CORPORATE GOVERNANCE POLICY AND ITS INFLUENCE ON THE FINANCIAL REPORTS TO THE PUBLIC INTEREST ENTITIES

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Abstract: *For the global market players, financial and accounting information has become an essential component of the corporate governance mechanism. In the current context, the influence of corporate governance principles and codes on the structuring and quality of financial-accounting information in financial reporting is the basis for approaching quality financial reporting at the level of public interest entities. The impact of accounting phenomena and trends and those related to the transparency degree of information (central issue of governance codes) on the economic decisions of the financial-accounting information users reveal the importance of the present research study.*
Key words: *financial reporting, corporate governance, transparency and quality of the financial-accounting information, decisions, financial communications.*
JEL Code: *M41 – Accounting; G34 – Governance.*

1. Introduction

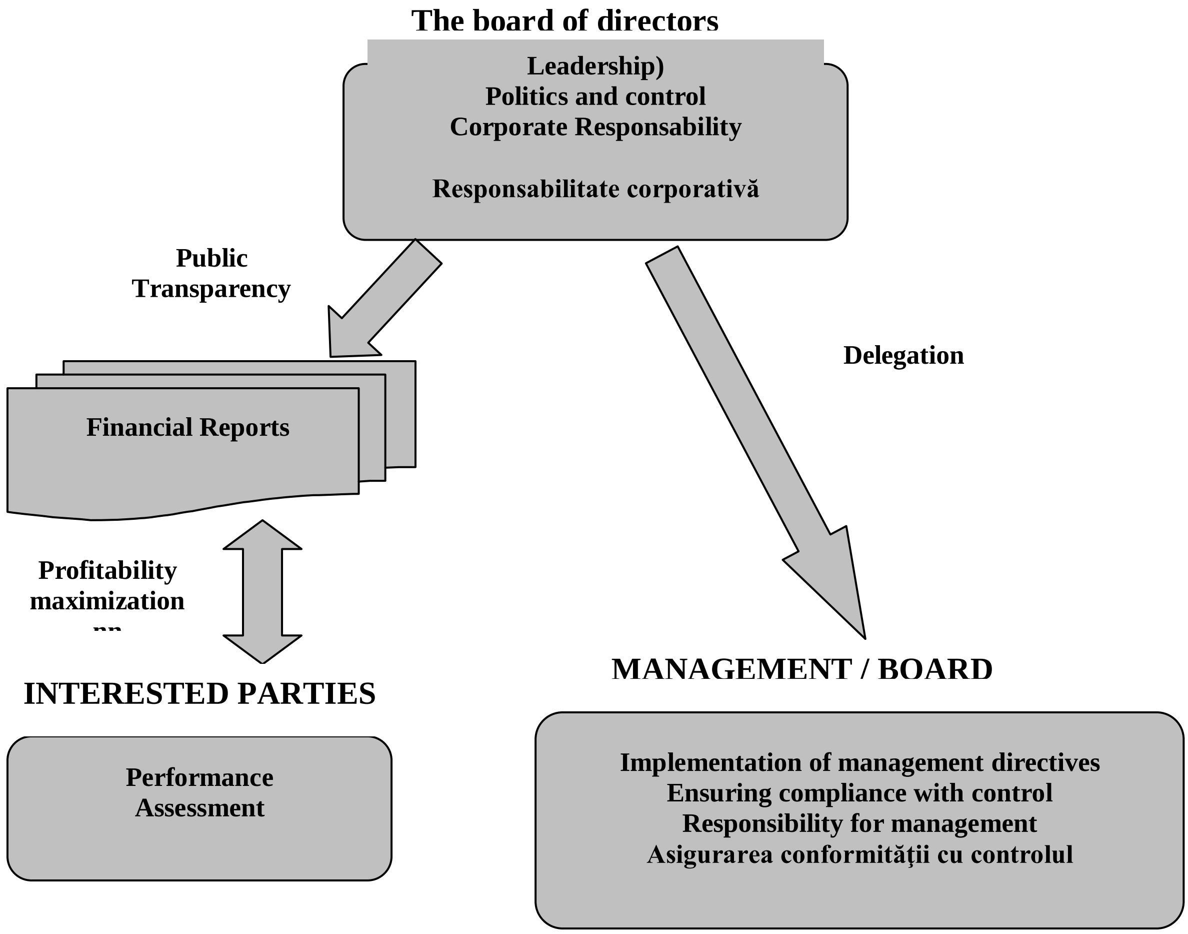
The financial reporting rules, in line with efforts to modernize the accounting techniques and policies, represent an essential element of the corporate governance system at European and global level. The relevant and especially credible information is intended to reduce agency conflicts and build trust between stakeholders' groups (Feleagă and Vasile, 2006, pp.21-30). The financial markets unification, the IT facilities for information disclosure and external communication, the volatility of the economic environment and the competition acceleration have imposed companies a continuous adjustment in order to be operational and efficient in the market. The lack of adequate information regarding the communication and transparency of information in financial reports has in some cases led to a corrosive effect on the level of trust in the reporting process.

