Environmental Factors influencing Financial Reporting Practices and Development in Sudan

Nawal H. Abbas[1]

Abstract

The purpose of this paper is to investigate the factors that shaped and determined the current status of financial reporting practices in Sudan. The methodology adopted is descriptive as well as explanatory. The paper seeks to explore why the financial reporting system in Sudan remained deficient and unsound over an extended period of time. The research relies mainly on Secondary data; both quantitative and qualitative data are used. The analysis involves reviewing areas of the Sudan's economy, Politics, culture and financial and legal systems for the last two decades; the 1990's and the 2000's. The analysis is made in the light of the several environmental factors cited in the literature as being influential in determining the level of development of a country's financial reporting system.

The research has demonstrated that the current status of financial reporting practices in Sudanic substantially influenced and determined by three environments; the external environment of the accounting profession which includes the investment climate, the financial sector characteristics and the cultural factors; the internal environment of the accounting profession which comprises education and training and organizations regulating the profession and the regulatory environment that encompasses regulatory requirements and degree of enforcement of rules and regulations.

This is the first empirical study to investigate the different environments of financial reporting in Sudan and assess their impact on the quality of reported financial information. Thus it may be of help to those concerned with the accounting profession and its development.

Keywords – Financial reporting, accounting profession, investment environment, financial sector characteristics, culture, regulatory requirements.

[1] Assistant Professor, School of Management Studies, University of Khartoum, Khartoum, Sudan. E-mail nawalelhussein@hotmail.com

المتغيرات البيئية التي تؤثر على ممارسات وتطورات التقارير المالية في السودان

ملخص الدراسة

تهدف هذه الورقة التي اعتمدت منهجية وصفية تفسيرية إلى تقصي العوامل التي حددت شكل ونوعية ممارسات الإفصاح المالي الحالية في السودان. وتسعى الورقة إلى معرفة الأسباب التي أدت إلى قصور وضعف نظام الإفصاح المالي في السودان على مدى فترة ممتدة من الزمن. اعتمدت الدراسة أساساً على البيانات الثانوية والتي تضمنت بيانات كمية ونوعية. ينطوي التحليل والذي تم على ضوء العديد من العوامل البيئية التي ورد ذكرها في الأدبيات على أنها مؤثرة في تحديد مستوى تطور نظام التقرير المالي، على استعراض بيئة التقرير المالي السودانية المتمثلة في مجالات الاقتصاد والسياسة والثقافة والنظم المالية والقانونية على مدى العقدين الماضيين.

أوضحت الورقة أن الوضع الراهن لممارسات التقرير المالي في السودان قد حددته وشكلته بيئات ثلاث: البيئة الخارجية لمهنة المحاسبة والتي تتضمن مناخ الاستثمار، وخصائص القطاع المالي والعوامل الثقافية والبيئة الداخلية لمهنة المحاسبة والتي تضم التعليم والتدريب والمنظمات التي تنظم المهنة والبيئة التنظيمية والتي تشمل المتطلبات التنظيمية والقانونية ومدى الالتزام بتنفيذها.

تعتبر هذه الورقة أول دراسة شاملة لفحص البيئات المختلفة للتقرير المالي في السودان وتقييم أثرها على نوعية المعلومات المالية المنشورة وبالتالي فإنها قد تكون عونا للقائمين على مهنة المحاسبة وتطورها.

1. Introduction

The basic objective of financial reporting is to provide information that is useful to present and potential users of financial information in making rational investment decisions. The key characteristics of accounting information useful for decision making purposes are comprehensiveness, adequacy, fairness, relevance and reliability. To insure availability and flow of such information financial reporting systems need to be strong, effective and efficient. A sound financial reporting system is perceived as an essential prerequisite for economic development and growth.

Financial reporting systems in developing countries in general have been claimed by many researchers; Abayo and Roberts (1993), World Bank (2003), IMF (2004), Salehi and Velashani (2009), Mohammad and Soheila (2009) and Dahawy, et al (2010) to be deficient, unsound and unsuitable for the needs of developing economies. The alleged drawbacks of these systems as asserted by researchers are their low level of development, poor reporting and disclosure standards, fragile accounting professions, weak enforcement of standards, noncompliance with rules and regulations and failure to provide information suitable for investment decision making, which is the essence of their existence. Accounting information produced by those systems is insufficient, not readily available and lacks reliability, relevance and timeliness and as such is incapable of meeting information users' demand.

Research has established and demonstrated that the development of accounting system, the regulation of accounting profession and the attitude towards financial disclosure follow different patterns in different parts of the world. The rationale for such differences is that the development of a national system is a function of its environment. Several environmental factors have been cited in the literature as being influential in determining the level of development of a country's financial reporting system and the quality of financial information being disclosed. A number of researchers; the pioneers being Muller (1967), Nobes (1983), Parker (1984),Belkaoui (1985), Gray (1988), Choi and Mueller (1992), Radebaugh and Gray (1993), and Nobes and Parker (1995) concluded that accounting systems and their development are shaped by a combination of factors which can be categorized as economic, legal, political, cultural, professional, educational and international.

