ RET	0.0764*	0.1024*	-0.0225	0.0740*	0.0302	-0.0092	-0.0116	-0.0061	-0.0127	-0.0058		
PROV_ LGL	-0.0308	-0.0351	-0.0245	0.0689*	0.0362	-0.0028	-0.0132	-0.0079	-0.0145	0.0069	-0.0058	
PROV_ SUM	0.2240*	-0.0115	-0.0828*	0.0347	0.1074*	0.6342*	0.7481*	0.6650*	0.0776*	0.3569*	-0.0009	0.0046

(***), (**) and (*) significant at %1, %5 and %10, respectively n=1078 firm-year observations between the years 2005-2010. BOARD_SIZE is the Size of the Board of Directors; BOARD_IND is the Independence of the Board of Directors; CEO_D is CEO Duality; OWN_CONC is Ownership Concentration; INST_OWN is the Institutional Ownership; PROV_LITIGATION is the Sum of Provisions for Litigation; PROV_WARRANTY is the Sum of Provisions for Warranty; PROV_LOYALTY is the sum of Provisions for Customer Loyalty; PROV_PENALTY is the of Sum of Provisions for Penalty; PROV_REHAB is the of Sum of Provisions for Rehabilitation Costs; PROV_RETURN is the of Sum of Provisions for Returns and Allowances; PROV_LEGAL is the of Sum of Legal Provisions; PROV_TOTAL is the of Sum of All Provision Classes.

Table 9 and Figure 3 show the average amounts of provisions for each classification according to year. Provisions for litigation points out an overall increasing trend however there is a sharper rise between the years 2007 and 2009. Similarly, provisions for warranty show an increasing tendency with a sharp increase in 2006. Provisions for customer loyalty display a remarkable rise in 2006 following a steadier trend in the coming years. Moreover, average provision amounts for penalty demonstrate a decreasing trend between the years 2005-2008 and then followed by an increase in 2009 and again a decrease in 2010. On the other hand provisions for rehabilitation costs illustrate a steady tendency between the years 2005-2008; and followed by a significant rise between the years 2008-2010. Provisions for returns and allowances show a decreasing tendency between 2005 and 2008, and then a substantial increase for the following years. Finally, legal provisions point out variable tendency, increasing between 2005 and 2007, then decreasing in 2008 and then again increasing in 2009 and 2010.

Moreover, Figure 4 and Figure 5 illustrates the change in average provisions in total over years and change in TP/TD ratio over years respectively. Results reveal that provisions in total show an increasing trend similar with the TP/TD ratio. However, from 2007 to 2008 average provision amounts show an increase, TP/TD ratio show a decrease. This may be because of the effects of 2008 crisis.

Table 9: Average Provision amounts in each category

Variables	2005	2006	2007	2008	2009	2010
PROV_LITIGATION	745727.1	1013697	1027878	2366533	3822491	3531722
PROV_WARRANTY	1721111	2638161	2473124	2489161	2680981	2794394
PROV_LOYALTY	165910.4	289715.8	255323.4	314369.7	325733.1	262856.6
PROV_PENALTY	243519.2	239678.2	203301.9	144264.5	225485.5	185549.3
PROV_REHAB	112811.7	69000.41	39324.14	35759.74	298291.5	873477.8
PROV_RETURN	4759.491	3714.676	2958.933	27763.55	50119.04	49510.15
PROV_LEGAL	956.9474	42118.6	54859.75	13848.07	28093.4	36996.4
PROV_TOTAL	2994796	4296085	4056770	5391700	7431194	7734507

PROV_LITIGATION is the Sum of Provisions for Litigation; PROV_WARRANTY is the Sum of Provisions for Warranty; PROV_LOYALTY is the sum of Provisions for Customer Loyalty; PROV_PENALTY is the of Sum of Provisions for Penalty; PROV_REHAB is the of Sum of Provisions for Rehabilitation Costs; PROV_RETURN is the of Sum of Provisions for Returns and Allowances; PROV_LEGAL is the of Sum of Legal Provisions; PROV_TOTAL is the sum of all provisions in total.

Figure 3: Change in average provisions over years considering the Provision Classes