In today's context, for globalized market players (large listed companies, investors, financial analysts, regulatory bodies etc.) the financial-accounting information is a "public asset" (Ionașcu and Ionașcu, 2006, p.243) used in decision making and therefore it must ensure the comparability that leads to its standardized production.

In the current business context, financial - accounting information has become a component of corporate governance mechanisms, transparency and quality of information being one of the principles of these mechanisms. Thus, it was questionable whether the financial reports published by the companies should serve the interests of shareholders, a specific approach of corporate governance in the Anglo-Saxon countries, or all the stakeholders' interests. The issue of the financial statements objectives (Ionașcu and Ionașcu, 2006, p.243) led to a series of discussions between the IASB and the FASB, both councils acknowledging (based on the conclusions of IASB-FASB, 2008:BCI.20) that the designation of investors as the main group of users (owner theory) offers an unrealistic perspective on financial reporting, the entity theory being considered much more appropriate for the current economic model.

Schematically, the main aspects of the corporate governance - financial reporting relationship can be represented as follows:

Figure no. 1. The corporate governance and the financial reporting



Source: Apud <Model Annual Report>, Deloitte, available on www.deloitte.com .

2. Literature review

Regarding the corporate governance (CG) and along with the concerns about its activity improvement, the European Federation of Accounting Experts of (EFAE) considers it advisable to revise the recommendations on CG (FEE, 2003) "so as to become equally effective in the preparation and presentation of quality financial information, by applying IFRS”. The document also refers to the basic elements inside and outside the enterprise (components of the CG system) as they are necessary for a quality financial reporting. In this context, the EFAE also supported the conclusions of the European Commission regarding the imperative introduction of a European Code of Corporate Governance and a common approach at European Union level of the provisions of the other codes.

In connection with the organization and management methods of a company at international level, there are both "monistic" management systems and "dual" management systems. Thus, within the "monistic" management, the shareholders may ask the board to be responsible for the company management and also for the results and the financial statements quality. The Cadbury Committee recommends that in the Board of Directors these companies appoint both executive directors responsible for the company management and non-executive directors who monitor, supervise and control the financial reporting. Within the "dual" management there is a board of directors with responsibilities for the company strategy and a supervisory board that ensures the quality of financial reporting and the resolution of conflicts of interest. Certainly, in practice, this delimitation of duties is not very rigorous, being influenced by the communication level and the habits of each area. In most countries where the "dual" structure is generalized, the supervisory board must analyze and approve the financial statements. In Germany, for example, the employees can appoint or elect members of the supervisory board, and in Italy, in addition to the board of directors, there is also a union council made up of independent accounting professionals with similar duties to audit committees. In Romania, the legislation stipulates the certification of financial statements by an independent auditor. In almost all countries there are concerns for the shareholders' protection, the balance of power within the governing bodies, the organization of the internal control, the certification of the financial statements of independent bodies, the understanding of the transparency and the quality of the financial information. Therefore, the expansion and globalization of the financial markets have required a consensus regarding the transparency and quality of the information presented through the financial reports, a first step being the adoption of IFRS standards.

