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Financial Reporting under the Good Corporate Governance Framework

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Abstract financial reporting is a process of compiling information for reporting the internal affairs of any entity to different stakeholder's 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 good corporate governance

Keywords Financial Reporting, Good Corporate Governance and Nigeria

1. Introduction

Good Corporate Governance (GCG), (according to Oman ,2001), is" a must for ensuring the required values to different stakeholders groups. It enhances the performance of corporations, by creating an environment that motivates managers to maximize Returns On Investment (ROI), enhance operational efficiency and ensure long-term productivity growth. Consequently, such corporations attract the best talent on a global society, by creating fairness,, transparency and accountability in business activities among employees, management and the board." Good Corporate Governance (GCG) in a corporate set up leads to maximizing 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 helps to enhance and increase the public confidence in a corporation, and lowers the cost of capital for investment, Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, management, and the board of directors. Other stakeholders include employees, customers, creditors, suppliers, regulators, and the community at large.

2. Concepts of Good Corporate Governance

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In A Board Culture of Corporate Governance, business author Gabrielle O'Donovan defines Corporate Governance as 'an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity. Sound corporate governance is reliant on external marketplace commitment and legislation, plus a healthy board culture which safeguards policies and processes. O'Donovan goes on to say that 'the perceived quality of a company's corporate governance can influence its share take as well as the cost of raising capital. Quality is determined by the financial markets, legislation and other external market forces plus how policies and processes are implemented and how people are led. External forces are, to a large extent, outside the circle of control of any board. The internal environment is quite a different matter, and offers companies the opportunity to differentiate from competitors through their board culture. To date, too much of corporate governance debate has centered on legislative policy, to deter fraudulent activities and transparency policy which misleads executives to treat the symptoms and not the cause.' It is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs.

Report of SEBI committee (India) on Corporate Governance defines corporate governance as the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate finds in the management of a company." The definition is drawn from the Gandhian principle of trusteeship and the

Directive Principles of the Indian Constitution. Corporate Governance is viewed as business ethics and a moral duty, See also Corporate Social Entrepreneurship regarding employees who are driven by their sense of integrity (moral conscience) and duty to society. This notion stems from traditional philosophical ideas of virtue (or set governance) and represents a "bottom-up" approach to corporate governance (agency) which supports the more obvious "top-down" (systems and processes, i.e. structural) perspective.

2.1. Parties to Corporate Governance

Parties involved in corporate governance include the regulatory body (e.g. the Chief Executive Officer, the board of directors, management, shareholders and Auditors). Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large. In corporations, the shareholder delegates decision rights to the manager to act in the principal's best interests. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Partly as a result of this separation between the two parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders. With the significant increase in equity holdings of investors, there has been an opportunity for a reversal of the separation of ownership and control problems because ownership is not so diffuse. A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital.

A key factor is an individual's decision to participate in an organization e.g. through providing financial capital and trust that they will receive a fair share of the organizational returns. If some parties are receiving more than theft fair return then participants may choose to not continue participating leading to organizational collapse.

3. Systemic Problems of Corporate Governance

• Demand for information: In order to influence the directors, the shareholders must combine with others to form a significant voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting.

Monitoring costs: A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis (in finance, the efficient market hypothesis (EMS) asserts that financial markets are efficient), which suggests that the small shareholder will free ride on the judgments of larger professional investors.

Supply of accounting information; Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should, ideally, be corrected by the working of the external auditing process.

4. Role of the Accountant

Financial reporting is a crucial element necessary for the corporate governance system to function effectively. Accountants and auditors are the primary providers of information to capital market participants. The directors of the company should be entitled to expect that management prepare the financial information in compliance with statutory and ethical obligations, and rely on auditor& competence. Current accounting practice allows a degree of choice of method in determining the method of measurement, criteria for recognition, and even the definition of the accounting entity. The exercise of this choice to improve apparent performance (popularly known as creative accounting) imposes extra information costs on users. In the extreme, it can involve nondisclosure of information. One area of concern is whether the auditing firm acts as both the independent auditor and management consultant to the firm they are auditing. This may result in a conflict of interest which places the integrity of financial reports in doubt due to client pressure to appease management. The power of the corporate client to initiate and terminate management consulting services and, more fundamentally, to select 'and dismiss accounting firms contradicts the concept of an independent auditor. Changes enacted in the United States in the form of the Sarbanes-Oxley Act (in response to the Enron situation as noted below) prohibit accounting firms from providing both auditing and management consulting services. Similar provisions are in place under clause 49 of SEBI Act hi India. The Enron collapse is an example of misleading financial reporting. Enron concealed huge losses by creating illusions that a third party was contractually obliged to pay the amount of any losses. However, the third party was an entity in which Enron had a substantial economic stake. In discussions of accounting practices with Arthur Andersen, the partner in charge of auditing, views inevitably led to the client prevailing. However, good financial reporting is not a sufficient condition for the effectiveness of corporate governance if users don't process it, or if the informed user is unable to exercise a monitoring role due to high costs (see Systemic problems of corporate governance above),