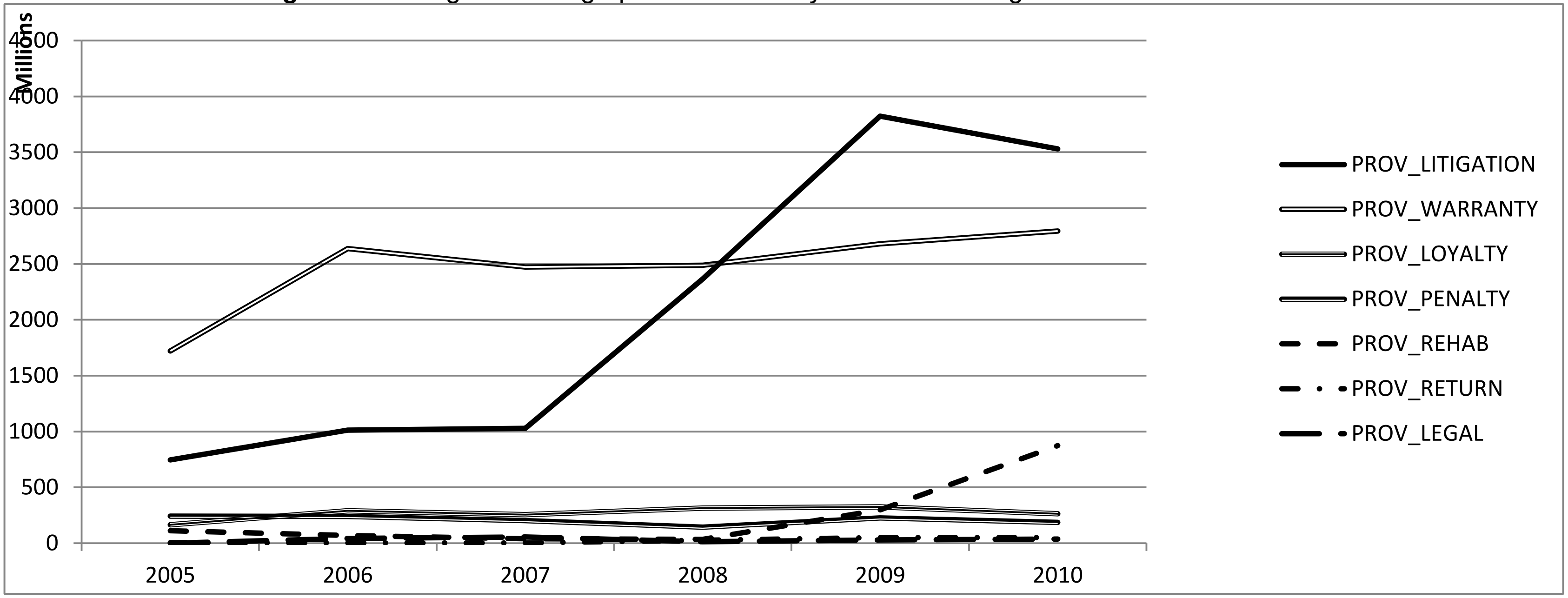


Figure 4: Change in average provisions in total over years

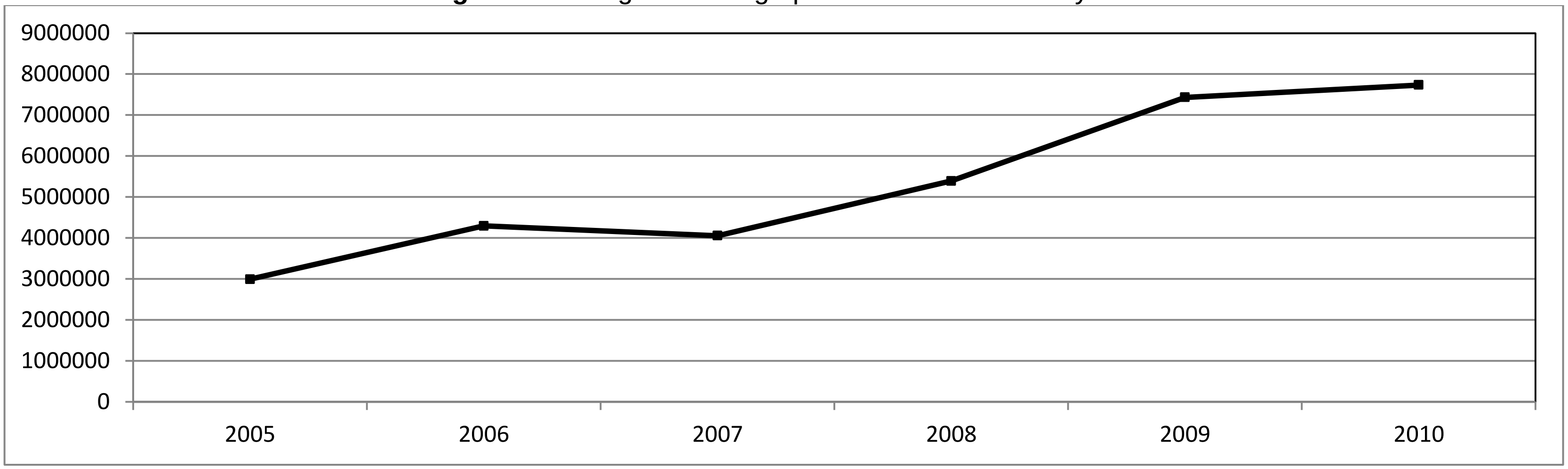
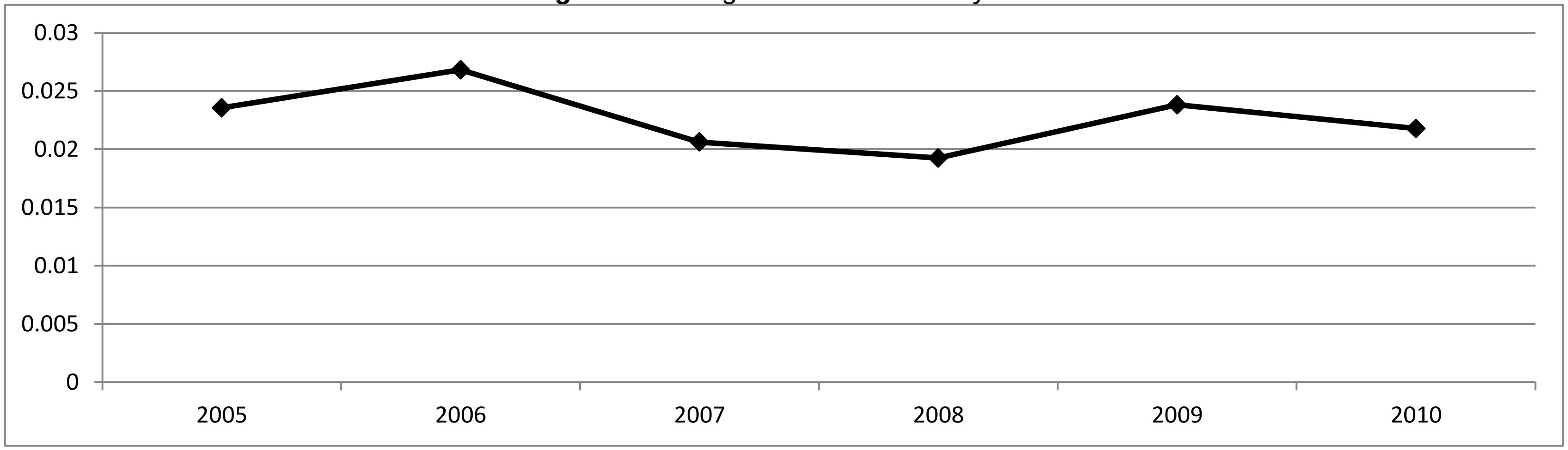


