



GLOBAL ACCOUNTING REGULATION: IMPACT OF IFAC ON FINANCIAL REPORTING QUALITY

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Abstract:

This paper provides an analysis of various dimensions of accounting and corporate governance that have led to the currently troubling state of affairs in the financial reporting environment. Good Corporate Governance (GCG) is a mandatory requirement in today's corporate world by every stakeholder groups. Failure of giant corporate groups in the last two-three decades strengthens the demand further. And surprisingly, in some of such failures, accounting as a discipline is held liable. The way accounting is practiced or the interpretations that may give different prescriptions in similar situations are some dark areas that may open some scope for the corrupted accountants. The paper covers the concept of corporate governance, its legal framework, its current status and how accounting may be practiced to protect corporates from corruption by establishing governance. The paper analyzes how IFAC is succeeding as an international standard setter with an established place in the global financial infrastructure and it reveals a growing reliance on governance by experts together with a growth in influence of the large, multinational accounting firms. Until corporate boards are truly independent of corporate management and are knowledgeable enough to act as effective shareholder advocates, changes in accounting will be of limited impact.

Keywords: *Corporate Governance; Financial Reporting Quality; IFAC.*

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1. Introduction

In today's global financial arena, it is important to subject the developing governance arrangements of global regulatory bodies to adequate scrutiny and to ensure that the histories of their development are not lost or written only by those implementing such changes (Humphrey et al., 2006). Some such bodies, like the World Bank, are clearly being studied in some depth by accounting researchers (Annisette, 2004), while other accounting bodies such as the International Accounting Standards Board (IASB) are now starting to be analysed by political scientists. There are potentially a variety of reasons why IFAC has not engendered a similar level of research attention. The differences between various international accountancy bodies and the differing

layers or tiers of regulation at the national, regional and global level may not be well-understood outside the accountancy field. IFAC may also not be seen as deserving special attention if it is classified as just another case of a professional body using declarations of commitments to the public interest, transparency and accountability as “a convenient mechanism for avoiding criticism and maintaining the power and privilege of delegated self-regulation” (Sikka, 2001). Such a perspective, though, ignores the fact that we are currently at a very important time in the shaping and formation of what is becoming known as the global financial infrastructure – and that bodies operating within this arena, such as IFAC, have experienced major change in its authority and jurisdictional significance in recent years.

The global governance debate is focused heavily on the reform and creation of international institutions and the need for these agencies to consult and to include non-governmental organizations and “global civil society”. Yet global governance is increasingly undertaken in a variety of networks, coalitions and informal arrangements which lie a little further beyond the public gaze and the direct control of governments. It is these forms of governance that need sustained and focused attention, to bring to light whose interests they further and to whom they are accountable (Woods, 2002.). While some studies examining the auditing standards produced by the International Auditing and Assurance Standards Board (IAASB), a constituent part of IFAC, are emerging (Curtis and Turley, 2005), there has to date been almost no research looking at IFAC's operating and governance structures. This lack of research is particularly intriguing given both the importance of the auditing function in enhancing the reliability of reported corporate accounting information and the widespread concerns expressed internationally about the quality of financial reporting and auditing following the corporate scandals of recent years (O'Connell, 2004). If confidence is to be established in global financial reporting, it is vital to know more about the structures and processes governing the development and approval of standards of international auditing practice. A common focus in accounting research is to ask how accounting and auditing contribute to the governance and accountability of other organisations.

Financial reporting quality is a major concern for all current and potential investors. According to Biddle et al. (2009) financial reporting quality is defined as the precision with which financial reporting conveys information about the firm's operations, in particular its expected cash flows that inform equity investors. Corporate scandals of the last decade and collapse of big firms in recent years raised concerns about financial reporting quality which led to the passage of Sarbanes–Oxley which had a focus on the financial aspects of corporate governance. A firm with a set of effective governance controls that lowers the conflict of interests between minority shareholders and insiders tends to increase its firm value by reducing information asymmetry and increasing management efficiency (Lee et al., 2011). Researchers often view corporate governance mechanisms as falling into one of two groups: those internal to firms and those external to firms (Gillan, 2006).

