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# EVALUATING THE EFFECT OF INVESTOR CULTURE ON INTERNAL CONTROL REPORTING AND INVESTOR PERCEPTIONS OF DISCLOSURE CREDIBILITY

## Abstract

Investors expect internal control reports to improve disclosed information credibility by demonstrating effective risk management, compliance, and transparency. Investment culture influences these expectations by shaping risk perception, emphasizing long-term stability, and setting standards for corporate governance. Thus, investment culture emphasizes robust internal control to enable a more thorough evaluation of investment opportunities. This study examines the relationship between internal control reporting and investor perception of disclosure credibility mediated by investor culture. The survey approach involved 166 respondents from 57 Jordanian brokerage firms. The partial least squares (PLS) method was used for analysis. The results showed that investor perception of disclosure credibility was influenced by internal control reporting as PV 0.000 and that investor culture positively mediated between the two variables as PV 0.000. Investors thus rely on internal control reporting to ensure the credibility of disclosure and aid their investment decisions. This study provides foundational knowledge to policymakers to design successful internal control reporting policies and support systems.

## Keywords

disclosure credibility, internal control reporting, investor culture, risk management, corporate governance, investment decisions, financial information, credibility enhancement, Jordanian brokerage firms

## JEL Classification

M42, M48, G11, G41

## INTRODUCTION

Disclosure credibility is the confidence of investors in management's trustworthiness and competence in disclosing financial information (Ozlanke, 2019). Current evidence shows that changes influence the ability of a firm to communicate information to investors in disclosure credibility (Balluchi et al., 2021). Internal and external information sources influence the perception of disclosure credibility. For instance, when a financial analyst, instead of management, draws attention to the alignment of reporting choices and managerial incentives, investors have a lower perception of disclosure credibility (Xiao & Shailer, 2022). Investors require comprehensive, relevant, and timely information to make investment decisions. In other words, investors should be able to evaluate the expected return for a given level of risk based on the disclosed information and its analysis (Bonna & Amoah, 2019). However, they are typically unable to actually assess whether a firm's disclosure is reliable or of quality because they lack the information to do so (Blankespoor et al., 2020). Investors must evaluate the quality



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and credibility of the information content of a firm's disclosure (Suharsono et al., 2020). Investors' perception of credibility may be as equally important as disclosure information in determining their reaction to disclosure (Hoang & Phang, 2021). To further enhance disclosure credibility, reporting entities must consider using other credibility-enhancing mechanisms (Sun, 2024). This is important because the perception of investors toward the credibility of the accounting information of a firm can increase their participation in equity markets and improve capital allocation efficiency (Rashid & Jaf, 2023).

## 1. LITERATURE REVIEW AND HYPOTHESES

Financial report reliability has been increasingly emphasized in recent years. Assurance of financial reports is critical because investors use reliable and accurate financial and non-financial data to make decisions (Hoang & Phang, 2021). Strong governance and control systems and reliable financial reports can also be developed with other mechanisms (Alabdullah et al., 2022). The amount of information that an investor can gather from a disclosure is determined by the credibility of the disclosure and the amount of new information that it contains (Jennings, 1987). Jennings also noted that investors consider credibility and new information in disclosures as equally important.

Financial statement users base their economic decisions on information provided about the financial performance, cash flow, and financial position of a firm. Investors or prospective investors are highly interested in a firm's income in an accounting period because it reflects its performance (Muhammad, 2023). From an information perspective, quality income results in positive investor responses in the form of stock price increases. Furthermore, by improving investors' perception of the reliability of accounting information, investors can be more driven to participate in equity markets and improve capital allocation efficiency (Houcine et al., 2022).

Also, Mercer (2004) designed a framework to assess investors' perception of disclosure credibility, noting that a key predictor is the degree of internal assurance, for instance, internal control. Information asymmetry can be minimized through disclosure and internal control while at the same time boosting the quality of the firm's earnings information quality. Internal assurance determines the perception of financial report users toward disclosure credibility (Farooq

& De Villiers, 2019). Disclosure perception is also determined by aspects of the internal control environment. For example, a firm with strong governance has higher reporting credibility, attracting more investments (Richard & Odendaal, 2021). Investors consider a firm as a good investment when it has no material weakness, provides mandatory disclosure, and has independent audit (Chan & Liu, 2023).