Regarding the level of quality of financial - accounting information displayed by the public interest companies in Romania, a series of studies have been carried out. Hence, Ionaşcu (2008) is conducting an empirical study that reveals mediocre scores on the quality of information published by the listed entities, underlining the hypothesis that the information quality is reflected in prices, and entities with a better information level are more appreciated by investors. Similarly, Bogdan and Pop (2008) carry out a study that reveals a low level of voluntary communication practices.

C.M. Vasile's study (Vasile, 2008, p.155) of a sample of 140 companies from four emerging countries (Romania, Poland, Czech Republic and Hungary) shows that, in terms of GC improvement, priorities are aimed at improving the internal GC mechanisms (67% for Poland and 42-47% for the other three countries) and the accounting standards, auditing and disclosure of information, as well as reducing the concentration of ownership (especially in the Czech Republic) and restricting transactions with related parties (especially in Romania).

3. Research Methodology

The investigation methodology included general and specific approaches regarding the critical analysis of the financial reports quality and the way the information is generated in the entities of public interest. Through *theoretical documentation*, there were taken into account the bibliographic sources related to *the corporate governance - financial reporting* relationship at the level of public enterprises and to the accounting and their financial-accounting information system. These sources were published in books, articles, printed studies and / or published online, relevant national and international accounting standards and regulations, official documents of the different profile bodies (IASB, FASB, SEC, EFRAG, etc.), analyses of the annual reports of some entities of public interest. The graphical representation method comes to visually present relevant aspects of the study. For the collection of theoretical data, the databases of some university libraries were consulted, such as: Central Library of the Academy of Economic Studies in Bucharest, Multimedia Library of "Valahia" University in Târgovişte, Central University Library in Cluj Napoca and University Library "1 December 1918 "from Alba Iulia. Access to online publications was obtained by consulting scientific databases such as Thomson Reuters, Springerlink, Ebsco, Eolss, Emerald, RePec, Jstore.

The empirical research was based on the specialized literature revision, on other authors' studies, but also on the practical realities within the entities of public interest. The applied deductive method regarded analysis of the financial - accounting information systems, but also of the content and quality of the financial accounting information from the financial statements of the public interest entities, as a final product of the system. The content analysis referred to that research technique for the objective, systematic and quantitative description of certain communications content, going to be interpreted later on.

4. Corporate governance and financial reporting quality

The financial reporting quality can be classified into four distinct categories depending on the level of transparency of the information contained:

- Poor quality financial reports, which contain a minimum level of accounting financial information that cannot be identified on the public interest entity's own site, in case the entity has a site.
- Financial reports of acceptable quality, provided that the public interest entity makes its financial statements known on its website.
- Good quality financial reports, in this case the public interest entities must make public both the financial statements and the management reports, the auditors' reports and any other information possibly relevant for the decision made by potential investors or any other interested parties.
- Financial reports of excellent quality, when the information quoted as such is complete, uncensored and undoubtedly proving the extent towhich the public interest entity has acquired the principles of corporate governance and has applied them throughout the previous financial year in own activity.

We can conclude that the application of the principles included in the codes of good practice in corporate governance was reflected in the structure and quality of financial-accounting information. However, in order to assess the stage of implementation and development of corporate governance, there must be a system based on two defining elements:

- the rating given to the country where the public interest entity exists;
- the rating given to the public interest entity.

The estimation of the country qualifier takes into account the support that is granted to the public interest entity by the state so that it could reach an adequate level in terms of corporate governance, achieved through: creating and developing a legislative framework in the field of corporate governance, regulating the capital market also through legal norms, bringing the way of reporting the annual financial statements to a common denominator for all public interest entities and last but not least the observance of international financial reporting standards .