Figure 5: Change TP/TD ratio over years



4.5.2 Hypotheses Testing

In order to test the hypothesis 1 (H1), two different statistical tests were conducted; independent sample t-test and chi-square test. As previously explained in detail corporate governance variables cover size of the board of directors (BOARD_SIZE), independence of board of directors (BOARD_IND), CEO duality (CEO_D), ownership concentration (OWN_CONC) and institutional ownership (INST_OWN). Size of board of directors is measured with the number of members in the board of directors, independence of board of directors is measured as the proportion of the independent directors to the total number of directors on the board and ownership concentration is measured with the percentage of shares held by the largest shareholder(s), namely they are all numeric in nature. On the other hand CEO duality is measured with a dichotomous procedure where "1" is coded when the CEO and chair of the board is the same person and "0" otherwise. Likewise institutional ownership is measured with a dichotomous procedure where "1" is coded if the largest shareholder is an institution "1" is coded and "0" otherwise. Thereby, CEO duality and institutional ownership have categorical nature among corporate governance variables. Moreover, recognition of provisions is again measured with dichotomous procedure where "1" is coded for the observations that provision exists and "0" otherwise. Therefore, to test the difference in corporate governance structure of firms that recognize provisions in terms of size of board of directors, independence of board of directors and ownership concentration independent sample t-tests were conducted. For testing CEO duality and institutional ownership chi-square tests were conducted.

The thesis covers 1078 firm-year observations. Among those 1078 firm-year observations 674 of them recognize provision, 404 of them do not recognize provisions. Based on the independent sample t-test results, the firms that recognized provisions had larger size of board of directors (M = 6.593472, SD = 1.865703) than the firms that did not recognize provisions (M = 6.113861, SD = 1.948953), t(1076)=-4.0176, p =.0001. As well, the firms that recognized provisions had higher ownership concentration (M = 51.52126, SD = 22.58869) than the firms that did not recognize provisions (M = 44.43606, SD = 21.85462), t(1076)=-5.0459, p =.0000. The results suggest no significant association for independence of board of directors.

As indicated above two different chi-square tests of independence were performed to examine the difference between CEO duality and institutional ownership by recognition of provisions. Results reveal that there is a statistically significant difference in the institutional ownership structure between firms that recognize and do not recognize provisions where $\chi 2$ (1, n=1078)=11.8246, p<.01. Firms that recognize provisions are more likely to have institutional owners. The results suggest no significant difference for

CEO duality. According to the results, larger board of directors, ownership concentration and institutional ownership were significantly different for the firms that recognize provisions. Therefore Hypothesis 1 (H1) is partially accepted for the size of board of directors, ownership concentration and institutional ownership.

The results for of independent sample t-tests for size of board of directors, independence of board of directors and ownership concentration are revealed in Table 10 below.

Table 10: *Corporate Governance Variables' Mean Differences for Provision Recognition*

	Provisions			
	Recognized(n=674)	Not Recognized(n=404)	*t*	*df*
BOARD_SIZE	6.593472 (1.865703)	6.113861 (1.948953)	-4.0176***	1076
BOARD_IND	.0484669 (.1107855)	.0477293 (.1132532)	-0.1049	1076
OWN_CONC	51.52126 (22.58869)	44.43606 (21.85462)	-5.0459***	1076

Note. ***= p < .01. n=1078 firm-year observations between the years 2005-2010. BOARD_SIZE is the size of the Board of Directors; OWN_CONC is the ownership concentration; BOARD_IND is the board independence. Standard Deviations appear in parentheses below means.

The results of chi-square tests for CEO duality and institutional ownership are illustrated in Table 11 below.

Table 11: *Crosstabulation of Provision Recognition and Corporate Governance Variables*

	Provisions			
CEO Duality	Recognized	Not Recognized	χ2	Φ
Yes	105 (110)	71 (66)	0.7364	-0.0261
No	569 (564)	333 (338)		
Institutional Ownership				
Yes	562 (540.2)	302 (323.8)	11.8246***	0.1047
No	112 (133.8)	102 (80.2)		

Note. ***= p < .01. n=1078 firm-year observations between the years 2005-2010. Expected frequencies appear in parentheses below group frequencies.