Being a developing country, Sudan is not an exception as regarding the current status of its financial reporting system. Studies that had researched areas of accounting information usage, accounting profession and securities market in Sudan; Eltayeb (1980), Rekabi (1984), Elmahi (1989), Hamza (1996), and Abbas (1999 and 2010) concluded that the country suffers deficient auditing and accounting professions, poor reporting and disclosure standards, accounting information which is either not readily available, irrelevant or unrealistic and false and insignificant usage of accounting information in internal and external decision making. The factors cited by these studies as possible causes for the low level of sophistication of accounting and auditing practices and low usage of accounting information in decision making in Sudan include: lack of a governing body to regulate the accounting and auditing profession in the country, lack of local accounting standards, shortage of qualified accounts and structure of enterprise ownership.

This paper seeks to investigate the environmental influences that have impeded the evolution and development of a sound and sustainable financial reporting system in Sudan. The remainder of this paper is organized as follows: section 2 reviews the literature concerning the environmental factors influential in shaping and determining the level of development of accounting systems. The financial reporting environment in Sudan is evaluated and analyzed in the light of these factors in section 3. Section 4 provides some concluding remarks.

2. **Literature Review**

It is argued that accounting is a product of its environment; it is shaped, affected and reinforced by characteristics unique to its prevailing atmosphere. The environmental factors causing differences in accounting systems and practices include a long list. Examples are stage of economic development, size and complexity of business, nature of business ownership, sources of finance, stage of development of capital markets, taxation, inflation, types of users of financial information, political and legal systems, colonial inheritance, culture, education, profession, religion,

and international factors. This variety in environmental factors implies that accounting systems and practices in different countries are more likely to be affected differently by different factors. What may be considered as an influential determinant of the accounting system in one country may just be a secondary factor for another. As a result a consensus is lacked as to the degree of importance accounted for by each of the environmental factors in shaping the accounting structure in a country. Some researchers emphasize the economic factors while several others consider culture as the most influential environmental factor. Yet a third group accentuates the political factors.

A discussion of how the above mentioned environmental factors can affect the accounting practices follows. However the long list of possible factors is regrouped as economic factors, political factors, legal factors, cultural factors, professional factors, and educational factors.

2.**1 Economic factors**

The relationship between the economic environment and accounting has been the subject of sizeable accounting literature; (Mueller 1967, Nair and Frank 1980,Belkaoui1983,Chio and Mueller 1984, Arpan and Radebaugh 1985,Belkauoi1985,Nobes 1988,and Adhikari and Tondkar 1992,).It is argued that factors such as type of economic system, stage of economic development, growth pattern of an economy, extent of government intervention and expenditures, inflation, level of exports, size and complexity of business firms, nature of business ownership, sources of funds and stage of development of capital markets can exert an important influence on the accounting practices of a country. Type of economic system is one of the key determinants of the status of the accounting system in general and financial reporting and disclosure in particular. The financial reporting system seems to benefit where there is a high degree of economic freedom, large private sector and relatively little intervention by the state, as success of private enterprises depends mainly on flow of adequate information between market participants. Stage of economic development and growth dictates the type and number of business transactions conducted in a country which in turn shapes the accounting system in use.

In small underdeveloped economies the need for financial information is minimal, however as the economy grows in size and complexity the demand for accounting information for decision making increases and this impacts favorably the financial reporting system. Extent of government intervention and expenditures also has a bearing on the state of accounting practice. According to Belkaoui (1983) the higher the level of government expenditures, the higher the level of government intervention and the better the adequacy of reporting and disclosure. Though this is applicable regardless of the type of economic system prevailing, however it is assumed that government intervention may be relatively influential in developing countries, as it ensures higher reliability and create public confidence and trust in corporations.

Inflation, if hyper and persistent, can render accounting information worthless. As a result efforts had been exerted by accountants to incorporate the impact of inflation on accounting information. This has led to usage of new measurement rules and procedures and accordingly different accounting practices. Level of exports also affects accounting practices because

exports necessitate free trade policies, cooperation with other countries and enhances flow of financing and consequently increases the need for adequate and reliable information. Thus it is maintained that the higher the level of exports, the better the reporting and disclosure practices.
Size and complexity of business firms is an important factor that determines the standards of reporting practices in a country. Business firms of different size and complexity require different methods and procedures for reporting their financial results. The larger the size and the more diverse the activities and markets of business firms, the greater the need for more sophisticated financial reporting techniques and consequently the more developed the accounting system and practices. Nature of business ownership impact on financial reporting is evident. When Business firms are either family owned and managed or incorporated as private limited companies disclosure of information about business activities will be restricted to those who are closely involved, namely its owners and management and this will affect adversely the financial reporting system by limiting the information available. In contrast when the dominance is for publicly held companies financial reporting and disclosure systems benefit; as those companies are publicly accountable and are obligated to be transparent and publish financial reports regularly.

Sources of funds are likely to have an influence on accounting systems and practices. In capital market economies there will be a demand for extensive public disclosure and for external audit. In credit based countries however, where economies are dominated by commercial banks providers of finance are likely to have privileged relationship with their clients which entitled them to private provision of timely and regular financial information. Accordingly the need for published information is minimal and reporting tends to be more conservative and directed to creditor preferences and requirements which centered on liquidity and solvency. Stage of development of capital markets is the most commonly agreed upon economic factor that plays a vital role in determining the level of development of a country's financial reporting system. It is held that capital markets enhance informed decision making through their ability to consolidate and transmit vast amounts of information from many sources through share prices. Hence countries with developed active capital markets tend to have strong financial reporting system, where asit is the opposite for countries with small inactive equity markets.

