CORPORATE GOVERNANCE AND ITS IMPLICATIONS FOR FINANCIAL REPORTING

Claudia-Elena GRIGORAȘ-ICHIM
"Stefan cel Mare" University of Suceava, 720229, Romania
claudiag@seap.usv.ro

Abstract
Why would it be important to study the financial statements of a company? The answer depends on the particular interest of everyone - whether you are a creditor, shareholder, potential investor, manager, government agency or a trade union leader. For example, short-term lenders, such as banks are primarily interested in the firm's ability to pay obligations to due date. In this case would be examined current assets and their relation to short-term liabilities to assess the short-term solvency of the company. Shareholders, on the other hand, look more on long-term indicators such as capital structure of the company, past and projected income and changes in financial position. Shareholders, or potential, are also interested in many of the characteristics considered by a creditor in the long term. As a shareholder, you should focus on revenues image because changes greatly affect the market price of the investment. They are also concerned about the company's financial situation as it affects indirectly the stability of income. The paper is a research that demonstrates the relationship between corporate governance and financial reporting.

Key words: *Interim financial reporting, accounting, decision making, corporate governance.*

JEL Classification: *M40*

I. INTRODUCTION

Managers are concerned about the content of a company's capital structure and changes and trends in earnings. These financial information have a direct influence on the type, quantity and cost of external financing that the company can achieve. In addition, company managers find useful financial information on an everyday operation in areas such as capital budget, breakeven analysis, variance analysis, gross margin analysis and internal control purposes (Boghean et. al., 2009b).

Readers of financial statements can gather information by examining the relationships between the elements of the situation and identify trends in these relationships. Relationships are expressed numerically in ratios and percentages and trends are identified through benchmarking.

One problem with learning how to analyze situations is that the means can become an end in itself. Analysts could identify and calculate thousands of possible relationships and trends. If you only know how to calculate ratios and trends without understanding how they can be used such information is made less.

II. STUDIES REGARDING CORPORATE GOVERNANCE AND FINANCIAL REPORTING

Based on theoretical investigations of Ross (1973), the purpose of empirical capital market research is to find significant links between corporate governance (reporting) and capital costs. Apart from a few exceptions (Larcker et al., 2005; Nowak et al., 2005), a positive correlation between the variables of corporate governance and reduce the cost of equity can be validated by empirical research (Weber et al., 2007) for both the stock market in the USA (eg, Gompers et al., 2003; Brown and Cayla, 2006) and in Germany (eg Drobetz et al., 2004; Zimmermann et al., 2006; Bassen et al., 2006). However, those studies do not agree on statistical significance. Therefore, no general conclusion can be drawn regarding a statistically significant correlation between several positive variables of corporate governance (contained in a corporate governance index) and firm performance on the stock market in Germany. Except Toks (2004), so far there is no empirical study that examines the impact of corporate governance on firm performance reporting by not taking into account other indicators of corporate governance. It is therefore of great importance to the continuation of empirical research on corporate governance. In addition, similar studies are lacking in the Prime Standard of Austria.

Reporting supervisory board is of major importance for reporting under the two-tier system of corporate governance. The two levels of Tirole's theory (1986) extends the theory of agency supervisor with a single level. According to this theory, the Supervisory Board is in a position to act as a main board and the shareholders agent

simultaneously. Based on the theory of Spence (1973), exonerating through shareholders can only be achieved by publishing specific information that is useful to decision of the supervisory board. To assess the activities of supervisory boards, shareholders are dependent not only by verbal reporting, but also by written one. Therefore, this article will focus on the written report. In addition, the monitoring board of the supervisory board is another factor that strongly influences the decisions of potential shareholders.

