Transparency in accounting and corporate governance

Word count: 2043 words

Table of Contents

1.0. Research Background

Extant literature argues that the quality and transparency of accounting and financial reporting has come under a lot of criticism following a number of accounting related scandals in the international financial community (Hopkins et al. 2014; Wilkinson and MacLean, 2013). A number of prominent organisations were involved in accounting related scandals including companies like Enron, Marconi, WorldCom and Parmalat. This has resulted in a weakening on the investors' confidence towards the financial reports filed by such firms (Armstrong et al. 2012). Firth et al., (2007) argues that because of the failure on the international financial companies, there is a need to improve the quality of financial information reported by organisations, increase the transparency levels among the management and improving the governance structures within the organisation

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In the capital market, financial information is the key factor that can help in persuading investors to invest in. In addition to this, accurate financial information is also beneficial to the creditors, regulators, owners, investors and firm partners as it aids in determining the company's performance in the past and also will allow predicting the company's future prospects (Imhoff, 2003). Researchers argue that when there is presence of positive corporate governance there is a possibility of improving the transparency and quality of accounting. In the case of developed nations, the link between the quality of financial information and the corporate governance has been discussed extensively. Studies by Han (2005) and Bradbury et al. (2006) focused on this link and stressed on aspects like concentrated shareholding, director shareholding, board independence and auditor reputation. In addition to this, Dimitropoulos and Asteriou (2010) state that there has been growing interest in the link between financial reporting and corporate governance in emerging economies which are rapidly growing and have distinctive features about corporate control, capital allocation and regulations.

There has been some work done towards implementing better quality and transparency in accounting. The aim behind this step is to make financial reporting more transparent and much better in terms of quality. Fraudulent practices in accounting such as intentional misleading has been a catalyst for the introduction of the new accounting standards (Eng and Mak, 2003). There might be a perception that financial reports are comparable on equal footing since accounting standards are standardised, however, such comparisons may not be accurate if it is not conditional upon firm specific corporate governance structure.

Therefore, as Bedard and Gendron (2010) argues, the presence of a rigorous corporate governance and corporate disclosure process may be linked to the quality of accounting. The authors argue that addressing the governance processes including the activities of the board and audit committee will impact the quality and transparency of accounting.

2.0. Research Rationale and Research Question

2.1. Rationale and Contribution of the Research

The main problem occurs due to a trade-off between information that can be verified and those which cannot be verified. A financial report is seen as the company's report card which clearly shows the current performance of the company and the future possibilities for the company. This information can be gleaned from the company's income and balance statements (Erkens et al. 2012). Therefore, all financial reports will contain observable as well as unobservable elements of information. In financial reports, there is always a struggle between information that is relevant and which have to be published versus unverifiable information. The asymmetric information with regards to an organisation's performance along with the differing interests in both the outside investors as well as inside investors give rise to the agency problem existing in financial reporting with consequences for the informational as well as contractual effectiveness of the report.

This research argues that the overall quality and transparency of reporting will influence the degree of recognition of unverifiable elements within the financial reports and that only the vigour of corporate governance can help in improving the overall quality and transparency.

2.2. Research Question

What is the relationship between the corporate governance system within the organisation and the quality and transparency of its accounting framework?

2.3. Objectives

- To identify the relationship between corporate governance and financial accounting and reporting from literature.
- To arrive at the determinants of corporate governance while impact accounting quality and transparency
- To present recommendations for target organisations to improve their overall quality and transparency of accounting.

3.0. Research Methodology

This section will detail the various research methods that will be used to answer the research questions for the current study.

3.1. Research Philosophy

There are two fundamental types of research philosophies that can be used. These are positivism and interpretivism. An interpretivist philosophy is one which requires the researcher to interpret the various elements of the study. Therefore, it can be stated that an interpretivistic philosophy integrates human interest into a study. According to Bryman (2012), an interpretivistic philosophy assumes that access to reality is only through social constructions such as language, consciousness, shared meanings, and instruments. Therefore, the current study will use an interpretivistic philosophy since the current study requires understanding the perspective of accounting manager (human element) when it comes to corporate governance structures. In addition to this, an interpretivistic philosophy also requires interaction between the subject and the researcher (Bryman, 2012). Since the current study will be interacting with the accounting managers, this philosophy is chosen as the best method for carrying out the research process.

3.2. Research Method

The research method refers to the type of information or data that needs to be obtained in order to carry out the necessary research process. Typically, the research methods are of two types: qualitative methods and quantitative methods. Qualitative methods involve using non numerical based evidences to carry out the research analysis process, whereas quantitative method involves using numerical based data to answer the research questions (Creswell, 2012). In the current study, the researcher plans on interacting with the accounting managers directly and getting relevant information from them. Therefore the data collected is going to be qualitative in nature. Hence, a qualitative research method will be adopted in the current study. The advantage of using a qualitative method is that it encourages people to expand on their responses to open up new topic areas not initially considered (Punch, 2013). This will in turn result in a deeper analysis on why people act in a certain way and their perceptions, feelings and attitude.