2.2 **Political factors**

Political factors have been cited by many authors as one ofthe determinants of the financial reporting systems and practices; Belkaoui(1983), Choi and Mueller (1984), Radebaugh and Gray (1993) and Nobes (1988). It is argued
that political freedom is important to the development of accounting in general and reporting and disclosure in particular. Political suppression which deprives people of their rights to select members of their government and participate in setting laws and policies is more likely to hinder the development of a strong accounting profession. This is because loss of freedom implies hindrance to the tradition of a full and fair disclosure. Thus
the relationship between political freedom and accounting freedom to report and disclose is claimed to be positive.

2.3 **Legal factors**

Impact of legal factors on accounting development and practices has been stressed by Choi and Mueller (1984), Belkaoui (1985), Radebaugh and Gray (1997) and Nobes (2004). Legal factors which include legal and tax systems play a role in determining the accounting standards, the amount of information to be disclosed and the pattern of information disclosure. Under civil law system which is characterized by detailed rules and regulations that are written into a collection, codified and not determined by judges, company law or commercial law sets in details rules for accounting and financial reporting, making the main objective of accounting adherence to laws and regulations. However accounting in common law legal systems which are basically non-legislative, is not subjected to a large number of detailed laws, as company laws put in general terms what information should be disclosed and how financial statements should be presented. Taxation also has a strong influence on accounting practices. Tax authorities are one of the most important users of accounting information and as such they exercise pressure to get the type of information they need and in the structure they prefer. In some countries the main purpose of financial statements preparation is determination of taxable profits, and so there is no difference between financial accounting and tax accounting. However in countries where published financial reports are deemed the main source for investment decision making, principles of accounting differ from those of taxation.

2.4 **Cultural factors**

Culture is considered as a powerful environmental factor that affects a country's accounting system and practices. The commonly held view is that the culture of a country influences its choice of accounting techniques.

Culture has been defined by Hofstede (1980),as "the collective programming of the mind which distinguishes the members of one human group from another". According to him culture is a collection of societal norms consisting of values, that is, a broad tendency to prefer certain state of affairs over others which is shared by major groups within a nation. He identified four underlying societal values which were recognized as common elements of culture; Individualism, Power Distance, Uncertainty Avoidance and Masculinity. Being a subculture within the society's culture accounting is expected to share common characteristic with other subcultures. Thus based on Hofstede societal values and a review of accounting literature and practices Gray developed four widely acknowledged accounting values that are used by many researchers to characterize a country's accounting system, that is, professionalism, uniformity, conservatism and secrecy. Though the general view regarding Gray theory is that it is difficult to test, some researchers have used the four value dimensions in comparative studies of accounting practice and voluntary social accounting disclosure. Colonial inheritance is also considered as one of the cultural factors that explain why a financial reporting system is the way it is; as colonial inheritance affects legal systems, culture and education and may result in direct importation of accounting systems. Additional cultural factors cited in the literature include attitude towards accounting profession, language and religion.

2.5 **Professional factors**

Relevance of professional factors to the level of development of the financial reporting system has been stressed by many; Chio and Mueller (1984), Nobes (1998) and Radebaugh and Gray (1993).It is claimed that the size, strength, independence and competence of accounting profession play an imperative role in determining the quality of a country's accounting system and practices. The more developed the accounting profession, the more flexible is the accounting system and the more its reliance on professional judgment as opposed to uniformity and compliance with legal rules and requirements.

2.6 **Educational factors**

Education is considered as an important determinant of financial reporting and disclosure. Though this view is originally held based on intuition (Gray 1988 and Cooke and Wallace 1990), empirical findings have supported it (Abayo and Roberts, 1993 and Ahmed and Nicholls, 1994). Level of education affects provision as well as usage of financial information. If accounting posts at all levels in company are occupied by those having good academic background in accounting, then they will be more inclined to preserve professionalism and disclose full, fair and reliable information However education is also essential for users of accounting information because if the demand function is weak, business entities may not be keen to provide the information appropriate for decision making. To sum up the factors that accounting research emphasizes as determinants of the state of financial reporting system and practices include economic, political, legal, cultural, professional and educational factors.

3. **Scope and Methodology**

This research is based on the accounting theory which conceives environmental factors as being the main rationale for accounting differences between countries and the key determinant of level of sophistication and development of financial reporting systems. Being the first attempt to study the determinants of the financial reporting system in Sudan and comprehend the reasons behind its current status, this paper employs the descriptive method of research. Generally if little is known about the phenomenon under investigation, descriptive research is needed. If however the phenomenon has been adequately described but its relationship to other phenomena are not known, then correlation studies are required. The methodology adopted is based on the prior contingency theory-based researches and models, namely, Mueller 1967, Radebaugh 1975, Frank 1979,Nobes (1983), Parker (1984), Choi and Mueller (1992), Radebaugh and Gray (1993), Nobes and Parker (1995), and Cooke and Wallace (1990).