5. Definition and Elements of Financial Reporting

Financial reporting is largely an effort to assess financial performance, that is, how well

•or how poorly the government performed with money entrusted to it. Financial decisions include raising and spending money as well making promises that have financial consequences. Financial reporting is considered a part of governmental accountability for financial decisions. Exactly how financial reporting is done depends in part on the model selected. With either model, many types of financial reports can be generated but a considerable amount of attention is given to the quantitative financial statements, which are one type of report, but usually the major report. These quantitative financial statements are found in the Comprehensive Annual Financial Report (CAFR).

Alternative Reporting Models: Compliance and Liquidity vs Accrual and Consolidation

The configuration and content of financial reporting and accounting in government is affected in large measure by one major issue: should government use its own model and set of principles or follow the model used by business? This issue is explored in detail in this paper. The two different models introduced in the beginning of this paper are defined and presented. The one mode) is called “The Compliance and Liquidity Model.” It assumes governmental information needs are different than those of business and thus there is a need for a separate and distinct mode). It focuses on assuring that the administration follows the legal directives of the legislature and that enough money is generated to pay the annual cost of government. The other, the accrual and consolidation mode), is essentially the model used by business. Many of those who see no basic difference between the information needs of government and business regard the accrual and consolidation model as the best and thus the one that should be used in government. It fries to match all expenses and promises with revenue collected so that costs are not pushed on to future generations. . The issue over appropriate model is presumed to be important since the assessment of financial performance can differ depending on which model is adopted. Learners will have an opportunity to use both models to assess financial performance. The battle over the models is technical and political; technical in finding factual grounds for the choice and political in using power to settle the issue. In fact, the battle continues as the Governmental Accounting Standards Board (GASS) for state and local accounting and reporting considers whether to add an accrual and consolidation perspective (called the entity wide perspective by GASB) to the compliance and liquidity model (which the board refers to as the hind model). If GASB decides to require reporting under both models, the board will call the approach the dual perspective. A. similar confrontation has been a part of deliberations for nonprofit organizations and for the federal government.

6. Financial Statements in Government: A Compliance and Liquidity Approach

We have decided to examine and critique the formal approach (i.e., the compliance and liquidity model) used by state and local governments to prepare their financial statements, particularly governmental hinds. For the most part, this will entail looking at the financial statements as they appear in the Comprehensive Annual Financial Report (CAFR) or financial statements released separately. The rules and format for these statements are established by the Governmental Accounting Standards Board (GASB). Given the nature and emphasis of the compliance and liquidity model, this chapter concentrates on the annual financial performance as reported in the financial statements in contrast to long term issues or consequences. In the compliance and liquidity model, costs or promises that go beyond one year are not given the same attention in the financial statements as are current inflows and outflow of money.

7. The Accounting Cycle in Government

In order to move from the big picture of the alternative models and the prevailing reporting approach to the details of generating financial statements under the current model, there is the need the for details, and such details are called “The Accounting Cycle.” In short, the accounting cycle is the process that takes the detailed day-to-day transactions and events and converts them to the aggregate level financial statements and also closes the so-called books in order to ready the process to start again. The role of the Accounting Equation as a link between the big picture and the details in introduced. The coverage of the cycle is done by discussing and defining the steps in the cycle and by offering simple and complex examples of the cycle. The cycle is briefly presented for the commercial model. It is done more thoroughly for governmental hinds which would include: general, special revenue, capital projects, and debt service. The cycle is also covered for account groups which include fixed assets and long term debt. The emphasis is on the accounting cycle for the current compliance and liquidity model.