3.3. Data Collection

The researcher will be collecting qualitative information as stated above. However, data collection can involve gathering two types of data. These are: primary data and secondary data. Primary data refers to information that is obtained first hand or directly from a live source. Typically, primary data can be collected by using interview methods, surveys or through questionnaires (Saunders et al., 2012). In the current study, the researcher will be conducting a semi structured interview method to collect the relevant and necessary data for the study. Hence primary data will be collected by the researcher for the current study.

Secondary data refers to data that has been previously established by another source. Typically, secondary data is collected from peer reviewed journals, magazine, newspapers and online databases (Saunders et al., 2012). In the current study, the researcher will also depend on secondary data to determine the corporate governance structures that exist among the various public listed companies in the London Stock Exchange. Therefore, the researcher will collect secondary data from the annual reports that the companies have filed and which is public record.

3.4. Research Sampling

The current study will target accounting managers of 5 different firms that are listed on the London Stock Exchange. The researcher will use purposive sampling method to target respondents for the semi structured interview. A total of 15 (three from each company) accounting managers' perspectives will be obtained by the researcher.

3.5. Research Ethics

The researcher will follow all the ethical guidelines that have been set by the university. The respondents will be assured on their anonymity and also will be assured that the data they provide will be coded and encrypted. Furthermore, the researcher will also promise them that the data will be destroyed once the study is completed.

4.0. Literature Review

4.1. Fraudulent financial reporting

There are three specific studies that give a detailed insight into the relation between fraudulent financial reporting and corporate governance characteristics. Sloan (2001) contend that both fraudulent behaviour and the quality of the corporate governance structure are inversely related to each other. Another study has shown that the likelihood of a company being caught for carrying out financial fraud and being sued has an impact on how the company's corporate governance structure is framed (Fich and Shivdasani, 2007). Such suits are closely associated with the presence of a weak corporate governance structure, a tainted director, presence of a large board, CEO duality and insufficient board members with proper financial expertise. Another study has also proven that having a staggered board is negatively related to allegations of financial fraud when it comes to publishing the company's annual reports (Zhao and Chen, 2008). Furthermore, Zhao and Chen also report that fraudulent financial reporting is negatively related to board independence and positively related to weather a CEO chairs the board. Studies have also proven that when it comes to the incidence of fraudulent reporting of financial reports, it is found that companies that have more number of audit committee and insider directors on the board are far more likely to commit such fraud (Beasley et al. 2010). However, the authors question the practical significance of the noted differences.

4.2. Role of Restatements

By examining the effect of audit committee industry expertise and the role of the CEO in director nominations, numerous studies have extended our knowledge of governance and restatements. While there is empirical evidence that proves that financial expertise and independence of audit committees are negatively related to restatements (Bedard and Johnstone, 2004), Carcello et al., (2011) refute that evidence and state that no significant links can be found between independence of audit committee and restatements. Carcello et al., (2011) especially state that this is true if the CEO is involved in the selection of the directors. Another study by Xie et al., (2003) has concluded that the audit committee expertise and restatements are negatively associated and a stronger effect can be obtained with a greater level of industry related knowledge. The risk of restatement is lower if audit committee's industry expertise is combined with:

- Auditor industry specialisation
- Audit committee financial expertise

Another study by Larcker et al., (2007) delved into the links between governance characteristics and accounting outcomes. The authors began their investigation by including 39 governance measures, which was then reduced to 14 dimensions using a principal component analysis. The study concluded by saying that there is little relation between the 14 dimensions and accounting restatements.

4.3. Earnings Management/Accruals Quality

There are a number of research papers that have delved into the issues associated with earnings management. The current section will provide certain examples of studies that have dealt with subject matters relating to the relation between earnings management and governance quality. As stated above, the study by Larcker et al., (2007) looked at 14 dimensions and the relation between these dimensions and the different accounting variables. The authors determined that a mixed relation exists between these 14 dimensions and abnormal accruals. Furthermore, a study by DeZoort and Salterio (2001) has determined that a negative relation exists between the quality of corporate governance and accounting discretion. Attention has to be paid to the fact that there is empirical evidence proving the positive relation between accounting discretion and the future performance of a firm. Thus, the results clearly state that shareholders are not harmed, but instead they are the ones to benefit from earnings management that is attributed to poor corporate governance (Zhao and Chen, 2008). Studies have also proven that there is a negative association between the presence of a blockholder on the audit committee and the presence of staggered boards, and unexpected accruals. This proof of earnings management and staggered boards being negatively related is not consistent with the predominant result that weak governance is associated with poor financial reporting quality. Another study has shown that the performance adjusted discretionary accruals is negatively related to audit committee member experience as an audit partner.

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