CORPORATE GOVERNANCE RELATION WITH ACCOUTNING STANDARDS

PhD candidate Mr. ISSAM MF SALTAJI
Academy of Economic Studies, Bucharest, Romania
createmyworld@mail.ru

Abstract

The main objective of paper is to highlight on corporate governance relation with accounting standards through checking selective data base of leading companies in business world, annual reports of IASB, and random academic researches. Business world has been changes rapidly and dramatically requesting to harmonize accounting standards and corporate governance. The significant review of accounting standards is moved toward fair value evaluation called "mark-to-market accounting" shown obviously in IFRS 9 applied in 2013. Applicable guideline for IFRS 9 is presented in this paper with enhancing influences of corporate governance on responsible entities to adopt fair value as single measuring method. The main objective of these responsible entities is to gain lost-truth in financial markets. The paper presents a new perspective to academic researchers in relating accounting standards to corporate governance.

KEY WORDS: Accounting Standards, Corporate Governance, Fair value, Financial Instruments.

JEL classification: G34, M41, Q 56

1.Introduction

Recently significant emendations have taken place in accounting standards concentrating on measuring method. Using fair value as main measuring method in International Financial Reporting Standards is a step of several steps done by responsible organizations and institutions to face the new challenges of business world, which came as a result of integrating relationship between globalizations and unmoral attitude of leading

companies to reach unstable financial situation. Over all enhance a belief that companies should be prepared for globalization instead of stepping away, all challenge can be managed by well monitoring. That cannot be done only by adopting new measuring method. There is important need to develop corporate governance with allowing it to take its nature position in business world.

Corporate governance has been existed in academic research in eighties of last century and even before started with adopting new production technology, opened economy markets and mobilizing capital. That means globalization helps corporate governance to grow up to be as an individual applicable set applied in business world (Keasey, Thompson and Wright, 2005). Relating that with agency theory illustrates how governance is moving in internal and external levels. By having internal view; corporate governance concentrates on internal stakeholders and their relations to ensure decisions implemented correctly to create value for shareholders (Keasey, 2005). Value creation of shareholder can be done smoothly through interests' reconciliation of stakeholders done by governance mechanism. Value creation can take two perspectives: Accounting perspective; investors need a fair financial statements presentation before making investing decision, Governance's perspective: investors are social members have interests in corporate responsibility. Therefore, investing decision is not related to company success only, but company behavior with employees and society is important as well. American experience with collapsing financial institutions such as Enron and WorldCom is considered as a note that significant individual failures of a company can be spread leading to misallocation of funds in short-run and systemic impacts in long-term investment if trust is affected negatively (Keasey, 2005). Applying agency theory with globalization influences moves interests' conflicts between shareholders and other stakeholders to be between managers and all stakeholders including shareholders to set a need of having monitoring tools on management. Ira M. Millstein says that disclosing financial, operational and controlling reports highlighting on management attitude to protect all shareholders, provides affective strategies and maintains independence in business plans through directors' controlling on management performance.

Corporate Governance and Accounting Standards

In the last decade many changes have taken place in accounting standards as responding on financial scandals. Summarizing that can be categorized in two main types; measuring methods and disclosing requirements. Accountably responding on these changes can be simply

presenting in recognition and measuring methods. The relationship between fair value evaluation and invest decision with fixing other factors affects on equity and share capital positively. Quantitatively, there are no remarkable changes in International Accounting Standards and International Financial Reporting Standards limited on replacing standards. Qualitatively accounting standards are improved through adopting new measuring method presented in fair value, which is an independent factor and financial statements items are related factors. Empirical evidences show that measured items of financial statements by fair value are more likely to gain the lost trust of investors than traditional financial statements. As well the necessity of corporate governance is increased recently to pressure on the International Accounting Standards Board – IASB to amend accounting standards meeting governance needs. Many researches have treated these two topics individually and deeply without trying to connect accounting standards changes with governance developing requirements.