A financial statement (or financial report) is a formal record of the financial activities of a business, person, or other entity. In British English—including United Kingdom company law—a financial statement is often referred to as account, although the term financial statement is also used, particularly by account. For a business enterprise, all the relevant financial information, presented in a structured manner and in a form easy to understand, are called the financial statements. They typically include four basic financial statements:

1. Balance sheet: also referred to as statement of financial position or condition, reports on a company's asset, liabilities, and Ownership equity at a given point in time.

2. Income statement: also referred to as Profit and Loss statement (or a "P&L"), reports on a company's income, expenses, and profits over a period of time. Profit & Loss account provide information on the operation of the enterprise. These include sale and the various expenses incurred during the processing state.

3. Statement of retained earnings: explains the changes in a company's retained earnings over the reporting period.

4. Statement of cash flows: reports on a company's cash flow activities, particularly its operating, investing and financing activities.

For large corporations, these statements are often complex and may include an extensive set of notes to the financial statements and management discussion and analysis. The notes typically describe each item on the balance sheet, income statement and cash flow statement in further detail, Notes to financial statements are considered an integral part of the financial statements

8. Purpose of Financial Statements by Business Entities

"The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of uses in making economic decisions' financial statements should be understandable, relevant, reliable and comparable. Reported assets, liabilities and equity are directly related to an organization's financial position. Reported income and expenses are directly related to an organization's financial performance. Financial statements are intended to be understandable by readers who have "a reasonable knowledge of business and economic activities and accounting and who are willing to study the information diligently." Financial statements may be used by users for different purposes:

• Owners and managers require financial statements to make important business decisions that affect its continued operations. Financial analysis is then performed on these statements to provide management with a more detailed understanding of the figures. These statements are also used as part of management's annual report to the stockholders.

• Employees also need these reports in making collective bargaining agreements (CBA) with the management, in the case of labor unions or for individuals in discussing their compensation, promotion and rankings. Prospective investors make use of financial statements to assess the viability of investing in a business. Financial analyses are often used by investors and are prepared by professionals (financial analysts), thus providing them with the basis for making investment decisions.

• Financial institutions (banks and other tending companies) use them to decide whether to grant a company with fresh working capital or extend debt securities (such as a long- term bank loan or debentures) to finance expansion and other significant expenditures.

• Government entities (tax authorities) need financial statements to ascertain the propriety and accuracy of taxes and other duties declared and paid by a company.

• Vendors who extend credit to a business require financial statements to assess the creditworthiness of the business.

• Media and the general public are also interested in financial statements for a variety of reasons.

8.1. Government Financial Statements

The rules for the recording, measurement and presentation of government financial statements may be different from those required for business and even for non-profit organizations. They may use either of two accounting methods: accrual accounting, or cash accounting, or a combination of the two (OCBOA). A complete set of chart of accounts is also used that is substantially different from the chart of profit-oriented businesses.

8.2. Financial Statements of Non-Profit Organizations

The financial statements of non-profit organizations that publish financial statements, such as charitable organizations and large voluntary associations, tend to be simpler than those of for- profit corporations. Often they consist of just a balance sheet and a 'statement of activities" (listing income and expenses) similar to the "Profit and Loss statement" of a for-profit.

8.3. Personal Financial Statements

Personal financial statements may be required from persons applying for a personal loan or financial aid. Typically, a personal financial statement consists of a single form for reporting personally held assets and liabilities (debts), or personal sources of income and expenses, or both. The form to be filled out is determined by the organization supplying the loan or aid.

9. Audit and Legal Implications

Although laws differ from country to country, an audit of the financial statements of a public company is usually required for investment, financing, and tax purposes. These are usually performed by independent accountants or auditing firms. Results of the audit are summarized in an audit report on that either provides an unqualified opinion on the financial statements or qualifications as to its fairness and accuracy. The audit opinion on the financial statements is usually included in the annual report. There has been much legal debate over who an auditor is liable to. Since audit reports tend to be addressed to the current shareholders, it is commonly thought that they owe a legal duty of care to them. But this may not be the case as determined by common law precedent. In Canada, auditors are liable only to investors using a prospectus to buy shares in the primary market. In the United Kingdom, they have been held liable to potential investors when the auditor was aware of the potential investor and how they would use the information in the financial statements. Nowadays auditors tend to include in their report liability restricting language, discouraging anyone other than the addressees of their report from relying on it. Liability is an important issue: in the UK, for example, auditors have unlimited liability.