Agency theory can also be applied by the external auditor. He should act as an "assistant" and, in particular, be responsible for writing reports by audit supervisory board. In this context it should be noted that the auditor is not only part of internal corporate governance, but also external. The latter implies that with the auditor's opinion, it provides a reliable judgment on the capital market, thus acting as a watchdog. If the stock market including impairment independence of the external auditor, the role of assistance to the supervisory board is a conflict of objectives with watchdog function. According to Antle (1982), the auditor may be classified also as a trader. From a theoretical perspective, this may lead to a coalition of auditor oversight arrangements taken by the board (such as evasion), which do not comply with shareholder objectives. Accordingly, shareholders are not only interested in reporting on the audit of the supervisory board of directors, and reporting on cooperation with the external auditor, external audit oversight.

In an attempt to investigate major differences in annual reports (financial year 2007 or 2006/07) in Germany and Austria, the research conducted by Patrick Velt in 2009 provides an overview of the results of that investigation. The survey analysed corporations in the Austrian and German Prime Standard (Frankfurt and Vienna Stock Exchange) in order to examine the reports specific to corporate governance supervisory board in particular the role of "collaborator" of the external auditor. Germany and Austria were chosen from various similarities in terms of corporate values and business law, including corporate governance codes and the predominance of two-tier system (board of directors and the supervisory board) in both countries. This study firstly identifies key gaps in reporting both the Austrian and German Prime standard, especially the specification of jobs and monitoring activities of the supervisory board.

The influence of reporting of corporate governance on firm performance was tested using correlation analysis. Price-earnings rate and Tobin's Q were used to measure firm performance. Empirical hypothesis 1a (1b) implies a correlation (positive) between corporate governance and firm performance reporting, correlation that could be supported only by a few variables. Therefore, the hypothesis 0 (assuming no correlation) cannot be rejected. Reporting to the Supervisory Board regarding the independence of its members has shown positive meanings on the company's performance. The first German standard, both performance indicators show positive meanings to reporting on the financial expertise of the supervisory board. Austrian standard in first reporting the Supervisory Board regarding the independence of the external auditor and the auditor's fee agreement proved to be positive meanings. 3b assumption, assuming that a low level of reference trend in these countries increase the probability of significance, it may be supported by the trend. Therefore, the hypothesis 2 assuming no influence of country-specific indicators for reporting on the occurrence of significance in those countries due to similar corporate governance systems can be questioned. Taken together, the effects identified correlations of all variables in both raw standards are rather weak and diverse.

The positive effects on the future of corporate governance reporting to the Supervisory Board are expected to modernize the Accounting Act of German and Austrian law. They require only a clarification of the rules in the German and Austrian legislation on corporations, and amending both proper corporate governance codes. Among other things, the amendments relate to future mandatory issuance of a report of corporate governance for listed companies, formation of audit committees (Germany) and fleshing out their duties (Germany, Austria). Reporting gaps identified in this study justifies increased reporting obligations. This is especially true for the composition and activities of the supervisory board and its committees, which were already covered by current law reforms in Austria and Germany (BilMoG and URA G). It is therefore an ideal starting point for future research regarding corporate governance in Germany and Austria, to address changes that occur with reforms of law.

Firth (1976) and Foster (1981) are the first to provide evidence that the information on the revenues of other companies in the industry are also part of the information provided that the stock market uses continuous evaluation process of share price. Other informational events include gains for quarterly ads (Clinch and Sinclair, 1987; Freeman and Tse, 1992; Han and Wild, 2000; Asthana and Mishra, 2001; Ramnath, 2002; Thomas and Zhang, 2008), forecast management (Baginski 1987; Han et al., 1989; Pyo and Lustgarten, 1990; Kim and Park Lacina, 2008) and profit warnings (Tse and Tucker, 2010). When a corporate announcement contains information at the sectoral level, stock prices of companies announcing and related moves in the same direction (positive or contamination). Alternatively, when an announcement contains information about a change in market power between competing firms, prices and related companies announced moves in opposite directions (competitive or negative). In general, the literature confirmed that a variety of information events are able to provide valuable information relevant to companies announcing not only in itself but also about companies who

announces in the same industry.

