# Issues In Accounting and Accountability

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***Abstract- This research aims to describe financial reporting and its roles, challenges as well as limitations in today's business world. It goes further by explaining the extent of the importance of financial reporting in facilitating informed business decision-making, contributing to an efficient capital market, and enabling shareholders to hold management accountable, through a theoretical approach of agency and stewardship theory. The second part of the paper examines the concept of corporate governance, audit committees, and gender-diverse boards, and the contribution of audit committees and gender-diverse boards in providing assurance and improving reporting quality. It also highlights that corporate governance legislation requirements vary between countries, it's optional in some and mandatory in others, by using examples of Enron and Parmalat. Findings revealed that gender-diverse boards make better and sound decisions. It concludes by emphasizing that, the efficacy and heterogeneity of the board and audit committee have been shown to enhance financial reporting and collaboration by increasing the disclosure and trustworthiness of financial statements and audit quality by minimizing the risk of a report of auditing.***

Question 1 "Financial reporting plays a key role in facilitating informed business decision making and contributes to an efficient capital market". Explain why financial reporting is considered important and discuss how usefulness and limitations of financial reporting is enabling shareholders to hold management accountable.

A Financial Report (FR) is a disclosure of financial statements other useful and relevant financial information over a duration, identified, measured and transmitted Info in order to allow relevant parties/users of such info make better judgements and take more informed decisions. Like Tesco, Next and all other annual reports' financial reporting, most, not all, companies structure their report using similar format, content and pattern. They include information such as strategic report, cooperate governance and financial statements with emphasis on highlights, cash flow, dividends, key performance indicators, business model amongst many other aspects of business operations. In addition to this, they also contain all over other financial info gathered through the accounting process, which are unaudited financial statement, press releases, newsletters, company forecasts, and projections etc. In general, strong financial reporting reflects competition and excellent corporate governance

FR has changed and become broader overtime. Some decades ago, FR was only practiced to the concept of stewardship where reports were limited to and based on the contribution of wealth of the owners. But today, FR has gone way beyond that especially with the growth of financial markets and has started incorporating performance related and decision-usefulness concerns in FR. Besides the need to attract both local and foreign investors as well as acquire capital has led to the expansion of financial disclosures. James Doty, the chairman of The Public Company Accounting Oversight Board (PCAOB) in his speech at Rice University, stated that ''*corporate governance has evolved to suit the needs of capital markets''* and that *''the auditing profession must heed changes in public needs and demand to maintain its importance to capital markets"* (Watts and Zuo, 2016).

The nature of FR is such that it is based on accounting principles, concepts and conventions, such as reliability and relevance, assumptions/presumptions like going concern and opinion and judgements like depreciation. Therefore, due to this nature, FR has some strengths and weaknesses depending on the accounting theory that is used to view it. Accounting theories, such as agency and stewardship theory, use hypothesis and principles to form a conceptual framework to describe or prescribe the expectations of accountants, the focus of FR and who it should be

addressed it. It talks about accounting regulations what we regulate and how we regulate financial reporting.

In agency theory shareholder's knowledge is always different from manager's knowledge, which leads to the asymmetric information, hence the need for FR. The directors/managers (agent) usually act in their personal/ selfish interest and not in the interest of the shareholders (principal). For instance, as an experienced international tax specialist, I have encountered many situations where multinationals incorporate creative accounting such as window dressing, accounting engineering to practice Base Erosion and Profit Shifting (BEPS) which leads to partial or non-disclosure, especially concerning their cross-border transactions and their transfer pricing affairs. Most digital giants like Apple, Netflix, and many others, hide transactions with related parties, subsidiaries, associate companies (especially those situated in tax havens because they usually have stringent non-disclosure agreements and high level of secrecy), in order to reduce, avoid and sometimes completely evade, dividends to certain shareholders and tax obligations to the government.

In Stewardship theory, the shareholders nominate the directors who act as stewards in their interest. Their first duty is to the shareholders and not to themselves or any other stakeholder. Directors are accountable to shareholders on the use of their capital and the maximization of returns of that capital. They are expected to work with the highest level of integrity and independence; however, this is not usually the case.