In order to test Hypothesis 2 (H2) which argued that TP/TD ratio would change according to corporate governance structure of firms, independent sample t-tests were used for each corporate governance variable. Hence, a total of 6 different independent sample t-tests comparing the means of groups were conducted. The sample comprises 1078 firm-year observations which both cover observations that recognized and not recognized provisions. Since Hypothesis 2 (H2) focuses on TP/TD ratio, among those 1078 firm-year observations only the ones recognizing provisions were selected. Otherwise the ratio would be pointless. In the whole sample 674 observations recognized provisions where remaining 404 did not recognize. Therefore to test Hypothesis 2 (H2), initially TP/TD ratio for 674 firm-year observations was computed.

Later, natural logarithm of size of board of directors (LN_BOARD_SIZE) is computed[6]. Then, mean value of LN_BOARD_SIZE which is 1.812786 was selected as the group variable. The observations that are higher than the mean were coded as "1" and labeled as large boards; the observations that are lower than the mean were coded as "0" and labeled as small boards within the sample. For the independence of board of directors a similar procedure was followed. Again a dummy variable was created by coding the observations as "1" having at least 1 independent member and "0" having no independent member in the board. Moreover, the other corporate governance variable ownership concentration was labeled as high and low depending on the percentage of shares held by the largest shareholder(s) is higher or lower than 50%. If the percentage of shares held by the largest shareholder(s) is higher than 50% that observation is coded as "1" and labeled with high ownership concentration, and if the shares held by the largest shareholder(s) is lower than 50% that observation is coded as "0" and labeled with low ownership concentration. On the other hand, CEO duality and institutional ownership have categorical nature among corporate governance variables. If the CEO is also the chair of the board that observation is coded "1" and "0" otherwise.

[6] *"If the distribution of a variable has a positive skew, taking a natural logarithm of the variable sometimes helps fitting the variable into a model. Log transformations make positively skewed distribution more normal. Also, when a change in the dependent variable is related with percentage change in an independent variable, or vice versa, the relationship is better modeled by taking the natural log of either or both of the variables"* (http://dss.princeton.edu/online_help/stats_packages/stata/log.html). Also in literature there are studies that uses the natural logarithm of the board size (ie. Adams and Mehran, 2011; Weterings and Swagerman, 2012).

Similarly institutional ownership is coded “1” if the largest shareholder is an institution “0” otherwise.

Results revealed that TP/TD ratio is significantly different for size of board of directors (BOARD_SIZE), independence of board of directors (BOARD_IND) and ownership concentration (OWN_CONC). Based on the independent sample t-test results, the firms that have larger board of directors have higher TP/TD ratio (*M* = .0260522, *SD* = .0251544) than the firms that have small board of directors (*M* = .0193819, *SD* = .0433047), t(480.731)= 2.3925, *p* =.01. Moreover, the firms that have at least one independent member have higher TP/TD ratio (*M* = .0246553, *SD* = .0367217) than the firms that do not have any independent member in the board of directors (*M* =.0127213, *SD* = .0226533), t (289.171)= 4.6487, *p* =.0000. Finally, the firms that are engaged with high ownership concentration have higher TP/TD ratio (*M* = .0254147, *SD* = .0394519) than the firms engaged in low ownership concentration (*M* = .0198977, *SD* =.0226533), t (579.192)= 2.0159, *p* =.01. The results suggest no significant difference for CEO duality and institutional ownership. Therefore Hypothesis 2 (H2) is partially accepted for size of board of directors, independence of board of directors and ownership concentration.

The results are revealed in Table 12 below.

Table 12: *TP/TD Ratio Mean Differences for Corporate Governance Variables*

	Board Size			
	Small	Large	*t*	*df*
TP/TD	.0193819 (.0433047)	.0260522 (.0251544)	2.3925**	480.731
	Board Independence			
	No	Yes		
TP/TD	.0127213 (.0226533)	.0246553 (.0367217)	4.6487***	289.171
	CEO Duality			
	Yes	No		
TP/TD	.0299335 (.0485002)	.0210806 (.0315745)	-1.8013	120.769
	Ownership Concentration			
	Low	High		
TP/TD	.0198977 (.0301447)	.0254147 (.0394519)	2.0159**	579.192
	Institutional Ownership			
	Yes	No		
TP/TD	.0220964 (.0318382)	.0242833 (.0473376)	0.4683	131.704

Note. ** = p < .05, *** = p < .01. n=674 firm-year observations between the years 2005-2010. Standard Deviations appear in parentheses below means.

The main argument of Hypothesis 3 (H3) is the difference in corporate governance structure of firms that make full disclosure. Constructing the disclosure level index was explained in detail previously. The thesis focuses on 6 disclosure items for provisions. The total score of firm-year observations for the disclosure index is calculated. If the score is equal to 6, it is coded as “1” which points out full disclosure. On the contrary, if the total disclosure score is less than 6, it is coded as “0” which points out partial disclosure. Among 674 firm-year observations recognizing provisions 220 of them provide full disclosure where 454 provide partial disclosure. To test the difference in corporate governance structure of firms according to disclosure level independent sample t-tests and chi-square tests were conducted. The same procedure in Hypothesis 1 (H1) was followed for testing Hypothesis 3 (H2). For testing size of board of directors, independence of board of directors and ownership concentration independent sample t-tests were done as those variables are numerical where chi-square tests were conducted for testing CEO duality and institutional ownership as those variables are categorical.

Based on the independent sample t-test results, the firms that make full disclosure of provisions had larger size of board of directors (*M* = 6.890909, *SD* = 1.827469) than the firms that make partial disclosure (*M* = 6.449339, *SD* = 1.86896), t(672)= -2.8969, *p* =.003. Moreover, firms that make full disclosure had higher ownership concentration directors (*M* = 57.40218, *SD* = 20.47446) than the firms that make partial disclosure (*M* = 48.67148, *SD* = 23.0316), t(482.256)= -4.9797, *p* =.000. The results suggest no significant difference for independence of board of directors.