Good corporate governance (GCG) in a corporate set up leads to maximize the value of the shareholders legally, ethically and on a sustainable basis, while ensuring equity and transparency to every stakeholder – the company's customers, employees, investors, vendor-partners, the government of the land and the community (Murthy, 2006). GCG is a must for ensuring the required values to different stakeholder groups. It enhances the performance of corporations, by

creating an environment that motivates managers to maximize returns on investment, enhance operational efficiency and ensure long-term productivity growth. Consequently, such corporations attract the best talent on a global basis. It also ensures the conformance of corporations with the interests of investors and society, by creating fairness, transparency and accountability in business activities among employees, management and the board (Oman, 2001). The author, here, uses accounting as a mean for establishing and retaining corporate governance. Accounting is a process of compiling information for reporting the internal affairs of any entity to different stakeholders at the end of a certain interval. It is defined as the language of business and can play a vital role for ensuring and continuing with GCG. As a discipline, accounting practice is highly controlled by accounting standards in a global set up. As accounting becomes an international discipline and the practice of accounting is harmonized aligned with the varied needs of stakeholders, it can be used as a tool for ensuring good governance within a corporate setup. The author has tried to devise the way out, how accounting may be used as a tool to ensure and enhance GCG. Thus, the basic objective of the paper concentrates on the issue of the interrelationship between accounting and governance; and how accounting may be practiced in such a way that corporate governance is achieved, by and by, both accounting and corporate governance is demanded for the betterment of the stakeholders, as it is reflected in the financial reporting quality. IFAC's 2016-2018 Strategic Plan charts the future of the global profession, identifies opportunities and risks for the profession within the context of the current and anticipated environment, while highlighting the unique position and economic benefits of IFAC's activities, as well as IFAC's planned activities in response to macro trends with significant implications for the profession. The purpose of this paper is not to establish a new theory of IFAC per se, but rather to contribute to setting an agenda of research issues around its development.

2. Objectives

The main objective is to investigate the impact of accounting governance on financial reporting quality. The specific objectives are;

- To determine the significant relationship board size and financial reporting quality.
- To investigate significant relationship between board independence and financial reporting quality.
- To examine the significant relationship between individual ownership and financial reporting quality.
- To determine the effects of the controlling variables on financial reporting quality.

3. Conceptual Framework

3.1. International Federation of Accountants as a Global Standard Setter

The International Federation of Accountants (IFAC) is a non-state actor that has become recognized as the authority to set international standards for accountants. Its current formal mission includes commitments to establishing and promoting adherence to high-quality professional standards, furthering international convergence and speaking out on relevant public interest issues (IFAC, 2006). Registered in Geneva, Switzerland as a non-governmental organization (NGO) under Articles 60-79 of the Swiss Civil Code, IFAC has in recent years

become an integral player in global financial governance, (EC, 2004). Despite the breadth of its membership (some 130 countries) and the growth in its influence, IFAC has attracted relatively little recognition and analysis in the global governance literature. Leading governance texts tend to refer to financial reporting simply by noting the IASB's standard setting role for accounting and IFAC and its position in relation to auditing and other standards are rarely mentioned (Held and McGrew, 2002). Although the complexity of the global financial system and the importance of financial reporting is widely recognized, IFAC, as a global body, has attracted much less attention than organizations such as the World Bank. Founded in 1977, for many years IFAC operated in the shadow of the better-known International Accounting Standards Board (IASB). IFAC's purpose was initially defined as advancing “the development and enhancement of a coordinated worldwide accounting profession with harmonized standards. IFAC has emerged in the twenty-first century as an international authority for the global accounting profession. IFAC is responsible for constructing international standards on auditing (ISAs), has established an international code of ethics for professional accountants, issues international standards on accounting education and standards for international public sector accounting. It now describes itself as “the global organization for the accountancy profession” and as at 2016, had 175 member bodies from 130 countries representing 3 million accountants in public practice, education, government service, industry, and commerce. IFAC has been successful in obtaining a crucial place in the networks of what has been called the “new international financial architecture” (Thirkell-White, 2004).