Corporate governance has failed to prevent financial scandal asking academic researchers and concerning institutions to develop corporate governance. The contents of corporate governance are increased dramatically with strong adopting by companies through issuing regulations and giving more space for self-regulation. By looking by one eye that could be an amazing effort has done by experts in this field, but that is limited since corporate governance is not acting alone in business world. There is an important partner called accounting standards need to be updated and improved as well. Governance reports must be presented in numbers attached to financial reports that means accountancy and corporate governance are communicating by accounting standards. Taking United Kingdom experience of corporate governance strongly considered as global application, corporate governance failures in facing financial crisis are reflected by adopting new changes in governance codes presented as the following (UK Corporate Governance Codes):

Code	Number		Category
Cadbury code 1992	-	⇩	Main principles
Greenbury code 1995	-		
Combine code 1998	-		
Revised combine code 20003/06/08	17		
British corporate governance code 2010	18		
Cadbury code 1992	-	⇩	Supporting principles
Greenbury code 1995	-		
Combine code 1998	-		
Revised combine code 20003/06/08	26		
British corporate governance code 2010	24		
Cadbury code 1992	-	⇩	Principles
Greenbury code 1995	-		
Combine code 1998	17		
Revised combine code 20003/06/08	43		
British corporate governance code 2010	42		
Cadbury code 1992	19	⇩	Provisions
Greenbury code 1995	39		
Combine code 1998	47		
Revised combine code 20003/06/08	48		
British corporate governance code 2010	52		

The experience of American auditors is reflected in Sarbanes Oxley, which should grant assuming possibility for external auditors to expand role of providing confidence review on directors' statements of corporate governance, has been failed as well. Each code contains independent provisions and principles which in somehow minimize the role of external auditors to keep it in role of effective contributing with other stakeholder ensuring corporate governance. These updating or changes can be dropped on accounting standards. Simply checking accounting standards starting from 1990 till now tells that natural positive relationship between changes in corporate governance and in accounting standards exists.

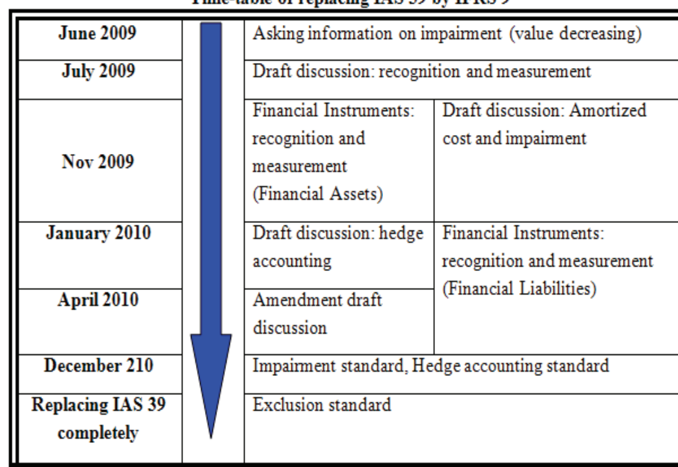
The fact is that corporate governance supports Financial Reporting through assuring the need of high level of transparency; high quality standards and framework of regulation create a development key of economic. Financial statements provide indispensable information about a company to stakeholders. This information should be reliable, free-bias and comparative meaning that financial reports in cooperating with accounting standards to reflect a fair and real view of financial situation although to assure accountability. Financial crisis after global economic growth and

corporate governance failures raise many challenges to be faced by business world through growing need to enable high quality of accounting standards to take place. In common sense board responsibility should be increased to be pursued with all stakeholders. G 20 enforces accounting institution to do more efforts in this direction; the responding comes from International Accounting Standards Board (IASB) by developing IFRS. In same direction of assuring high quality of accounting standards, corporate governance responsibility is growing up to face challenges of financial crisis caused by insufficiencies of financial reports and missing real disclosure. That makes real and visible problem caused of combing failures of accounting standards and corporate governance (UK Corporate Governance Code 2010). Principle-based characterizes IFRSs' features instead of rule-based; IFRSs involve widely in judgment of suitable accounting policies and substitute treatments including adoption time issue and developing acceptable high quality standards through issuing principle-based reporting standards and removing allowance of accounting substitutes by assuring better measuring method presented in fair value to be used in judgments, assumptions and estimates of management. Over all, important impacts affect on financial reports and force auditor committee and board of directors to deal with challenges effectively and to concentrate on how IFRSs gear companies' reports and how the quality of accounting standards should be increased. Also as part of the solution, IASB moves in three direction; toward generalizing accounting standards across all the world making accounting standards comparable between different companies in different places in same domain, other movements is that IFRS and IAS emendations adopt fair value serving transparency, and updating disclosure standards to cover gaps of pervious experiences.