In another context, internal control is a series of policies, procedures, practices, and organizational culture that aims to provide reasonable assurance in achieving organizational goals and detect, prevent, and correct risky events (Jamil et al., 2020). Internal control disclosure is informative to market participants as it enables them to assess the effectiveness of a firm's internal control system (Lai et al., 2020). Consistent with the signaling theory, a firm's internal control disclosure signals to external stakeholders that its internal control system is of high quality and that its accounting and financial information and system are accurate and reliable. Exercising internal control over financial reporting ensures its reliability.

Investors are more likely to perceive a firm with ineffective internal controls as riskier than a firm with effective internal controls (Elsayed & Elshandidy, 2021). Internal control can perform the function of information transmission (Turner et al., 2022). Stronger internal control can lead to the disclosure of more credible information (Oradi et al., 2020). Additionally, the share of institutional investors in a firm increases along with the disclosure of internal control information.

Moreover, investor culture means that investment is made based on the scientific method and not rumors. The Internal Organization of Securities Commission defined four dimensions of investor culture: investment culture, smart investment culture, risk culture, and financial and accounting

culture (IOSCO, 2018). The ideal investor is smart, rational, knowledgeable, self-assertive, masculine, and autonomous (Hirsto et al., 2014), willing to be exposed to risks while remaining prudent, and active in the market (Tang & Lee, 2020). The ideal investor is capable of dealing with risks and uncertainties, earning returns from his exposure to them, through skillful wealth management (Singh et al., 2020). However, Xiao et al. (2022) argued that the average person often cannot behave rationally and responsibly due to the lack of financial capability. Culture influences the co-movements of stock prices across countries by influencing the correlation between the trading activities of an investor and the information environment of a country (Eun et al., 2015).

Empirical evidence indicates that culture is a predictor of reporting outcomes. Culture negatively relates to accounting fraud (Halimatusyadiah & Robani, 2021). Effective internal control is also positively correlated with a positive and active culture (Abiodun, 2020). Culture and investor protection also influence internal control reporting (Yang et al., 2020). Common language and culture and economic freedom influence investment (Lucke & Eichler, 2016). Similarly, investment decisions may be influenced by cultural differences within a country (Kandogan, 2023). Cultural values are also associated with disclosure decisions (Khlif, 2016). Culture is also found to be positively associated with reluctance to corporate reporting (Adnan et al., 2018). Also, investor culture is expected to mediate between the selected independent and dependent variables (Baron & Kenny, 1986; Thuneibat et al., 2022). The mediator is influenced by the independent variables and, in turn, influences the dependent variable.

Furthermore, the agency theory posits that the principal-agent relationship has inherent problems, for example, information asymmetry and moral hazard, because managers possess inside information and may engage in behaviors that maximize their own, not shareholders', interests (Jensen & Meckling, 1976). Consequently, investors are typically unable to actually assess whether a firm's disclosure is reliable or of quality because they lack the information to do so (Jennings, 1987). Investors must evaluate the quality and credibility of the information content of a firm's disclosure. Investors'

perception of credibility may be as equally important as disclosure information in determining their reaction to disclosure (Jennings, 1987).

In individualistic societies, agency problems are also exacerbated by the emphasis on personal goals (Dagnino et al., 2019). In such societies, shareholders demand voluntary internal control disclosure as a mechanism to monitor managers. At the same time, managers voluntarily provide such a disclosure because it is highly valued by shareholders. In contrast, the agency problem is modulated in collectivist societies. They place less value on internal controls, and so voluntary disclosure from managers is rare (Hooghiemstra et al., 2015).

While the agency theory has described the problems inherent in the owner-manager relationship and their solution (Schillemans & Bjurström, 2020), the nature and characteristics of these problems may be influenced by cultural values (Hooghiemstra et al., 2015). Therefore, an investor must espouse investor culture to truly determine the credibility of financial reports and make decisions based on their understanding of said reports. In this study, define investor culture according to the dimensions defined by IOSCO (2018):

1. Investment culture: Knowledge, scientific, and practical experience that help investors to make good choices and distinguish between investment opportunities.
2. Culture of smart investment: Keeping pace with and understanding rapid technological innovation and financial transactions via the internet.
3. Risk culture: Awareness and knowledge of the risks associated with investing and willingness to take on investment risks.
4. Financial and accounting culture: Ability to read and analyze financial statements and audit and control reports.