The first strength of FR is that choice is substantially reduced as a result of this regulation, hence, there is global uniformity in its core. Secondly, it can be regulated in two ways, by law and through standards. Within this regulation, there is also enforcement. It is hard to compare accounting reports provided by companies based in regions across the world in the absence of uniform standards and rules. In 2002, the EU made a law that mandated all companies in those countries to adopt International Financial Reporting Standards (IFRS) in the preparation and reporting of their financial statements. The U.K was part of them. Apart from the EU, other countries in some parts of Asia, America and Africa were also compelled to adopt IFRS in 2005. Those who didn't comply to this regulation, practiced accounting standards accurately reflecting the IFRS. The US, Canada and Japan are exceptions to the rule. Because they use other accounting standard boards such as the US Generally Accepted Accounting Principles (US GAAP). Third, FR is mostly regarded as general purpose as it contains generic information, and it is prepared by the company for the general public. Lastly, it is quite reliable because it is prepared by people who are professionally qualified and experienced.

Apart from its strengths, certain limitations and weaknesses of FR have been debated all over the world. It has been argued that since FR is highly regulated, it can be very rigid, and that compliance may not necessarily be appropriate, hence it is less likely to adapt. Many also argue that it is not in qualitative nature because it is number based and it doesn't address other areas of the business that shareholders are interested in i.e., climate, carbon, environment and sustainability etc. This means that FR is not all that there is and the lack of qualitative information, could also determine the decision to invest by shareholders. To add, sometimes FR doesn't reflect current business reality as entries can be altered i.e., under or overstated by inexperienced bookkeepers in the sense that it is highly subjective as judgements could materially misstate the report produced, because the company is not telling you what exists, they are telling you what they believe you should know, which leads to disinformation, misleading or harmful that could be to the detriment of the shareholder. The use of highlight statements which could be misleading to users of accounting info, especially when those users are less financial literate as seen in the Tesco report, where the highlight showed that the company had a percentage increase in revenue in 2021 but the continuing operations showed that they made a loss that same year. Besides, value judgement leads to bias in that agents can be selective in the whole process of FR, including or excluding of accounting method, what information to be disclose, and how to present such information can be manipulated to suit personal /self-interest and rationality as seen in agency and positive accounting theory. For the purpose of checkmating this, the reason what the audit committee was formed. An example is the case of bonus plan hypothesis, where managers and directors inflate figures for their benefits through creative accounting,

adjust accounting methods and omit some important financial information that they think will be detrimental to the image of the company but be of great advantage to them. Lastly, financial reporting is usually provided and incurred at a cost. For example, the cost of resources (manpower and other logistics), time cost (disclosure time vs understanding and usage time by the shareholders), and adverse effects of disclosure which relatively means the effects or impact of disclosing certain information on the organizations share price, brand and value.

It is important to note that, FR must provide information on management accountability. Management is accountable to the shareholders on how their resources are being utilized (efficiently and effectively) to run the company (stewardship and reliability), which is one of the key principles of accounting information.

Financial Reporting has been identified to be useful in four main functions. Firstly, in compliance with globally acceptable standards and penalties, companies prepare FR to avoid penalties, fines and sanctions associated with non-disclosure. They also comply to avoid public hostility towards the firm. Secondly, in finance and investing, shareholders use FR to assess the firm's ability to pay dividend on capital/equity borrowed. They are usually considered as the most important group out of all the users because they provide the equity needed to finance the company. They also use FR to make management accountable, that is, to evaluate the execution of the business strategy and their ability to generate long-term shareholder value. It serves as a rationale for investment in determining the level of risk involved and the return on investments. Thirdly, in terms of performance, FR is used to examine its financial strength, as a company and in comparison, to competitors (industry). Lastly, FR depicts the financial position of a company because it is used to know the knowledge of time, certainty and the company's capacity to generate cash flow/capital and future earning power over a period.

Financial reporting is not a goal, but rather a means to an end. Its other generic uses include, decision making, tool of evaluation and control, bargaining, measurement, forecasting, comparison, government regulation and taxation. It can also be used to secure credit and loan facility. FR shows the economic resources of a firm at a particular point in time and displays its capital structure in order to know its liquidity and solvency. Since it is prepared in compliance with various statutes and regulations, it can be used for statutory audit.