Results of chi-square tests reveal that there is a significantly difference in CEO duality between firms that make full disclosure and partial disclosure of provisions where $\chi 2$ (1, n=674) = 5.4149, p<.05. Firms that have CEO duality are more likely to make partial disclosure of provisions. In other words, firms that make full disclosure are less likely to have CEO duality.

Furthermore, chi-square tests illustrate a significant difference in institutional ownership between firms that make full disclosure and partial disclosure of provisions where $\chi 2$ (1, n=674) = 20.5827, p<.01. Therefore, firms that make full disclosure are more likely to have institutional owners. Consequently Hypothesis 3 (H3) is partially accepted for size of board of directors, CEO duality, ownership concentration and institutional ownership.

The results for of independent sample t-tests for size of board of directors, independence of board of directors and ownership concentration are revealed in Table 13 below.

Table 13: *Corporate Governance Variables' Mean Differences for Disclosure of Provisions*

	Provisions			
	Full Disclosure (n=220)	Partial Disclosure (n=454)	*t*	*df*
BOARD_SIZE	6.890909 (1.827469)	6.449339 (1.86896)	-2.8969***	672
BOARD_IND	.0537933 (.1155697)	.0458858 (.1084275)	-0.8687	672
OWN_CONC	57.40218 (20.47446)	48.67148 (23.0316)	-4.9797***	482.256

Note. ***= p < .01. n=674 firm-year observations between the years 2005-2010. BOARD_SIZE is the size of the Board of Directors; OWN_CONC is the ownership concentration; BOARD_IND is the board independence. Standard Deviations appear in parentheses below means.

The results of chi-square tests for CEO duality and institutional ownership are illustrated in Table 14 below.

Table 14: *Crosstabulation of Disclosure of Provisions and Corporate Governance Variables*

CEO Duality	Provisions: Full Disclosure	Provisions: Partial Disclosure	χ2	Φ
Yes	24 (34.3)	81 (70.7)	5.4149**	-0.0896
No	196 (185.7)	373 (383.3)		
Institutional Ownership				
Yes	204 (183.4)	358 (378.6)	20.5827***	0.1748
No	16 (36.6)	96 (75.4)		

Note. ** = $p < .05$, *** = $p < .01$. n=674 firm-year observations between the years 2005-2010. Expected frequencies appear in parentheses below group frequencies.

4.5.3 Further Analysis

As further analysis stepwise regression was conducted. The aim of running a stepwise regression is to build a model that predicts well or explains the relationship in the data by adding or removing variables. Forward stepwise method starts with the empty model namely no variables in the model. Then, continues to add the variables step by step considering their p-values. Finally, stops adding variables when no new variable remains significant. On the contrary, backward stepwise method starts with all independent variables and step by step the least significant variable is removed. Finally, stops removing variables when no new variable remains non-significant (Williams, 2007).

Initially, to evaluate whether size of board of directors (BOARD_SIZE), independence of board of directors (BOARD_IND), CEO duality (CEO_D), ownership concentration (OWN_CONC) and institutional ownership (INST_OWN) were necessary to predict the tendency of firms to recognize provisions (PROV_EXIST) a forward stepwise logistic regression was conducted. First of all, ownership concentration was entered into the regression equation and afterwards size of board of directors was entered. The prediction model contained two of the five predictor variables and was reached in two steps with no variables removed. The model was statistically significant indicating that predictors (chi square = 41.16, $p < .000$ with $df = 2$) ownership concentration (OWN_CONC) and size of board of directors (BOARD_SIZE) accounted for approximately 2% of the variance of recognition of provisions (Pseudo $R^2 = 0.0289$) which demonstrates a poor relationship between prediction and grouping. The odds of recognizing a provision would change by a factor of 1.01 for every percentage of increase in ownership concentration (OR_{OWN_CONC}=1.015047, p=0.000). Moreover, the odds of recognizing a provision would change by a factor of 1.15 for the increase in the size of board of directors (OR_{BOARD_SIZE}=1.150686, p=0.000). This indicates that when the size of board of directors is raised by one unit (one person) firms are 1.15 more times likely to recognize a provision. The results are revealed in Table 15 below:

Table 15: Forward Stepwise Logistic Model Results for Recognition of Provisions

Model	Odds Ratio	Coefficient	z
OWN_CONC	1.015047	.0142679	4.24***
BOARD_SIZE	1.150686	.1346755	3.88***

*Note: The dependent variable was recognition of provisions (PROV_EXIST), ***= p < .00. n=1078 firm-year observations between the years 2005-2010. BOARD_SIZE is the size of the Board of Directors; OWN_CONC is the ownership concentration, R^2 = .0291.*

Secondly, a stepwise multiple regression was conducted to evaluate whether size of board of directors (BOARD_SIZE), independence of board of directors (BOARD_IND), CEO duality (CEO_D), ownership concentration (OWN_CONC) and institutional ownership (INST_OWN) were necessary to predict TP/TD ratio. As step 1 of the analysis independence of board of directors (BOARD_IND) entered into regression equation and was significantly related to TP/TD ratio; afterwards CEO duality (CEO_D) was entered and again was significantly related to TP/TD ratio. Finally, the prediction model contained two of the five predictor variables and was reached in two steps with no variables removed. The model was statistically significant indicating that predictors [F (2, 671)=8.18, p<.000] independence of board of directors (BOARD_IND) and CEO duality (CEO_D) accounted for approximately 2% of the variance of TP/TD ratio (R^2 = 0.0238) which demonstrates a poor relationship between prediction and grouping. Furthermore, the correlation coefficient was -.0390366 indicating approximately 4% of the variance of the TP/TD ratio could be accounted for by independence of board of directors.