The aim of this article is to study the relationship between internal control reporting and perceived disclosure credibility and to examine how investor culture mediates this relationship in Jordan.

According to the literature review, the following hypotheses were formulated:

- H1: Internal control reporting influences investor perception towards disclosure credibility.*
- H2: Internal control reporting positively influences investor culture.*
- H3: Investor culture positively influences investor perception towards disclosure credibility.*
- H4: Investor culture mediates between internal control reporting and investor perception towards disclosure credibility.*

## 2. METHODOLOGY

This study employed a quantitative survey design. Primary data were collected using a questionnaire comprising close-ended items adapted from the literature (e.g., Ge et al., 2021; Weli et al., 2019; Hussein, 2018; Ali et al., 2016; Triki et al., 2015; Triki, 2015). A five-point scale was used to measure the items. SmartPLS was used for descriptive and inferential analysis.

Questionnaire validity was established through review by academics, and the items were corrected according to the feedback. Reliability was established using Cronbach's alpha: investor culture (0.72), internal control reporting (0.81), and investor perception towards disclosure credibility (0.78). Therefore, the questionnaire was valid and reliable.

The questionnaire was distributed to 175 brokers from 57 Jordanian brokerage firms. They were selected because of their familiarity and knowledge with the research subject. They help investors to buy and sell securities and make investment decisions. Table 1 shows the variables, their items, and the sources of the items.

**Table 1.** Questionnaire items

No.	Variable	Code	No. of items	Reference
1	Internal control reporting	ICR	10	Ge et al. (2021), Weli et al. (2019), Deumes (2000)
2	Investor culture	IC	10	Ali et al. (2016), Hussein (2018)
3	Investors' perceptions of disclosure credibility	PDC	8	Triki (2015)

## 3. RESULTS AND DISCUSSION

Data analysis was carried out in two stages: measurement model assessment and structural model assessment. Assessment of the measurement model aims to ensure the convergent and discriminant validity and reliability of the model. SmartPLS version 5 was used for this assessment. Table 2 shows the establishment of convergent validity, as Cronbach's alpha and composite reliability of the constructs were >0.9 (Sarstedt et al., 2021). The average variance extracted (AVE) values of the constructs were also >0.5 (Suharsono et al., 2020). The loadings of the items ranged from 0.527–0.582.

**Table 2.** Convergent validity

	IC	ICR	PDC	Cronbach's alpha	Composite reliability	Average variance extracted (AVE)
	0.752			0.933	0.934	0.582
IC10	0.791					
IC2	0.779					
IC3	0.686					
IC4	0.706					
IC5	0.780					
IC6	0.829					
IC7	0.789					
IC8	0.693					
IC9	0.806					
ICR1		0.713		0.918	0.921	0.527
ICR10		0.705				
ICR2		0.643				
ICR3		0.744				
ICR4		0.619				
ICR5		0.701				
ICR6		0.712				
ICR7		0.737				
ICR8		0.804				
ICR9		0.855				
PDC1			0.775	0.903	0.905	0.535
PDC2			0.829			
PDC3			0.768			
PDC4			0.690			
PDC5			0.653			
PDC6			0.754			
PDC7			0.745			
PDC8			0.614			

Discriminant validity was analyzed using Heterotrait-Monotrait Ratio (HTMT), which is recommended to be between 0 and 1 (Sarstedt et al., 2021). In this study, every latent variable had an HTMT ratio of <1, ranging from 0.864–0.882 (Table 3).

**Table 3.** HTMT values

	IC	ICR	PDC
IC			
ICR	0.874		
PDC	0.864	0.882	

The structural model assessment began with the computation of the  $R^2$ , which for IAP was 0.84 and MS was 0.571. These are categorized as high based on Sarstedt et al.'s (2021) criterion. Thus, the structural model had adequate predictive power.