All the studies outlined above are limited to the same country and evidence of transnational information transfer that is limited. Firth (1996) examines the existence and determinants associated with income transfers information communicated in the context of two countries (USA and UK). He found evidence to suggest that analysts were able to extrapolate corporate earnings information from USA companies to British businesses, and to a lesser extent, vice versa, to evaluate securities. Alves, Pope and Young (2007) investigated the effect of profit warnings on the share prices of similar companies that are not announced and distributed on a set of European countries. Their results also support the existence of transnational transfer of information, although the magnitude is much weaker.

III. INVESTOR – FINANCIAL REPORTING RELATION

It is well documented that obtaining private equity (PE) has a profound impact on the operation of entrepreneurial companies. Investors are active, financial intermediaries, operating in an environment characterized by extensive asymmetries of information leading to high adverse selection and risks of moral hazard (Bottazzi et al., 2004; Brander et al., 2002). Moreover, the lack of liquidity and non-reliability of PE investment firms, creates idiosyncratic and high market risks. Accordingly, investors are active intermediaries, enabling them to reduce these risks. As such, they occupy two distinct roles: one to monitor progress of the portfolio company and one supporting the company's portfolio, thus affecting the corporate systems of government (Cowling, 2003; Kaplan and Stromberg, 2004) and the creation of value (Manigart and Sapienza, 1999).

Thus, we highlight the impact of governance on investors on a specific aspect of the operation and professionalization of portfolio companies. More specifically, we explore the relationship between stake ownership of an investment and the quality of accounting information disclosed by the company portfolio, expanding by this finding that investors have a positive effect in disseminating information sheets of portfolio companies (Beuselinck et al. 2004; Davila and Foster, 2005; Katz, 2006). It provides evidence that the degree of PE ownership in a company underlines the significantly quality of its financial accounts. We explain this by finding basic economic theory, where high quality financial reporting is a natural result of the monitoring and governance of PE, but also depends on the proportional ownership of PE investors.

This is an important research topic and various stakeholders such as banks, credit rating agencies, credit, employees, customers and suppliers, all based in part on publicly available accounting information for decision making. By improving the quality of accounting information in portfolio companies, investors' servers, thus not only their own interests but provide valuable services and to other stakeholders. This could partly explain why investors have a positive effect on certified portfolio companies beyond simply providing funding (Gompers and Lerner, 1999). Despite the economic importance of this topic, few studies have looked at so far properties value and relevance of financial reporting in PE-backed firms (Armstrong et al., 2006; Beuselinck et al., 2004; Hand, 2005). This paper adds to this stream of research not only recognizes that the mere fact of having a PE investor as a shareholder may influence the quality of accounting information, but also gives importance property issues.

The relationship contractor - investors almost inevitably result from the investor's need for intensive supervision and close governance structures. Because both sides are interdependent by the relationship principal-agent if the personal incentives of the agent (entrepreneur) may deviate from those of principal (investors), investors usually try to solve the problem of the agency through contracts and monitoring intensive entrepreneurial activities (Kaplan and Stromberg, 2004). Paper Guide (Chapter 4, p. 40) to European Venture Capital and Private Equity Association (EVCA) provides that "monitoring should allow the manager [investment] to confirm that the investment is progressing in accordance with the business plan concerned and should provide sufficient information to identify any failures to meet targets or milestones and formulate plans for remedial actions where necessary." Monitoring occurs often through its representative on the Board if the progress of risk are evaluated regularly (Kaplan and Stromberg, 2001). In addition, investors have informal contacts with the contractor and key managers (Sapienza et al., 1996) and need structured information between interim council meetings (Beuselinck et al., 2006). Finally, they accelerate the introduction of a professional system developed controllable financial reporting and internal control in their portfolio companies (Davila and Foster, 2005; Mitchell et al., 1995). In addition to monitoring portfolio companies, investors contribute to their progress in different ways: they offer strategic business and financial consulting (Sapienza et al., 1996), were instrumental in recruiting members of the management team from the top (Hellmann and Puri, 2002) and acts as a source of professional and industrial contacts (Sapienza et al., 1996).