In conclusion, there has been a high demand for a shift in nature of FR to forward-thinking and non-FR to enrich rather than substitute FR. It has been observed that non-financial performance measures exceed financial key metrics, especially in today's fast-paced environment where businesses must be flexible and responsive to exist. Furthermore, excessive dependence on FPI has been accused of primarily favouring the interests of shareholders, which is contradictory to the pluralist approach of Financial Reporting. It should typically revolve around customers, employee and people relation, environment and sustainability, growth, innovation and development and value-chain creation and process (Aruwa, 2010).

Question 2 Explain what corporate governance is and discuss the contribution of audit committees and gender-diverse boards in improving reporting quality. Corporate Governance refers to the rules, laws, standards, codes operated, regulated and controlled in how businesses are governed and the exercise of power in supervising, controlling and directing the overall affairs of the company. Its main aim is to safeguard the integrity process of financial reporting (FR), and to give reasonable assurance that the financial statement provides a true and fair state of the company. It involves the monitoring of and accountability to shareholders and stakeholders. It also deals with the operations of the board in relation to the shareholders, managers, regulators, auditors and other relevant stakeholders. It is important to note that CG practices varies all over the world.

Corporate governance legislation requirements differ greatly between nations, with some being optional or suggested best practices and obligatory in others (Zaman et al, 2011). For example, while it is voluntary to comply in the UK, the Sarbanes Oxley Act compels the US to implement it. In the UK, companies are allowed to have a wider variety in the composition of

their board, compared to the US. In the US, companies are mandated to have audit committees (AC) while in the UK, AC is not compulsory.

Agency theory is the most often used theoretical framework for analyzing corporate governance. It gives an understanding for how contemporary corporations may be controlled, mainly through the establishment of two main control mechanisms: an external system, which is the demand for corporate control, and internal systems, the board of directors being the most important. Shareholders assign decision-making authority to executives inside an entity, through this potential agency costs are mitigated by boards exercising decision control, which includes supervising management decisions and performance (especially through independent Non-Executive Directors) (Roberts, McNulty, & Stiles, 2005).

A well-known example of CG failure is the fall of Enron, one of the greatest companies in the US (based on turnover) to exist during its time. The company's failure was as a result of poor financial management and lack of proper governance, as well as unethical practices and accounting frauds committed by the founder, directors and its auditors which led to a decline of its business operations, profitability, and ultimately its share price. This scandal led to the largest bankruptcy in the history of US and eventually the collapse of the business. Similarly, in the case of "Europe's Enron", Parmalat, an Italian company, whose founder also falsified its accounts, in its financial reporting, misled investors and other regulators, and led to its shutdown (Tricker 2015).
CG usually encompasses of the board and management, and sometimes their duties and responsibilities may overlap or be carried out completely separately, depending on whether it's a unitary or two-tier structure. The board refers to the group of people appointed by the shareholders to represent them, and they are legally responsible for the business. They are the most important pillar in CG. They formulate and determine the company's goals, strategies, plans, and objectives, and develop policies on how to achieve them. They also appoint the CEO. The board of directors usually appoints the management and while the management drafts the mission and vision of the company, the board approves it.

Research has proven that the more diverse a board is, the more holistic their understanding and approach will be. Thus, they tend to attach more importance to social responsibility and stakeholder issues. Higher-quality sustainability reports have been linked to gender-diverse boards, and independent female directors have a stronger influence on the quality of sustainability reporting than female directors.

To start, owing to more diverse viewpoints and non-traditional solutions to challenges, board diversity may have an impact on decision-making. A diverse board may show a better understanding of the business environment and may improve the board's capacity to identify the interests of different stakeholders. This could also lead to having access to the skills of individuals who are resourceful and bring great value to the organization.

Further, female directors have distinct values and are often more stakeholder-focused than male directors, according to Adams (2016). Their management styles are different compared to the male directors, and they are more likely to promote community projects and social responsibility. The participation of female directors on boards can strengthen stakeholder engagement and improve the authenticity of corporate reporting. Furthermore, female directors differ from male directors in terms of character, communication skills, academic background, and professional experience. Female directors are more morally opposed to lawsuits and reputational harm. Because of these variances, a gender-diverse board may have an impact on the performance of sustainability reporting.