The proposed model below identifies three environments that affect and shape the financial reporting system in Sudan; the external environment, the internal environment and the regulatory environment. The factors external to the accounting profession that are presumed to have a substantial influence on the accounting practice in Sudan are the investment environment, the financial sector characteristics and the cultural factors. The internal environment includes education and training and the accounting profession. The regulatory environment comprises the regulatory requirements and the degree of enforcement.

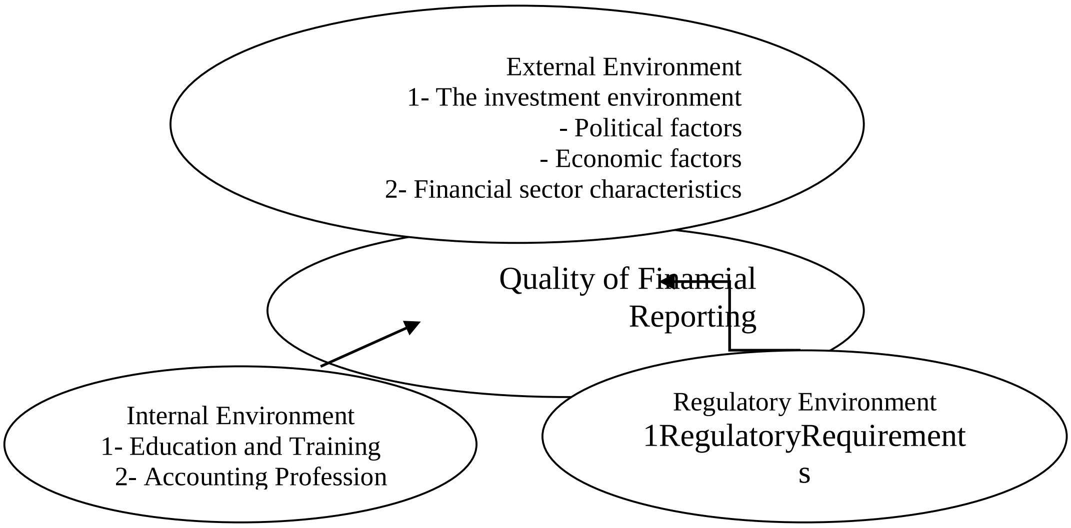

Figure 1. Environmental influences on Quality of Financial Reporting in Sudan

The methodology followed is descriptive as well as analytical. The research relies mainly on Secondary data; both quantitative and qualitative. The analysis involves reviewing areas of the Sudan's economy, Politics, culture and financial and legal systems for the last two decades; the 1990's and the 2000's. The accounting profession and its associated education and training are also examined in details. Various sources of information have been utilized to gather data for this study including research papers, articles, study reports, and official records.

4. The Analysis

The Quality of financial reporting reflects the in formativeness of financial disclosure, which depends on amount, reliability, adequacy, relevance and timeliness of disclosed information. In formativeness of financial disclosure is further ensured by ability of users of financial information to make informed decisions. As far as Sudan is concerned, the quality of its financial reporting has been demonstrated to be consistently low over an extended period of time. Researches covering different periods; 1980's, 1990's and 2000's have concluded that financial information is either not readily available, irrelevant or unrealistic and false. Further usage of such information in internal decision making and control and external users' decision is found to be insignificant.

In the following sections the determinants of the financial reporting in Sudan are reviewed and discussed.

4.1 The investment environment

The determinant factor in making investment decisions is the characteristics of investment environment, which is highly influenced by investors'' perception of risk relating to the prevailing political, economic and financial conditions. It is confirmed by experience worldwide that the country risk declines if it enjoys certain macroeconomic characteristics such as political stability, market-oriented economy, fair and sustained fiscal and monetary policies and normal financial relations with external creditors. Judging the Sudanese macroeconomic environment in terms of these characteristics reveals the inadequacy of this environment which in turns adversely affects inflows of capital, development and growth of corporate sector and availability and usage of accounting information in decision making.

4.1.1 Political Influences

Since its independence in 1956 Sudan has been ruled by six political regimes; three of which are democratic and the other three are military. The military regimes account for 44 years of the 55 years of independence by January 2011. Further the country suffers civil war between its Northern and Southern parts for 50 years; one year before its independence up to 2005 when a Peace Accord was signed by the conflicting parties. In addition an armed conflict between the government and a number of opposition parties still exists in its western part. These facts rendered the investment environment unattractive and uncompetitive. Military expenditure forms the major part of government spending and only very limited resources are directed to basic infrastructure and productive activities, it averaged 4% of GDP in the period 2000-2005. Moreover, due to an entrenched one-party state the country ranks high in corruption perceptions index (CPI), 172 in the 178-nation index and governmental financial transparency is weak. Many agencies have refused to be audited or give access to their records in the last three years and embezzlement and improper financial transactions increased
from $5.3 million in 2009 to $8.3 million in 2010.Domestic savers feeling the risk associated with investment in productive activities prefer to tie their savings in liquid assets or at best in real estate and properties. This is evidenced by the high percentage of currency in circulation as well as the increased investment in residential buildings. Money in circulation represents a sizable portion of the total money supply; an average of 37% for the 1990's and 27% for the 2000's.Investment in residential buildings averaged more than 47% of gross fixed capital formation during the 1990's.(Information for 2000's is unavailable.)