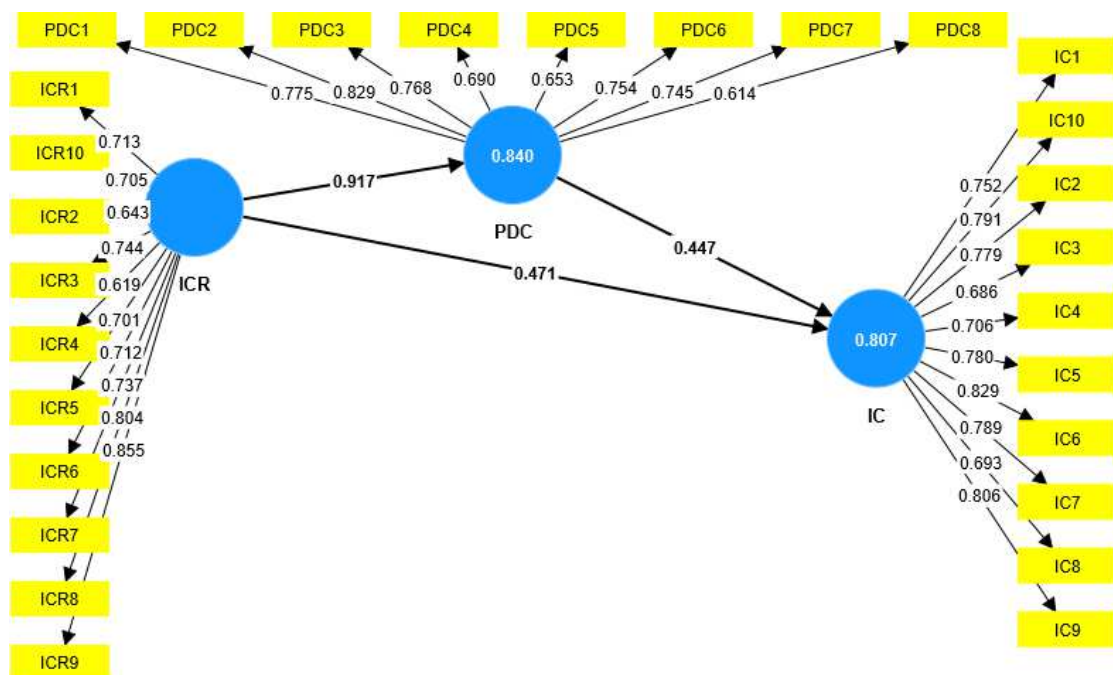
**Table 4.**  $R^2$  and  $Q^2$  of the endogenous variables

	R-square	R-square adjusted
IC	0.807	0.806
PDC	0.840	0.840

**Table 5.** Testing of path coefficient

	Path coefficient	Sample mean	Standard deviation	t	p	Decision
ICR → IC	0.471	0.475	0.096	4.89	0.000	Supported
ICR → PDC	0.917	0.917	0.015	59.597	0.000	Supported
PDC → IC	0.447	0.444	0.097	4.619	0.000	Supported

Note: \*\*\*  $p < 5,000$  bootstrap samples.



**Figure 1.** Testing of path coefficient

The PLS algorithm in SmartPLS was run on the hypothesized model to generate the path coefficients (Figure 1). The significance of the construct coefficients was computed using bootstrapping. The  $t$ - and  $p$ -values of the path coefficients are shown in Table 5.

The bootstrapping results are shown in Table 6. Internal control reporting positively and significantly indirectly affected perceived disclosure credibility through investor culture,  $\beta = 0.627$ ,  $p = 0.000$ . The bootstrapped-corrected confidence intervals did not cross 0 (LL = 0.044, UL = 0.141), suggesting that a mediation effect was present (Sarstedt et al., 2020). The significance of the mediation effect means that H4 was supported.

Results in Table 6 indicate that internal control reporting has a significant indirect effect on perceived disclosure credibility through the mediating role of investor culture. These findings corroborate previous studies (e.g., Elsayed & Elshandidy, 2021; Lai et al., 2020) that have called for greater

**Table 6.** Indirect effect

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics ( O/STDEV )	P values
ICR → PDC → IC	0.348	0.349	0.035	9.868	0.000

recognition of cultural factors in influencing investor perceptions. The magnitude of this mediating effect underlines that internal control reporting assures not only the reliability of financial data but also interacts with the facets of culture in shaping investment behavior. These findings indicate that researchers must consider cultural background variables as antecedents of investor reactions. Future research might address how specific aspects of investor culture, such as risk culture or financial literacy, act to further moderate these relationships across markets.