Many academic researchers have described low-levels of integrity and low quality of financial reports as a result of governance and accounting standards limitations. To solve this issue is required process changing of corporate governance, but that cannot be done without changing in accounting standards. Accounting is part of boarder governance system, and governance limitations comes from weakness of accounting integrity and low quality of financial reporting creating a need from responsible players to act wiser. All of that is presented by IASB movement to apply widely fair value meaning IFRS will be "Fair-Value Based Standards". The valuation approach that IASC has embraced, is rapidly introducing 'fair value' as the primary basis for asset/liability measurement that financial reporting under IFRS largely involves in recognition process of asset and liability, initial measurement by fair value, largely revaluating at fair value and de-recognition. (Ernst & Young, 2005, p. 2)

Personal consideration, IFRS 9 is issued as responding to financial society demands communicating with governance requirements. Starting with 2013 IAS39 is considered from past through replacing with IFRS 9. The issue is not only related to categorizing financial statements' items, it is how to present these items and it becomes complicated with financial instruments. In 2009 the world leaders in G 20 announced that financial reports need some improvements especially IAS 39 to reduce its incompatibilities and difficulties. Some items had been recognized and others derecognized, which means the new standards must be applied in comparative period determining derecognized items. New classification models for financial assets and for amortized cost are found in IFRS 9 with no possibility of escaping from fair value estimating for non-enclosed equity investment, because of rising cash flow on certain dates exclusively considered as payments or interest on principal invest amount. European Union makes decision to delay applying IFRS 9 widely depending on financial considerations. In my opinion applying IFRS 9 now means financial assets must be re-evaluated in fair value, and by comparative methodology these assets are decreased by different rates inside EU. These losses must be recognized to affect the general financial situation to add other crisis for EU.

The decision was done by IASB cooperating with Accounting Council in United States of America to emendate Financial Instruments standard replacing IAS 39 with IFRS 9 through three stages; the first stage is focusing on financial assets recognition and measurement and other stages focus on impairment of financial instruments, hedge accounting, financial liabilities and exclusion.



Time-table of replacing IAS 39 by IFRS 9

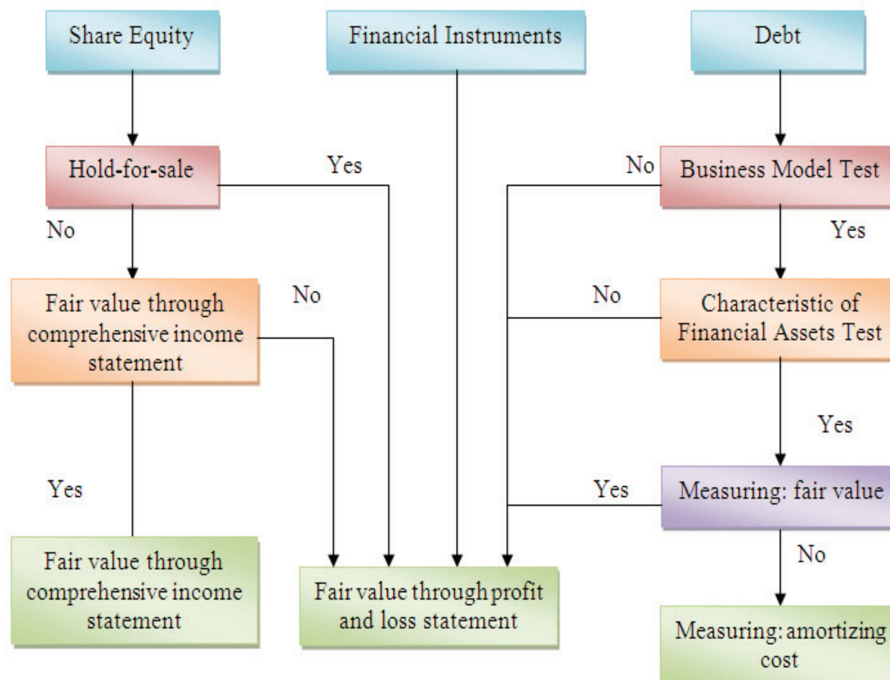
June 2009	Asking information on impairment (value decreasing)	
July 2009	Draft discussion: recognition and measurement	
Nov 2009	Financial Instruments: recognition and measurement (Financial Assets)	Draft discussion: Amortized cost and impairment
January 2010	Draft discussion: hedge accounting	Financial Instruments: recognition and measurement (Financial Liabilities)
April 2010	Amendment draft discussion	
December 210	Impairment standard, Hedge accounting standard	
Replacing IAS 39 completely	Exclusion standard	

Debt instruments: financial report indicates that financial assets are debt instruments should be tested in order to know if it is measured by using amortizing cost or not. Financial assets were hold according to Business Model – assets are retained to take advantage of cash – amortizing cost was used, among financial assets test – contractual conditions of financial instruments are referred in the date of cash flows considered as only payments for the asset and accrued interests basis on that asset – Fair value were used. Financial assets shall be measured at fair value, when is considered as investments in shares to be recognized in profit and loss statement. The company's option of financial instrument is not changeable unless investments in shares are hold for sale and in this case these investments must be recognized as profit or loss at fair value.