3.2. IFAC's Governance Development

IFAC's rise to an authoritative position as a standard-setter has been associated with its emergence as a key player within the global financial governance arena. The growth of global, financial governance has been linked with economic globalization – characterized by falling barriers to trade, growth of transnational production and growth in international financial transactions. (Knight, 2005). Although liberalization and free trade appear to demand just the meeting of a supplier and a consumer with no other bureaucratic intervention, in the complex real world there needs to be an informational framework to create and enable the information for this free market to exist. Especially since the East Asia crisis, financial convergence has “put a premium on a common set of financial reporting standards; hence the current efforts of international accounting standard setters to put one in place. In analyzing IFAC as an element of the international accounting and auditing landscape, relevant concepts and ideas may be drawn upon from literature that has considered the developing global governance and regulatory framework in other spheres. Shill, N. C. (2008) observe that global governance tends to be a complex and “multilayered” matter in the sense that it is constituted by the network of different infrastructures of governance: the supranational, the transnational and the national. Global governance is structurally complex, tending to be composed of “diverse agencies and networks with overlapping jurisdictions (functional and/or spatial)”. These seem to be appropriate ideas to apply to IFAC. In considering IFAC's governance structures consideration of the mechanisms through which interested parties can be involved in the discussion of standards is important. Critics have argued that international regulators lack the democratic institutions, procedures and accountability provided by national political systems (Moravcsik, 2004).

3.3. Accounting and Corporate Governance

The high profile scandals and rising investor dissatisfaction with governance practices have led to demands to ‘raise the baseline’ of mandatory disclosure and compliance by corporations. These concerns have triggered a shift away from “soft law” such as comply or explain requirements. In the U.S., the Sarbanes-Oxley (SOX) Act, and the revised, new York Stock Exchange (NYSE) listing rules have created more stringent standards for financial disclosure, committee and board nominations, and audit policies. In Asia, revised corporate governance regulations in several countries such as Hong Kong, Singapore, and India mandate a much stricter standard of compliance for corporations. SOX Act is obviously a great achievement in response to the scandals for restoring investors’ faith in corporation. It represents a shift toward government regulation of corporate standards relating to auditing, accounting, quality control, ethics, and independence, through the Public Company Accounting Oversight Board (PCAOB). The recent move, by SEC, to mandate full disclosure for managerial compensation and perks, is a welcomed one. Because, many CEOs have created significant asymmetries in compensation within their corporations, through undisclosed perks and incentives. For example, the CEO of a corporation was paid \$800 million including perks, over a 13-year period – a period during which his company profits had plunged, and shares provided Lower returns than even Treasury bonds.

4. Methodology

Considering that the present study uses historical data, it is post facto research in which researcher has no control on collected data in these sorts of study. In addition, because the relationship between corporate governance attributes and financial reporting quality investigated the research is descriptive-correlation study using documental method to collect data. The paper is completely a conceptual one whose basic foundation comes from various secondary sources like research articles, scholarly papers, and books, various international and local journals, and websites.

$$\text{Model Specification: (FRQ)} \quad Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon_{ii}$$

Where: Y = Financial Reporting Quality

β_0 = alpha (an intercept of the variables)

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = beta factor which is a measure of the impact of independent variables on the dependent variable.

X_1 = Board size

X_2 = Board Independence

X_3 = Individual ownership

X_4 = Ownership concentration

X_5 = Control variable

ε_{ii} = error term. Other factors that affected FRQ/y

Variables Definition

Research independent variables include board size, board independence, institutional ownership and ownership concentration; and dependent variable is financial reporting quality.

5. Results

Contrary results shown are not surprising while Doidge et al. (2007) show that “Corporate governance varies widely across countries and across firms. In countries with weak development, it is costly to improve investor protection because the institutional infrastructure is lacking and good governance has political costs. Further, in such countries, the benefit from improving governance is smaller because capital markets lack depth. Finally, such countries have poor investor protection and we find some evidence that there is complementarity between country-level investor protection and firm-level governance. However, financial globalization reduces the importance of country characteristics, thereby increasing the incentives for good governance”.

6. Conclusion and Recommendation

In this study the effect of corporate governance attributes on financial reporting quality in firms listed in Stock Exchange is investigated during the period of 2008 to 2015. In this study McNichols (2002) and Collins and Kothari (1989) are used for financial reporting quality measurement purpose and institutional ownership, ownership concentration, board independence and board size are considered as corporate governance attributes. The results of the study show that there is no relationship between corporate governance attributes including board size, board independence, ownership concentration, institutional ownership and financial reporting quality. In addition, no evidence is found to support significant relationship between control variables (audit firms size, firm size and firm age) and financial reporting quality. Good corporate governance is a must for today’s complex and dynamic business environment to ensure long-term sustainability Shill (2008) IFAC is no exception here and there remains much for researchers to explore in terms of the on-going development and application of its governance and accountability structures, its practical commitment to notions of public interest and its changing relationships with global, regional and national regulators, governmental entities, professional accounting bodies/firms and national professional accountancy bodies.

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