Table 16: Stepwise Regression Results for TP/TD

Predictor Variables	Coefficients	t
BOARD_IND	-.0390366	-3.24***
CEO_D	.008022	2.18**

Note: The dependent variable was Total Provisions/Total Debt ratio (TP/TD) ***= p < .00. , **= p < .05 n=674 firm-year observations between the years 2005-2010. BOARD_IND is the independence of the Board of Directors; CEO_D is the CEO duality, R^2 = .0238.

Finally, in order to evaluate whether size of board of directors (BOARD_SIZE), independence of board of directors (BOARD_IND), CEO duality (CEO_D), ownership concentration (OWN_CONC) and institutional ownership (INST_OWN) were necessary to predict disclosure of provisions (PROV_DISC) a forward stepwise logistic regression was conducted. First of all ownership concentration was entered into the regression equation and afterwards size of board of directors was entered. The prediction model contained two of the five predictor variables and was reached in two steps with no variables removed. The model was statistically significant indicating that predictors (chi square = 30.51, p<.000 with df=2) ownership concentration (OWN_CONC) and size of board of directors (BOARD_SIZE) accounted for approximately 3.5% of the variance of disclosure of provisions (Pseudo R^2 = 0.0358) which demonstrates a poor relationship between prediction and grouping. The odds of full disclosure of provisions would change by a factor of 1.01 for every percentage of increase in ownership concentration (OR_{OWN_CONC}= 1.017907, p=0.000). Moreover, the odds of full disclosure of provisions would change by a factor of 1.13 for the increase in the size of board of directors (OR_{BOARD_SIZE}= 1.137788, p=0.000). This indicates that when the size of board of directors is raised by one unit (one person) firms are 1.13 more times likely to recognize a provision. The results are revealed in Table 17 below:

Table 17: Forward Stepwise Logistic Model Results for Disclosure of Provisions

Model	**Odds Ratio**	**Coefficient**	**z**
OWN_CONC	1.017907	.0177488	4.62***
BOARD_SIZE	1.137788	.1290857	2.84***

*Note: The dependent variable was disclosure of provisions (PROV_DISC), ***= p < .00. n=674 firm-year observations between the years 2005-2010. BOARD_SIZE is the size of the Board of Directors; OWN_CONC is the ownership concentration,* R^2 *= .0358.*

4.6 Summary

In general, this chapter clearly identifies the research methodology and design. First of all research objectives and research questions were clarified. Then, considering the related literature about disclosure and corporate governance structure, hypotheses were developed. Afterwards, sample selection and data that will be used in the thesis were explained in detail. Finally, the results of analysis were revealed.

CHAPTER 5

CONCLUSION

5.1 Introduction

This thesis focuses on the relation between corporate governance and provisions under IAS 37. The thesis consists five chapters. Chapter one underlined the motivations together with the research objectives and research questions. Chapter two highlighted an overview of Turkish accounting and accounting related legal environment, particularly capital markets and globalization of accounting regulations. Chapter three reviewed the literature on corporate governance, disclosure and forward looking information, and then explained provisions underlying The Standard in detail. Chapter four clarified initially the research design and hypotheses development by revisiting research objectives and research questions. Also, chapter four explains the sample and data gathering process and measurement of variables. Chapter four concludes with the empirical tests and examine of the proposed research hypotheses.

Finally, this chapter concludes the thesis by interpreting the findings, expressing the contributions and explaining the limitations with further research suggestions.

5.2 Findings and Discussion

The aim of the thesis is exploring the overall provision structure for BIST firms and providing the linkage between provisions and corporate governance. In this context the results of the thesis reveals important findings on the relation between corporate governance and provisions under IAS 37. Specifically, the thesis examines the role of size of board of directors, independence of board of directors, CEO duality, ownership concentration and institutional ownership on forward looking information that provisions are used as a proxy under IAS 37. Initially, overall descriptive statistics indicate 62% of 1078 firm-year observations recognize provisions; and among the ones that recognize provisions only 32% provides the Standard's full disclosure requirements[7]. IAS 37 set forth the minimum disclosure guidelines which should be followed by

[7] Table 7: Descriptive Statistics for All Firm-Year Observations, mean values 0.62 and 0.32 for recognition of provisions and disclosure of provisions, respectively.

companies. Therefore the strictness of mandatory disclosure regime and enforcement power of accounting policy making bodies in Turkey should be examined. In the light of this issue, in previous years the president of IFAC has criticized auditors for declaring that financial statements comply with IASs when the accounting policies and other notes show otherwise (Cairns, 1997 from Street and Bryant, 2000). Since there is limited research on provisions under IAS 37, the thesis contributes to literature by exploring a provision classification which comprises Provisions for Litigation, Warranty Provisions, Provisions for Penalty, Legal Provisions, Provisions for Rehabilitation Costs, Provisions for Returns and Allowances and Provisions for Customer Loyalty. The highest mean values belong to Warranty Provisions and Provisions for Litigation as of 2117185.439 and 2475279.557, respectively. Data of the thesis covers 20 industries which cover 9 manufacturing, 11 non-manufacturing industries. However, in terms of firm-year observations there are 860 manufacturing and 218 non-manufacturing observations. Therefore, it is not surprising having the highest mean value for Warranty Provisions when considering the nature of the manufacturing industry [8]. Other than warranty provided for customers, similarly having a higher mean value of Provisions for Customer Loyalty for manufacturing firms may be interpreted as manufacturing firms consider their customers.