Transitional period: the actual date to apply IFRS 9 is the first of January 2013 with allowing earlier applying after first stage December 2009. The new standard is applicable in European Union countries with limitations. IFRS 9 is applied retroactively and the possibility of using amortizing cost or fair value for financial instruments is related to balance sheet instruments structured on facts and circumstance were available from fist applying. That asks financial statements after that date to not be tabulation.

Significant impact of applying IFRS 9: The applying of IFRS 9 will be different from company to another depending on impacts are caused by new rules of recognition and transitional period on profit and loss statement (IAS 39). By applying amortizing cost according to IFRS 9 only part of losses will be recognized in profit and loss statement caused by improvements of markets when IFRS 9 is applied. In same way, when the instrument were measured by amortizing cost (IAS 39) then it will be recognized by fair value through profit and loss statement (IFRS 9). Equity instrument hold-for-sale is re-recognized by fair value in profit and loss statement (IFRS 9), and investments hold-for-sale and recognized by fair value will be shown in comprehensive income statement (IFRS 9). Impairment of fair value will not be recorded as impairment, it will still appear in comprehensive income statement, and for instrument hold-for-sale and its value does not decrease by measuring at amortizing cost (IFRS 9), it will be reserved in comprehensive income statement.

Applicable guideline of IFRS 9



Challenges facing IFRS 9: the challenges can be presented as the following:

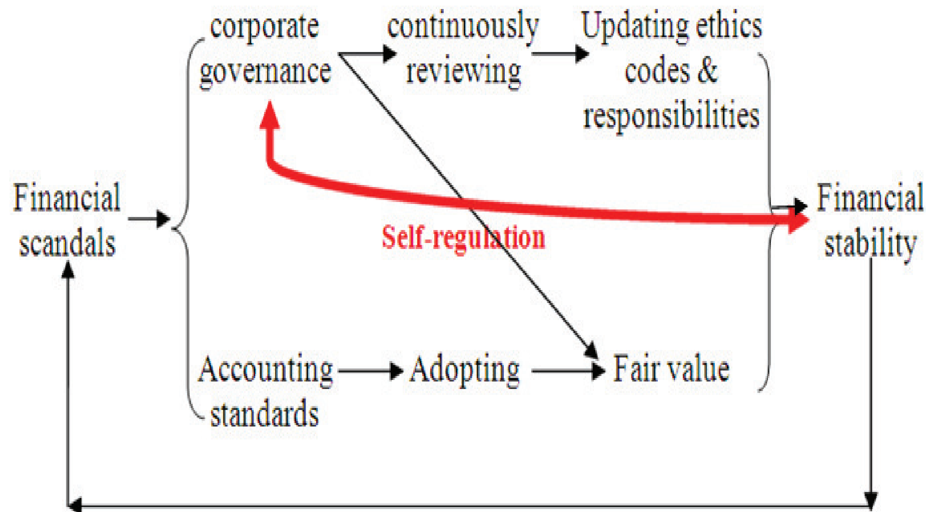
- ➢ Company needs to evaluate all financial instruments by IFRS 9. That requires applying necessary modifications on accounting system.
- ➢ There are many areas need to diligence and interpretation.
- ➢ Re-recognition financial instruments measured by IAS 39 may need to be recognized in fair value depending on business model and its characteristics.
- ➢ Re-recognition slides of debt securities will be complicated, because it will be subjected for underlying examination.
- ➢ Re-recognition financial assets from fair value to amortized cost; it is impossible to apply hedge accounting retroactively. The fair value amounts of last year would need explanation in case of profit or loss of these financial assets reflected on last year statement by changing financial instruments values. In addition, the effect on retrain earning of transitional period could be essentially in

case of re-recognition hedge item retroactively by amortized cost and derivatives by fair value.

- The company needs to determine the tax affection and supervisory authorities when IFRS 9 is applied. That means changing in measuring method lead to changes in net profit and loss statement of the period.