The external financing environment faced by Sudan reflects the financial isolation which the country suffers. The early years of the nineteen nineties witnessed the deterioration of political relation with the west and a number of Arab and African countries. This has a severe negative impact on official foreign flows which decreased substantially, from about US $ 159 million in 1991 to only US $ 1.5 million in 1995. During the last fifteen years foreign loans and grants stopped completely with the exception of some contributions from some regional organizations. These contributions decreased from US $ 34.7 million in 1996 to US $ 21.8 million in 2001.

However during the rest of the 2000's they increased to record a yearly average of US $ 297.6 million. This has limited government spending on infrastructure and development projects which are essential prerequisites for sound investment environment. Thus the political conditions in Sudan assume a major responsibility for causing investment environment to be daunting and discouraging.

4.1.2 **Economic factors**

The long years of military ruling, planned economy and public sector domination of overall economic activity have created a small and weak private sector and obstructed development of the notion of financial transparency. For more than 35 years, since its independence in 1956 and up to 1991 the Sudanese economy was led by the state. However in recognition of the failure of such closed state-led economy model to achieve sustainable economic development and growth, the Sudanese government has embarked in the early years of the nineteen nineties on economic and financial reform programs aiming at paving the way for movement towards a market-based economy. Reforms suggested are centered around liberalizing trade, currency and foreign investment; abolishing Privileges to public companies, monopoly and subsidies; encouraging private ownership and privatizing state-owned companies and setting consistent, stable and enforceable fiscal and monetary rules and regulations that increase investor confidence in public policies.

These macroeconomic and structural reform programs are expected to create an environment characterized by declining fiscal deficits, stable and realistic exchange rates and lower inflation. Although the program aged almost twenty years by the end of 2010, it does not seem to achieve what is expected of it. The exchange rate for the Sudanese Dinar Kept on deteriorating throughout the period 1995-2010, from SD 81 to one US dollar in 1995 to SD 243.6 to one US dollar in 2005. During the period 2006-2007 the exchange rate increased to record an average of SD 209.2 to one US dollar, but it sank to SD 275.5 to one US dollar by 2010 year-end reflecting the severe adverse impact of the financial crises. Further the country suffers excessive inflation during the 1990s; 78% annual average. Though the inflation rate decreased substantially throughout the period 2000-2007 to record an annual average of 8%,it plunged to 13.4% by the end of 2010.Though Sudan has maintained positive GDP growth rates since the implementation of the macroeconomic reform program in 1991, an average of 4% for the 1990,s and 7.6% for the 2000's,which are fairly above those for Northern African countries(an annual average of 3.1% for the 1990's and 6.5% for the 2000's),this yet again was not reflected positively on other economic indicators. The current account of balance of payment showed increasing big deficits throughout the nineteen nineties and two thousands; -16.3% of GDP for the 1990's and -10.5% of GDP for the 2000's (the average for Northern African countries was -2.4% for the 1990's and -0.7% for the 2000's).As well the government budget demonstrated continuous fiscal deficit averaging -5.1% of GDP for the 1990's and -2.1% of GDP for the 2000's (Northern African countries average for the 2000's was -0.8%). (Data for the 1990's is unavailable).

The ultimate goals of reduced government expenditure, controlled money supply and circulation, and stable exchange rate have not yet been reached. Government expenditure averaged 16% of GDP in the 1990's and 23% in the 2000's.Moreover the ratio of investment and development expenditure to total government expenditure is very low, it averages 12% of total expenditure for the 1990's and 19% for the 2000's (the regional average was 23% for the 1990's and 26% for the 2000's).Government revenue on the other hand fell far short of government expenditure; it represented 7% of GDP for the 1990's and 20% for the 2000's, whereas the average for the Northern African countries was 29% for both periods.

The rate of growth in money supply portrayed a general upward trend. It records an annual average increase of 61% in the 1990's and 29% in the 2000's. This is well above the annual money supply growth in most of Northern African countries, which ranged between 17% and 14% in the last two decades. Further the percentage of M1, which is considered as an ideal liquidity indicator, to total money supply is extremely high, it averaged 65%for the 1990's and 60% for the 2000's. This reflects the general tendency of public to keep their savings either outside the banking system or in banks in the form of current deposits just for the sake of facilitating settlement of payment obligations or simply for the sake of security and not for investment purposes.

The policies followed to stabilize the exchange rate for domestic currency or to establish a foreign exchange market did not seem to succeed. The exchange rate for the Sudanese Dinar continued its dramatic downward trend since the implementation of the macroeconomic reform programs, from US$ 0.125 in 1991 to US$ 0.0036 by the end of 2010. This is mainly due to the fact that the fiscal and monetary policies adopted are unclear, unstable and lack coordination. For instance measures undertaken to regulate foreign exchange dealings varies from an extreme of a free market, in which exchange rate is determined according to forces of supply and demand to a highly restricted market in which the rate of exchange is fixed and enforced by the central bank.