Lastly, women directors seem to be more concerned about stakeholder interests, ethical standards, and socially responsible behavior, as well as taking steps to mitigate uncertainties. Females, in comparison to males, are more likely to create trusting relationships and hence place a higher value on increased stakeholder participation and the reduction of information asymmetry. They are also more socially and ethically conscious. As a result, a gender-diverse board is likely to influence sustainability reporting

quality due to females' stronger awareness for social responsibility problems and more stakeholder focus (Al-Shaer and Zaman, 2016). Studies have therefore proven that the gender of the board and the Audit Committee (AC) may affect audit quality, financial reporting quality and therefore, corporate governance. The introduction AC began in the 70's in the US, when the Securities and Exchange Commission (SEC) compelled all the companies to establish AC to establish a connection (by constantly raising relevant areas of concerns on accounting, finance, internal and external audit control systems) between the board and external auditors (Tricker, 2015).

The audit committee is responsible for monitoring the Audited Financial Statement (AFS) before the financials and other documents containing financial accounting information are made public. They also oversee the internal control systems, carry out risk management, observe the activities of the corporation's governing authorities and recommend the employment of external auditors, as well as authorize the appointment of internal auditors. They are chosen by the board, and they report to the board. Members and profile of the AC is essential to the confidence of the shareholders therefore it should not be viewed in isolation, because if the board is weak, the AC cannot be effective, because it is a subcommittee of the BOD. They are to ensure that FR is not materially misleading. It is important to note that these sub-committees do not replace the role of the board, instead they remain accountable to the board. The effectiveness of the Audit Committee, Management and External Auditors will normally affect the quality of a financial report. In ensuring that FR is not materially misleading, the AC must possess certain qualities, which are independence, size, diligence and expertise.

Independence refers to the autonomy and sovereignty of power. They must have the power and be able to use it in carrying out their duties without external influence. Any action they take will be bound on every shareholder. Diligence is how attentive to the quality of the work the AC is and sometimes the number of meetings they hold within a specified period. Size is the number of people that make up the committee. While some believe that, If the AC is too small, their capacity may be limited, and their opinion may not be given priority with the board, others believe that a smaller audit committee will improve control and monitoring functions. They also argue that a bigger audit committee would be less effective due to lack of cooperation and other practical considerations. As a result, the larger the audit committee, the harder it is for employees to exert influence on directors, making it even more difficult to oppose the recommendations made by external auditors (Oussii and Taktak, 2018). In terms of expertise, the members of AC should have sound financial knowledge, accounting, auditing and legal issues. They must also possess oversight, that is, the ability to venture into other parts of the business and not just only auditing.
In fact, the Smith Report (2003) and (Zaman et al., 2011) recommend that for an AC to be effective, it must have all non-independence executive directors who will have more authority over management in seeking a broader audit scope to ensure audit quality. As a result, AF would rise. Also, it must have at least a director with sufficient financial knowledge and experience because financially informed members can more successfully execute their supervisory function in the financial reporting process, such as recognizing significant misstatements. Hence reducing the possibility and occurrence of internal control issues. Further, the AC must meet at least thrice a year because meeting frequently can be an indicator of audit committee diligence and has been linked to a lower risk of fraud. Lastly, AC must have a minimum of 3 AC members since a larger audit committee is more likely to use its position and authority inside an organization to demand for greater audit quality.

In 2012, at an event in London, Doty said that ''*public investors require new safeguards of auditor independence and stronger ties among regulators to eliminate gaps in auditor oversight*'' (Watts and Zuo, 2016).

It is important to note that, auditors are usually given fees (Audit Fees and Non-Audit Service Fees) for their services and an increase in audit remuneration, affects the quality and effectiveness of audit committee, while the effectiveness of audit committee affects Corporate Governance quality i.e., there is a higher degree of monitoring and auditing. The board protects the auditor's independence by appointment and deciding their remunerations, hence that way they don't only

have control over auditors' quality but also have control over auditors' fees and NASf. Businesses with high-quality audit committees are more likely to perform their duties and supervise the external audit process more successfully than firms with low-quality audit committees, owing to the possibility for litigation and reputational damage. As a result of the need for a broader scope of audit, AF are anticipated to rise, to assure the audit quality organizations with high-quality audit committees, which is more likely to improve auditor independence and ultimately reinforce internal controls. NASF is projected to be reduced too, as a result of the control procedure. (Zaman et al, 2011).

In conclusion, effectiveness and diversity of the board & audit committee tends to improve financial reporting and cooperate governance, through transparency and reliability of F.S and audit quality through reduction in risk of audit opinion.

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