Conclusion

The crazy financial collapsing calls out all entities in business world to gather their efforts to breathe out through achieving stability in financial markets. That cannot be achieved without gaining mistrust in financial market and enhancing strong relationship between corporate governance and accounting standards (Shankaraiah, 2005). Accounting standards and their principles should be well-understood serving powerful corporate governance, because IFRSs are principle-based depend in their practices on management's judgments required ethical behaviors from managers to judge all stakeholders' interests. In other hand, the changes in accounting standards require time from companies to adopt and to understand these changes otherwise these changes will be useless and leave the door open for more corruption ensuring that all regulatory entities are part in convergence implementation with IFRS. In meanwhile, necessary regulations are issued to strengthen convergence with IFRS and to be completed correctly; for example tax-parity should assure on convergence and non-convergence accounts. Fair value as estimating method has clear objective of reflecting financial information clearly to be transferred to stakeholders helping them in decision-making. This information is used by new investors to determine the direction of company's performance in future. Also for employees, this information helps them to make decision to continue working in that company in case that their individual interests are going in same direction with other stakeholders' interests especially shareholders. This relation between corporate governance and accounting standards can go far than accounting evolution to involve in official accounting regulations such as tax legalizations; taxes have meaning far than achieved obligation from a company to government, it is that way to redistribute fortune to poor people, develop societies and protect environment meaning that corporate governance has its own way to communicate with accounting regulations.



References

1. An Overview by The World Commission on Environment and Development, http://www.un-documents.ne
2. Bob Tricker, 2010, Twenty Steps to Better Corporate Governance http://corporategovernanceoup.wordpress.com/category/economic-crisis/
3. Bob Tricker, 2011, The Cultural Dependence of Corporate Governance http://corporategovernanceoup.wordpress.com/category/corporate-governance-models/
4. Bob Tricker, 2012, UK Stewardship Code - Compliance http://corporategovernanceoup.wordpress.com/tag/financial-reporting-council/
5. Chairman Alan Greenspan, 2002: Corporate Governance, At the Stern School of Business, New York University, New York, New York.
6. Deloitte, 2011 – IFRS9 – impairment survey 2011: a changing landscape, available at http://www.deloitte.co.uk
7. EC staff consolidated version as of 18 February 2011 FOR INFORMATION PURPOSES ONLY: International Accounting Standard 39 Financial Instruments: Recognition and Measurement, available on-line at http://ec.europa.eu/internal_market/accounting/docs/consolidated/ias39_en.pdf

8. Financial Reporting Council, Codes & Standards: Corporate Governance http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance
9. Accounting Horizons, 2003. *Accounting quality, auditing, and corporate governance*http://business.highbeam.com/3839/article-1G1-105368179/accounting-quality-auditing-and-corporate-governance
10. International Financial Reporting Standards: IFRS 9: Financial Instruments (Replacement of IAS 39) http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Instruments-A-Replacement-of-IAS-39-Financial-Instruments-Recognitio/Pages/Financial-Instruments-Replacement-of-IAS-39.aspx
11. International Financial Reporting Standards (IFRS) 9 Financial Instruments: Disclosures, available at: http://www.iasplus.com.
12. Kenneth W. Freeman 2011; To Create Long-term Shareholder value, start with Employees.
13. Kevin Keasey, Michael Wright, Steve Thompson 2005, Corporate Governance: Accountability, Enterprise and International Comparisons, Wiley, John & Sons.
14. Kevin Keasey, Steve Thompson, and Michael Wright, 2005, Corporate Governance: Accountability, Enterprise and International Comparisons. www.amazon.co.uk
15. Patrick McColgan; 2000: Agency theory and corporate governance: a review of the literature from a UK perspective; available at http://www.google.co.uk/url?sa=t&rct=j&q=agency+theory+and+corporate+governance&source=web&cd=1&cad=rja&ved=0CDQQFjAA&url=http%3A%2F%2Fciteseerx.ist.psu.edu%2Fviewdoc%2Fdownload%3Fdoi%3D10.1.1.202.286%26rep%3Drep1%26type%3Dpdf&ei=uNdHUanMHeam4gS4zoHIDw&usg=AFQjCNFYvxEonNI9m9ykJgWCRFfOIwXHIQ&bvm=bv.43828540,d.ZWU
16. STEPHEN SPECTOR, MA, FCGA, 2009. International Accounting Standard 39 (IAS 39), Financial Instruments: Recognition and Measurement, available on-line at http://www.cga-pdnet.org/Non_VerifiableProducts/ArticlePublication/IFRS_E/IAS_39.pdf