The experience of many developing countries indicates a favorable impact of normal payments relations with external creditors on domestic and foreign private sector's perception of the country transfer risks. Unfortunately Sudan suffers from a continuous growing imbalance between the external contractual obligations and its debt servicing capacity. This has resulted partially from inappropriate domestic policies and mainly from deterioration of political relations with granting countries especially western countries and failure of attempts to improve relationship with international financial institutions, namely, the World Bank and the IMF. This has obstructed rescheduling of external debt obligations or their treatment within the framework of the international debt strategy of debt forgiveness and debt and debt service reduction packages. By the end of 2009 the country's total debt amounted to US$ 35.7 billion, with over US$30 billion in arrears. IMF estimated Sudan external debt to grow up to US$ 37.8 billion by 2010 end. Due to debt arrears, Sudan has been deprived from any concessional financing from the international organizations.

The fiscal policies and procedures implemented to enhance and improve the productive sector suffered ambiguity and lack of coordination with fiscal policies in other areas. Moreover enforcement of such policies is very weak.

Though these policies clearly state that the major part of bank resources is to be directed to financing of productive sectors, some of these resources found its way to speculation and other non-productive activities. In addition tax burden on the productive sector is very high, more than what is officially stated due to additional fees and charges imposed by different state authorities. The privilege enjoyed by public sector can easily be noticed. Many public sector companies and corporations enjoy duty, fees and tax exemptions.

The narrowness of structure of enterprise ownership in Sudan has also impeded the development of an environment conducive to private investment. Most businesses in the country are family owned and managed. Those, which are incorporated, are characterized by high share concentration. To preserve corporate control in the hands of existing shareholders

small companies depend mainly on their own family resources and larger ones rely heavily on commercial bank loans for expansion and working capital. This has limited the size and complexity of business enterprises and accordingly the need for financial information. The privatization policy adopted as part of macroeconomic reform programs does not seem to impact favorably on the investment environment. In addition to its principle objective of improving enterprise performance, privatization was expected to increase the supply of equity for domestic and
foreign investors. This however was not the case in Sudan; as the different methods adopted for privatizing state owned companies in Sudan did not include share offerings. Out of the 60 governmental units disposed by the end of 2002, 16 were sold at low prices to private companies and individuals and 30 were freely transferred to some state government organizations. The rest were either leased or liquidated. Surprisingly while public sector corporations were being sold to the private sector, the government was establishing new ones. Khartoum state alone established 50 new corporations since the endorsement of the privatization program. This clearly defeats the objective of moving the public sector out of productive activities.
To conclude the economic environment which is characterized by high exchange rates, excessive inflation, high rates of growth in money supply, increasing fiscal deficits, huge external debt, worsening relations with international financial institutions and narrowness of the structure of enterprise ownership has discouraged private investment and adversely affected the financial reporting system by limiting the information available and rendering that available worth less.

4.2 **The Financial Sector Characteristics**

The characteristics of the financial sector represent another factor that plays an important role in shaping the financial reporting system and determining the quality of reported financial information. The general prescription for an appropriate financial system include well-capitalized, proper functioning and strongly regulated and supervised financial institutions and clear and enforceable financial policies. Judging the financial system in Sudan in terms of these characteristics reveals its inadequacy and weakness. Sudan has a relatively small financial sector relative to its regional peers; a total of 75 financial institutions by the end of 2010. These include the central bank, 38 commercial and specialized banks,15 insurance and reinsurance companies, 20 foreign exchange bureaus and one stock exchange. The banking sector is the backbone of the Sudan's financial system and is the primary source of financing for domestic economy. Almost all financing for productive activities comes from commercial banks; it amounted to a yearly average of SD 329 billion over the period 1995-2010. Compared to this figure financing through the stock exchange since its establishment in 1995 is negligible, a yearly average of 14 million over the period 1995-2010. However the banking sector does not seem to succeed in providing neither the type of funding needed nor the quantities required for growth and expansion of corporate sector. As regarding the first part of the problem, the type of funding, commercial banks tend to concentrate on short-term lending and are, thus, not able to meet the growing demand for medium and long-term credit required for economic development. Though this is mainly due to the structure of commercial banks deposits which are of short-term nature, high rates of inflation which render majority of investment with negative real returns induced banks to favor short term financing. With regard to the second part of the problem, the required quantities, funds available for financing from the banking sector always fall short of market demand. This is principally owing to the limited resources of the banking sector. The ratios of deposits to GDP and credit to GDP averaged 15% and 11% for the period 1995-2009 (regional averages were 20.8% and 13% respectively).Banks are undercapitalized; the ratio of capital to risk-weighted assets registered 11% percent in 2009, whereas regional average was slightly above 17% and the level of non-performing loans is high 20% of total outstanding loans by the end of 2009 compared to a regional average of 9.5%. The demand for the limited bank financing is further hindered by high financing cost. Although the cost of finance decreased substantially during the 2000's; an average of 12.6%, compared to an average of 36% in the 1990's, it is still very high compared to a regional average of 6%. Though established after extensive studies that dated back thirty years since its establishment in 1995 and despite being in operation for 16 years, Khartoum Stock Exchange (KSE) is still a very limited and underdeveloped capital market. In terms of all measures of stock market development KSE seems to lag far behind regional markets and least developed markets monitored by the International Finance Corporation. The market capitalization ratio averaged 4.6% over the period 1995-2010 which is well below the average market capitalization ratio for regional emerging markets which is 7.5% over the same period. The growth in number of listed companies also suggests slow stock market development. By the end of 1996 the number of listed companies was 40. In fourteen years' time the market has attracted only 13 companies, thus increasing the number of listed companies to 53 by December 2010. The KSE has a very low total value traded ratio over the period 1995-2010, 0.7% which is below the standards of IFC emerging markets, 2.3%. This reflects the very limited trading of equities when compared to the size of the economy and informs about the illiquidity of the market. The turnover ratio also indicates the limited volume of trading in KSE when compared to the value of the shares listed; it averaged 5.3% over the period 1995-2010 which is just equal to the regional average, 5.2%. This limited trading relative to the size of KSE is due to the fact that out of the 53 listed companies shares of only 25 companies do actually trade with the rest of companies never trading. Moreover, of the 25 companies only 12 companies trade frequently and the other 13 seldom trade. Thus the number of companies never or seldom trade represents 77% of listed companies (41 companies out of 53).