This study has investigated the relationship between internal control reporting and perceived disclosure credibility via the mediation of investor culture. Internal control has increased significantly because of the higher demand for internal control services and the rapid growth of professional organizations. This result is consistent with other studies (e.g., Elsayed & Elshandidy, 2021; Lai et al., 2020). Internal control reporting provides investors with critical insights into the reliability and accuracy of financial disclosures, which are essential for making informed investment decisions. Understanding how different aspects of internal controls affect these perceptions can help regulators and companies refine reporting practices to enhance transparency and trust. Investor

culture mediates how these disclosures are interpreted and valued across different markets and regions, influencing risk assessments and investment behaviors. By examining this mediating effect, researchers can uncover nuanced factors that shape investor perceptions beyond mere financial metrics, enabling a more comprehensive understanding of decision-making processes and global investment dynamics. Therefore, this study not only informs regulatory frameworks but also enhances the effectiveness of corporate governance practices, ultimately fostering more efficient and trustworthy capital markets worldwide.

It is clear that investor culture plays a key role in mediating these perceptions in relation to how financial information is interpreted and valued across different markets, influencing risk assessments and investment decisions. Interactions between internal controls and investor culture are likely to become more critical in the future, necessitating that regulators and companies consider cultural contexts when designing internal controls. Furthermore, this points to the need for tailored approaches to corporate governance and the potential integration of advanced technologies to enhance transparency. Using these insights, policymakers can develop regulations that foster more efficient and trustworthy capital markets.

## CONCLUSION

The purpose of this study was to investigate the relationship between internal control reporting and perceived disclosure credibility via the mediation of investor culture. This study has confirmed that internal control reporting significantly enhances perceived disclosure credibility among Jordanian investors, with investor culture playing a key role as a partial mediator. The finding thus supported the hypotheses of this research, highlighting how internal controls and cultural dimensions are relevant in building investor confidence. Policymakers could also facilitate such efforts by increasing the quality of corporate governance mechanisms that might help attain market transparency and investor trust. Future research would be welcomed in investigating such dynamics in various settings and with the addition of other variables, such as corporate social responsibility practices or technological innovation.

The following conclusions were inferred from the regression results. Internal control reporting enhances the perception of investors toward disclosure credibility. The overall findings confirm the research

hypotheses that investor culture positively mediates between internal control reporting and investor perception of disclosure credibility. Investors in Jordan use internal control reporting to ensure that firm disclosure is credible. This study contributes to the body of knowledge on investor perception of disclosure credibility in the Jordanian context. This study provides foundational knowledge to policy-makers to design successful internal control reporting policies and support systems.

Additional research is needed to address the research limitations. Scholars are encouraged to examine other industrial contexts and employ different methodologies. They may also include other variables, such as internal audit compliance and corporate governance policies. Additionally, the findings may not be generalizable to other firm contexts as the study focuses on brokerage firms. Research on perceived disclosure credibility is still limited. The respondents were unable to understand some items, and further work may clarify this issue.

## AUTHOR CONTRIBUTIONS

Conceptualization: Mithkal Hmoud Alqaraleh.

Data curation: Mithkal Hmoud Alqaraleh.

Formal analysis: Mithkal Hmoud Alqaraleh.

Funding acquisition: Mithkal Hmoud Alqaraleh.

Investigation: Mithkal Hmoud Alqaraleh.

Methodology: Mithkal Hmoud Alqaraleh.

Project administration: Mithkal Hmoud Alqaraleh.

Resources: Mithkal Hmoud Alqaraleh.

Software: Mithkal Hmoud Alqaraleh.

Supervision: Mithkal Hmoud Alqaraleh.

Validation: Mithkal Hmoud Alqaraleh.

Visualization: Mithkal Hmoud Alqaraleh.

Writing – original draft: Mithkal Hmoud Alqaraleh.

Writing – review & editing: Mithkal Hmoud Alqaraleh.

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