In the United States especially in the post-Enron era there has been substantial concern about the accuracy of financial statements. Corporate officers (the chief executive officer (CEO) and thief financial officer (CFO) are personally liable for attesting that financial statements do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report." Making or certifying misleading financial statements exposes the people involved to substantial civil and criminal liability. For example Bernie Ebbers (former CEO of WorldCom) was sentenced to 25 years in federal prison for allowing WorldCom's revenues to be overstated by S 11 billion over five years.

10. Standards and Regulations

Different countries have developed their own accounting principles over time, making international comparisons of companies difficult. To ensure uniformity and comparability between financial statements prepared by different companies, a set of guidelines and rules are used. Commonly referred to as Generally Accepted Accounting Principles (GAAP), these set of guidelines provide the basis in the preparation of financial statements. Recently there has been a push towards standardizing accounting rules made by the International Accounting Standards Bcg4 ("lASS"). TASB develops International Financial Ripping Standards that have been adopted by Australia, Canada and the European Union (for publicly quoted companies only), are under consideration in South Africa and other countries. The United States Financial Accounting Standards Board has made a commitment to converge the U.S. GAAP and IFRS over time.

11. Summary

As, a matter of good governance, the signing of accounts and the annual directors' report should consider the following matters.

1. It is not good practice to have only one director sign the reports.

2. The board resolves who will sign, and best practice suggests the signatories would be: The chairman of the board (if a non-executive director) or the senior non- executive director, and the chief executive (if a director), or the chairman of the Audit Committee (if a non- executive director). The sole signature of the chief executive or chairman of the Audit-Committee or of any one director is not sufficient.

In addition, the chief executive and the chief financial officer (by whatever titles they may be known) certif3' in writing to the board that the financial statements are true and correct, that the entity has complied with all relevant laws and regulations and that there are no outstanding matters that may affect the accuracy of the financial statements. The board should approve the auditors' representation letters and ensure their signatures are authorized by the chief executive and chief financial officer.

The certification should only be provided after all appropriate investigations have been conducted.

When the Audit Committee commences deliberations in relation to adopting financial reports, it is good governance for the committee to:

1. Receive and review: the statements by the chief executive officer (or equivalent) and chief financial officer (or equivalent) that the entity's financial reports present a true and Fair view, in all material respects, of the entity's financial condition and operating results in accordance with relevant accounting standards

2. All other wording to appear in the annual report ensure that appropriate accounting techniques have been adopted in the preparation of the financial report and any changes have been appropriately addressed and approved

3. Assess if there is any correlation between executive remuneration and financial performance that could influence accounting practices

4. Meet with the external auditor to discuss the financial report, including issues such as any aggressive or conservative accounting treatments adopted by the entity, additional disclosures recommended by the auditor and details of the wording of the audit report 5. Ensure that all related party transactions are thily recognized, recorded and disclosed

6. Ensure that the financial reports reflect the Audit Committee understands of the performance of the entity during the financial period

7. Ensure that the company can pay its debts as and when they fall due, and that this is reflected in the financial statements

8. Consider the issue of the company as a going concern and whether any statement is required by the directors

9. Report to the board on the committee's review of the financial report.

12. Conclusions

Financial Reporting 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, it 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 group. This paper is completely a conceptual one whose basic foundation comes from various secondary sources like research articles, published and unpublished scholarly papers and books; various international and local journals, speeches, newspapers and websites. The linkage of accounting for successful corporate governance is the personal idea of the author. To remain with the main idea of the paper, OCO is defined followed by a discussion of different variant of frameworks of GCG, status of corporation, accounting and GCG inter-relationship, justification with the concluding remarks at the end. GCG is a must for today's complex and dynamic business environment to ensure long term sustainability. So, it should be cultivated and practiced regularly within the current structure of the business. We may institute international awards for good governance behavior, and promote a global corporate governance ranking system. If, as corporations, we ignore the lessons that companies like Enron, WorldCom and Tyco have to offer, we will fail to regain the public trust that is so essential to our long-term success and survival. Corporations that genuinely recognize and embrace the principles of 'good governance' will derive enormous benefits, the availability and lower cost of capital, the ability to attract talent clients and business partners, improved competitiveness and financial performance, and truly sustainable long-term growth.

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