[8] Mean value of Warranty Provisions for manufacturing and non-manufacturing industries are 2904346 and 782631.3, respectively. Appendix 1, Table A1.

On the other hand overall descriptive statistics provides the results for corporate governance variables. The table comparing the results with US, European, Australian and Asian firms are below (Table 18). It is clear that Turkey has a relatively small board of directors with low independency and CEO duality. Also the ownership structure is highly concentrated and characterized by institutional owners.

Table 18: *Corporate Governance Variables: An International Comparison*

	Country	**BOARD_ SIZE**	**BOARD_ IND**	**CEO_D**	**OWN_ CONC**	**INST_ OWN**
The Thesis	*Turkey*	*6.41*	*0.48*	*0.16*	*48.86*	*0.80*
Allegrini and Greco (2013)	Italy	9.67	0.38	0.41	36.61	n/a
Karamanou and Vafeas (2005)	USA	11.60	0.78	n/a	n/a	0.58
Lim et al. (2007)	Australia	7.13	0.70	n/a	n/a	n/a
Ho and Wong (2001)	China	n/a	0.34	0.29	n/a	n/a
Haniffa and Hudaib (2006)	Malaysia	7.94	0.58	0.25	n/a	n/a
Desender et al (2013)	Spain	n/a	0.77	0.56	70.00	n/a

The remainder of the part focuses on the findings of the analysis regarding the hypotheses and interpreted in two groups as (i) provisions and corporate governance and (ii) disclosure and corporate governance.

Provisions and Corporate Governance

The relation between provisions and corporate governance is examined twofold. First phase explores the tendency of firms' to recognize provisions. The firms that recognize provisions have larger board of directors comparing to firms that do not recognize provisions. Also the firms that recognize provisions are more likely to be characterized with concentrated ownership and institutional owners comparing to firms that do not recognize provisions.

Hypothesis 1 is partially accepted only for size of board of directors, ownership concentration and institutional ownership.

Secondly, the role of corporate governance structure on the amount of provisions recognized is examined. Since provisions are liabilities, TP/TD ratio is used as a measure for the provision amounts. Results illustrate that firms that are characterized with larger board of directors, higher independence of board of directors and concentrated ownership have higher TP/TD ratios. Hence, the firms with larger board of directors, higher independence of board of directors and concentrated ownership recognize higher amounts of provisions.

Hypothesis 2 is partially accepted for size of board of directors, independence of board of directors and concentrated ownership.

Disclosure and Corporate Governance

The firms in the sample are grouped according whether they fulfill or partially accomplish the disclosure requirements of the Standard. Firms that make full disclosure of provisions are more likely to have larger boards. Moreover, firms that make full disclosure are more likely to have higher ownership concentration and institutional owners. Finally, firms that make full disclosure are less likely to have CEO duality.

Hypothesis 3 is supported for all corporate governance variables except independence of board of directors.

As clearly indicated in previous chapters, among the observations that recognize provisions, only 32% provide the Standard's disclosure requirements in full instead they are mandatory. The low mean score of disclosure level of provisions is consistent with the prior Turkish literature. Uyar and Kılıç (2012) studied the corporate attributes of forward looking information for Turkish companies and they found that the average forward-looking information disclosure index is 17.80%[9]. It is argued that non-compliance or full compliance with mandatory disclosure requirements is not always attainable in practice, and more especially in emerging economies. This may be due to less strict regulatory and enforcement systems, and high cost of employing professionally qualified accountants (Tai et al., 1990; Ahmed and Nicholls, 1994). Consequently, the low disclosure level might be attributed to the incentives about weakening the competitive position in the market, and/or the perception about provisions is bad news. Because prior literature suggests that firms tend to present good news, and hide bad news (Clarkson, 1994).

5.3. Contribution of the Thesis

Accurate corporate reporting is a necessary tool for the short-term and long-term survival of the firms hence the capital markets. Therefore, this thesis makes significant contributions to the literature by studying the financial reporting in Turkey considering disclosure level. Studying the level of disclosure will enable us to have additional insights about corporate reporting and will enhance our understanding of the nature of corporate reporting in developing countries. Disclosure practices by developing countries were empirically investigated in the past, however, the relation

[9] The items included in the study of Uyar and Kılıç (2012) are explained in Chapter 3 in depth.

between provisions under IAS 37 and corporate governance has been unexplored in the literature. Thus, this is a pioneering research on provisions and corporate governance structure. The contribution of the thesis is twofold. Initially the thesis contributes to forward looking information literature by using provisions as a proxy. On the other hand it contributes to IFRSs literature by studying one specific standard IAS 37 regarding provision structure and its disclosure level, in depth. Particularly, a detailed classification of provisions has been introduced by providing specific examples for each, as well.

Furthermore, this thesis contributes to corporate governance literature. The thesis reveals the internal corporate governance structure of BIST firms between the years 2005-2010. Moreover, the thesis explores the linkage between corporate governance structure of firms and provisions which is the first for the corporate governance literature.