Although our understanding of the role of monitoring and added value to investors is growing fast, how these actions affect corporate governance practices of portfolio companies remain largely unexplored. Moreover, it is difficult to prove whether and how this change in corporate governance practices affecting corporate

decisions and disclosure of PE portfolio companies. A recent research stream addresses this important research and analysis of the interaction between the presence PE value reliability and relevance of financial statements. Hand (2005) illustrates that the presence of PE has a positive impact on the value relevance of financial statements of support - PE, especially when they are more mature. The document's Beuselinck et al. (2004) report public financial information of unlisted Belgian PE firms are of higher quality than non-PE similar firms. Katz (2006) found similar results for a sample of USA companies with unlisted public debt ratios. The positive impact of investors on the quality of financial reporting of portfolio companies is due to the effort of monitoring and active governance by investors and ensuring the professionalization of its portfolio companies.

In analysing the financial statements, analysts use various devices to emphasize the importance and relative comparative information presented (Boghean et. al., 2009a). These devices include ratio analysis, benchmarking, analysis and examination of data related percentage. No device is more useful than another. Every situation is different, and analysts often get the answers they need from a careful examination of interdependencies in the data. Analysis report is the starting point. Rates can be classified as shown in figure 1.

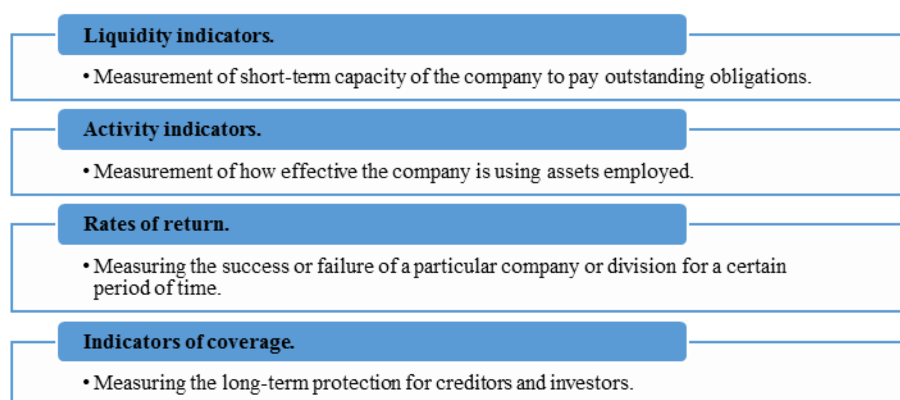

Figure 1 – Types of financial reporting indicators

IV. CONCLUSION

Although the incontestable usefulness of financial reporting, it must be mentioned several limitations. The financial statements report on the past. The analysis of these data is an examination of the past. When using such information in a decision-making process (forward-looking), analysts assume that the past is a reasonable basis for predicting the future. This is usually a reasonable approach but its limitations should be recognized.

The report also helps in identifying and analysing the strengths and weaknesses of a company's present. They can serve as "red flags" that indicate problem areas. In many cases, however, such analysis will not reveal why things are as they are. Finding answers about "why" usually requires in-depth analysis and an awareness of several factors about a company that are not reported in the financial statements.

Another caveat is that a single rate itself is not likely to be very useful. For example, analysts can generally view the current rate of 2 to 1 (current assets are twice current liabilities) as satisfactory. However, if the media industry is 3 to 1, such a decision may be invalid. Even given the industry average, it can be concluded that a private company to do well, if you know that the report of the previous year was 1.5 to 1. Therefore, to achieve meaning in rates, analysts need a standard with which to compare them. Such a standard can come from industrial environments, the amounts of previous years, a certain competitor or planned levels.

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