The few listed shares that frequently trade remained almost unchanged over the sixteen year period indicating an inactive and illiquid market. Measuring KSE in terms of degree of concentration also indicates its very limited development and growth. The largest ten companies accounted for almost 93% of the market over the period under study; indicating a narrow and shallow market. Judging KSE in terms of its principal objective of savings accumulation and capital mobilization reveals the fact that the market has not yet begun to play its role as a means for capital mobilization. Capital Mobilization Ratio which is the ratio of capital raised through the Stock Exchange to total fixed capital formation is very low. It averaged 1.1% for the sixteen year period, 1995-2010. This indicates that KSE contribution to country's stock of capital goods is very minor. The ratio of new issues to total shareholders' equity averages 10% for the period under study. However knowing that 85% of new issues came from only one company and the remainder from 14 companies out of the 53 listed companies, it can be inferred that KSE primary market is very limited and undeveloped.

These inadequate and weak financial institutions in addition to the instable, ambiguous and contradictory fiscal and financial policies have restricted the need for and the usage of financial information and impeded the development of the financial reporting system.

4.3 **The Cultural Factors**

Cultural factors and societal values in Sudan affect both the size and complexity of business and demand and usage of financial information. Colonial inheritance is considered one of the cultural factors that have an influential impact on the status of financial reporting in Sudan. The colonial impact can easily be noticed both in areas of education and legislation and regulation of accounting. Accounting education is British based and the main legislation governing financial reporting in the country, namely, the 1925 Act is also British. This has contributed greatly to the lack of local standards and deficiency of accounting practices that suit the Sudanese economic and cultural environments. Other cultural factors that have limited the usage of and demand for accounting information include high degree of secrecy in businesses, disbelief in public companies and mistrust between business enterprises and tax authorities. High degree of secrecy is due to the fact that many businesses are family owned and managed, which restricted disclosure of information to those who are closely involved, namely, owners and management. Public companies are believed to be of benefit only to mangers and members of board of directors. Poor performance of the majority of public companies in the country has contributed greatly to deepening of this belief. For instance out of the 53 public companies registered in KSE, the performance of only 15 companies can be considered as satisfactory. This has discouraged incorporation of companies which is evidenced by the small number of public companies compared to that of private ones; only 19% of registered companies are public and 81% are private. Loss of confidence in tax authorities in is caused by the general tendency of tax personnel to refute audited accounts presented for profit tax purposes and base tax liability on an assessed income. To guard against this businesses develop the practice of preparing two sets of accounts; one which reflects true financial position and it is for their own use and another which is manipulated for taxation purposes. Cultural factors that limit the growth of business in Sudan are high consumption rates, preference for tangible wealth such as precious metal and real estate and risk aversion which led to inclination for liquid and near-liquid assets and less risky, nonproductive activities. This has reduced investment in financial assets and consequently hampered the development of corporate sector.

4.4 **The Education and Training**

In Sudan the accounting education and training have expanded greatly since the early nineteen nineties. However the expansion was in terms of quantity and not quality. The emigration of a large number of academicians and professionals with higher degrees in accounting during the late nineteen eighties and nineteen nineties has adversely affected the quality of graduates of the most reputable universities. Furthermore difficulties of acquiring up-o-date educational materials and periodicals published abroad due to financing problems, has a negative impact on the accounting education in the country. Lack of concern of educational institutions and training centers about offering continuing training programs for accountants is another factor contributing to low standard and quality of accounting practitioners.