This thesis is provides significant insights to government, investors, business management, regulatory bodies, educators, researchers, accountants, auditors and scholars particularly in the field of accounting by seeking to make theoretical and practical contributions in the area of accounting disclosures and also serves as bench mark for future researches on corporate disclosures.

5.4 Limitation of the Thesis

As with all research, there are several limitations of the current thesis. This thesis suffers from data constraints both for disclosure items and corporate governance variables. Due to the lack of a reliable database for internal corporate governance structure and disclosure, prohibitive costs of data collection preclude the thesis from having further information on variables. Data for disclosure focused only on 6 disclosure items; the results might be different if more items are considered. Moreover, a relatively small capital market of Turkey hence a limited firm-year observations also limits the findings generalizability.

The thesis also suffers from the lack of literature about provisions under IAS 37. The thesis actually investigates the relation between corporate governance and forward looking information by using provisions as proxy. However, the lack of literature directly focusing on provisions or IAS 37 appears to be one of the main limitations as well as one of the main contributions.

Finally, as all other disclosure index research current thesis is based on content analysis in which text units are classified into categories via computer-aided or human-coded. Reliability and validity of classification process is crucial in order to reach accurate inferences. Accordingly, the content analysis is human-coded in this thesis in order to have the advantage of the quantitative assessment of achieved reliability (Beattie et.al, 2004).

5.5 Recommendations for Further Research

In the view of the limitations of the current thesis the following suggestions are recommended for further study:

i. The thesis covers 1078 firm-year observations in BIST firms for the years between 2005 and 2010. Further research can consider increasing the observations by including recent year's data which will provide additional evidence on accounting disclosure practices in Turkey.

ii. The current thesis focuses on 6 disclosure items for provisions under IAS 37. Future research can consider the Standard as a whole and include the disclosure data for contingent liabilities and contingent assets.

iii. The thesis focuses on BIST firms in Turkey which is a relatively small capital market in emerging economy. Further research can be comparative including any other emerging economy's capital market data.

iv. The thesis focuses on mandatory disclosure items as they are indicated in the Standard. Further research can cover any other mandatory disclosure information specified in IASs/IFRSs and can provide comparative results about the compliance and strictness of the mandatory disclosure regime.

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APPENDIX I
SUPLEMENTRAY ANALYSES' TABLES

Table A1: *Provisions' Mean Differences Manufacturing and Non-Manufacturing Industries*

	Industry			
	Manufacturing (n=860)	Non-Manufacturing (n=218)	*t*	*df*
PROV_LITIGATION	981923.3 (28721262)	6595743 (4620490)	2.8765***	219.854
PROV_WARRANTY	2904346 (16929218)	782631.3 (3557463)	-3.3918***	1057.33
PROV_LOYALTY	336875.5 3093160	5048.06 45526.72	-3.1447***	860.466
PROV_PENALTY	184776.9 (971207)	291414.9 (1688811)	0.8955	254.457
PROV_REHAB	173135.8 (1487449)	535958 (6045514)	0.8794	223.698
PROV_RETURN	28307.74 (372563.5)	5403.991 (38930.32)	-1.7652	927.781
PROV_LEGAL	18108.38 (253111.6)	75537.03 (639945.7)	1.2995	234.458
PROV_TOTAL	4627474 (20192132)	8291736 (32010601)	1.6108	262.308

Note. ***= $p < .01$. n=1078 firm-year observations between the years 2005-2010. PROV_LITIGATION is the Sum of Provisions for Litigation; PROV_WARRANTY is the Sum of Provisions for Warranty; PROV_LOYALTY is the sum of Provisions for Customer Loyalty; PROV_PENALTY is the of Sum of Provisions for Penalty; PROV_REHAB is the of Sum of Provisions for Rehabilitation Costs; PROV_RETURN is the of Sum of Provisions for Returns and Allowances; PROV_LEGAL is the of Sum of Legal Provisions; PROV_TOTAL is the sum of all provisions in total.Standard Deviations appear in parentheses below means.

APPENDIX II
SUPLEMENTARY TABLES

Table A2: *Example for Provisions and Contingent Liabilities*

After a wedding in 2010, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of authorisation of the financial statements for the year to 31 December 2010 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 2011, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable.

(a) At 31 December 2010

Present obligation as a result of a past obligating event – On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion – No provision is recognised (IAS 37 [15,16]). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (IAS 37, [86]).

(b) At 31 December 2011

Present obligation as a result of a past obligating event – On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement – Probable.

Conclusion – A provision is recognised for the best estimate of the amount to settle the obligation (IAS 37, [14,16]).

Source: IFRS Foundation Guidance on implementing IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Table A3: *Example of a Warranty Provision Disclosure*

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the end of the reporting period, a provision of 60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. The following information is disclosed required by The Standard, paragraph 85:

A provision of 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years after the reporting period.

Source: IFRS Foundation Guidance on Implementing IAS 37 Provisions, Contingent Liabilities and Contingent Assets

VITA

Ece Acar was born in İzmir, on November, 19, 1980. She completed her high school education in Izmir Özel Türk High School in 1998. She studied Public Finance in Dokuz Eylül University where she received her bachelor's degree in 2003. She completed her master degree in European Studies at Izmir University of Economics in 2006, where she began to work as a research assistant at the department of Business Administration. She started her PhD in the Department of Business Administration, in a major field of Accounting, in Izmir University of Economics in 2007. As part of her PhD studies, during July-August 2008, she stayed at University of Texas at Dallas, Dallas, USA as a visitor researcher to make research on her PhD research subject. Since September 2010, she has been working as lecturer at the department of Business Administration.