4.4 **The Accounting Profession**

The serious problem of lack of a governing body to regulate the accounting profession in Sudan, which is an important factor hindering the development of a sound accounting practice in the country, was solved by establishment of the Sudan Council of Certified Accountants (SCCA) in 1988, after attempts that date back to the early nineteen sixties. The council was entrusted to regulate and organize the accounting profession in the country. However the achievements of the council compared to its age, which was over sixteen years by the end of 2004, seem to be less than satisfactory. It issued only four standards and graduated 13 chartered accountants. This is caused by the over-lasting problem of political instability and government intervention. Failure of efforts to issue a comprehensive body of accounting standards and principles can mainly be attributed to lack of enthusiastic support by authorities and policy makers. This is because as asserted by Horngern (1976) the ability to set standards and legislate new laws and regulations is materially influenced by the power base on which the standard setters and legislators depend. Unfortunately in Sudan those responsible for accounting policy making are not always in power, sometimes they lack the strong support of those in power and sometimes although they have the power their political interests override their professional commitment. Moreover lack of cooperation and continuous conflict among practicing accountants have also impeded active participation of the SCCA in promoting the accounting practice in the country, and led to its dissolution in 2004 by the Constitutional Court and the establishment of a new council; the Council of Organizing the Accounting and Auditing Profession (CAAP). The new council is claimed by its advocates to provide the right legal framework, the proper tools, the extended membership and the required delegated authority to develop the accounting and auditing profession in the country. However no achievements towards its stated objectives have been materialized. Astonishingly since 2004 when the decree creating the Council was issued, the cabinet of ministers issued two resolutions: one in 2009reforming the board of the council and the other in 2010 dissolving that of 2009. Thus in contrast to the theoretical assertion of the positive impact of government intervention on financial reporting, it can be deduced that the continuous political conflict and government intervention assume key responsibility for the low level of development of the accounting profession in the country.

4.5 **The Regulatory Requirements**

The adverse impact of the regulatory requirement on financial reporting in the country is evident. Accounting practice in Sudan is regulated mainly by the 1925 Companies' Act. The Act is outdated and hence is incapable of meeting demands of changing business environment in the country. It does not provide for reporting of all information needed by users of accounts. For instance the Act ignores the requirement for an audited profit and loss account and does not provide for the preparation of cash flow statements or consolidated financial statements by holding companies. Many attempts had been made to amend the 1925 companies Act but unfortunately they failed completely. In mid nineteen seventies a committee entrusted with the evaluation and amendment of the Act submitted a comprehensive proposal for the necessary amendments, but for unknown reasons the whole matter was shelved and forgotten. Again in 1997 another committee was formed and assigned the duty of amending the Act or coming up with a new law, but the committee was spontaneously faded out. A third trial for updating the Act started in 2001, but yet again no achievements were made and 1925 Act persisted to exist. In fact the accounting practice in Sudan has gone far beyond the requirements of the old Act and when applicable the British companies' acts of 1948 and 1967 are followed, though they are not part of the financial reporting regulatory system. The other legislation affecting financial reporting accounting in Sudan includes the CAAP Act (2004), the Investment Promotion Act (1999), the Khartoum Stock Exchange Act (1994), the Auditor General Act (1986) and the Business Profit Tax (1986).

Some of these legislations have been amended and replaced several times in an attempt to update them but still they suffer some limitations and pitfalls. Others remained original as efforts to modify or replace them failed. For instance a proposed new act for KSE was initiated in 1999 and up to 2010 end nothing has been heard of it.

4.6 **The Degree of enforcement**.

A further shortcoming with the laws and regulations governing accounting practice in Sudan is their very weak enforcement. This is mainly due to fragile supervisory systems and shortage of qualified staff to closely supervise implementation of rules and regulations. In addition fines for non-adherence to laws and regulations are either lacked or not put into action. Also corruption plays a part in evasion of laws and regulations. Thus the regulatory environment of the financial reporting in Sudan has a negative impact on the supply of and demand for financial information.

5. **Summary and Recommendations**

In the light of the descriptive, explanatory and analytical study undertaken it is apparent that the financial reporting system in Sudan has been formed and largely affected by its surrounding environments; both external and internal. These environments have adversely affected inflows of private capital, development and growth of corporate sector, free flow of financial information and usage of accounting information for decision making. The constituents of the external environment that have contributed to the deficient accounting system and practices in the country include the political environment, the financial sector characteristics and the cultural factors. The internal factors that have impeded the development of the financial reporting in Sudan encompass education and training and accounting profession. In addition the regulatory environment of the financial reporting system has a negative impact on the supply of, demand for and quality of financial information. Though it is difficult to identify the degree each factor has played in shaping the financial reporting system in Sudan, it appears that the political factor assumes the major responsibility for the low level of development of the accounting profession in the country.

To enhance the financial reporting system the following recommendations may offer useful contributions:

First: an enthusiastic support for the macroeconomic reform programs is needed to boost the investment environment and make it more conducive and competitive. This is attainable through continuous monitoring and evaluation of these programs, coherent investment strategies, well-built infrastructure, sound and stable fiscal and monetary policies, fiscal and non-fiscal incentives to private domestic and foreign investors and more important serious government efforts to normalize financial and political relations with international financial organizations and donors to get the external finance which will provide an important supplement in supplying productive investments.

Second: Setting an action plan for accounting and auditing reforms which should center around enhancing the statutory framework of accounting and auditing through improved legislative, advocacy and strong enforcement of rules and regulations, strengthening capacity of the regulatory bodies, establishing an independent oversight body to monitor and enforce accounting and auditing standards and codes, enhancing and regular monitoring of professional education and training, upgrading the procedure of licensing practicing auditors and raising awareness of investors, directors, managers and auditors to improve the degree of compliance with financial reporting requirements.