The estimation of the public interest entity qualifier is based *on the ownership structure, on the transparency of the financial accounting information, on the efficient relationship with the stakeholders, on the executive directors' degree of independence and on the performance evaluation method.*

By summing up the ratings given to the country and to the public interest entity, respectively, the achieved final score helps potential investors to substantiate their decisions:

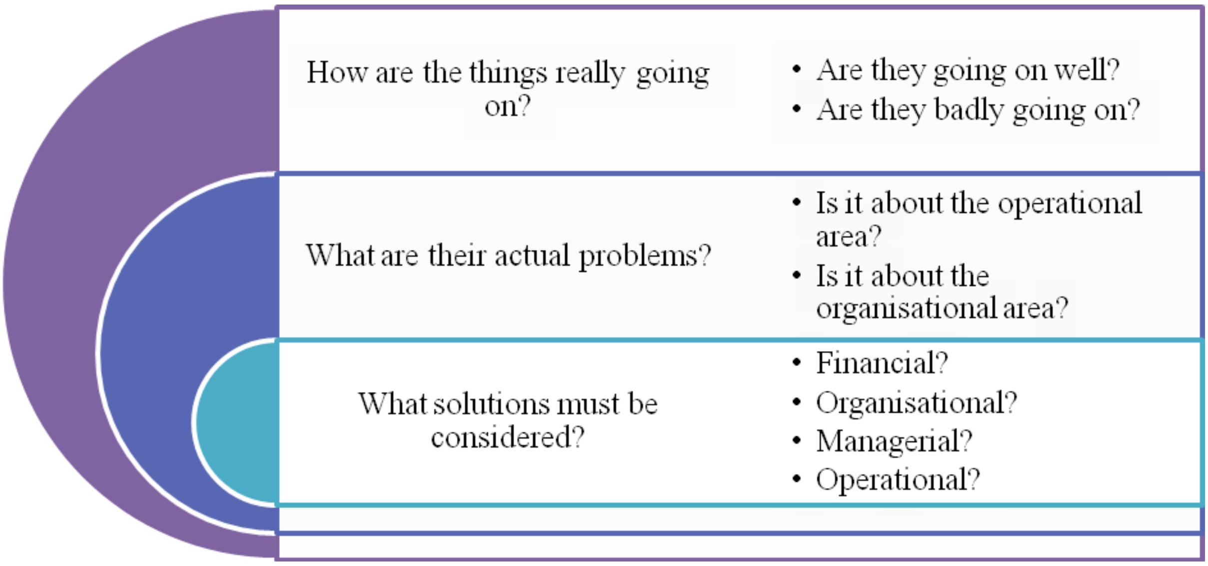
- the better the country's rating, the greater the confidence of investors;
- the lower the rating of the public interest entity is in stagnation or regression compared to the previous reporting period, the lower the investors' security level;
- for two public interest entities with the same rating but from different countries, the country rating is given priority and the investors' attention is directed to the public interest entity that operates in a country with a developed rating.

The financial-accounting information provided by the annual financial statements represents a range of essential elements in the development of the corporate governance concept for the following reasons:

- it strongly influences the decision-making process at the level of the public interest entity;
- it provides a complete, clear and timely picture of the financial results of the performed activities for everybody interested in the economic life of that entity;
- it accomplishes the integration of information and the connection between the economic field and all the other components of the information system developed at the level of the public interest entity.

The financial-accounting information provides answers (Figure no. 2) to questions of great importance both for the employees of the public interest entity and for the members of its management bodies, for the shareholders and for the potential collaborators as well.

Figure no. 2. Questions for the financial-accounting information



Source: own processing.

The corporate governance governs and controls the activity of the public interest entity. As an important part of this activity, the financial-accounting field is the steady provider of the collected and properly processed information, by means of the accounting instruments available, which provides all those interested, with information to support the decision-making process. As the main target of the shareholders of a public interest entity is to maximize the profit, we can undoubtedly state that the financial-accounting information represents the key elements, essential and relevant for good activities administration.

5. The financial reporting in the context of corporate governance reqirements

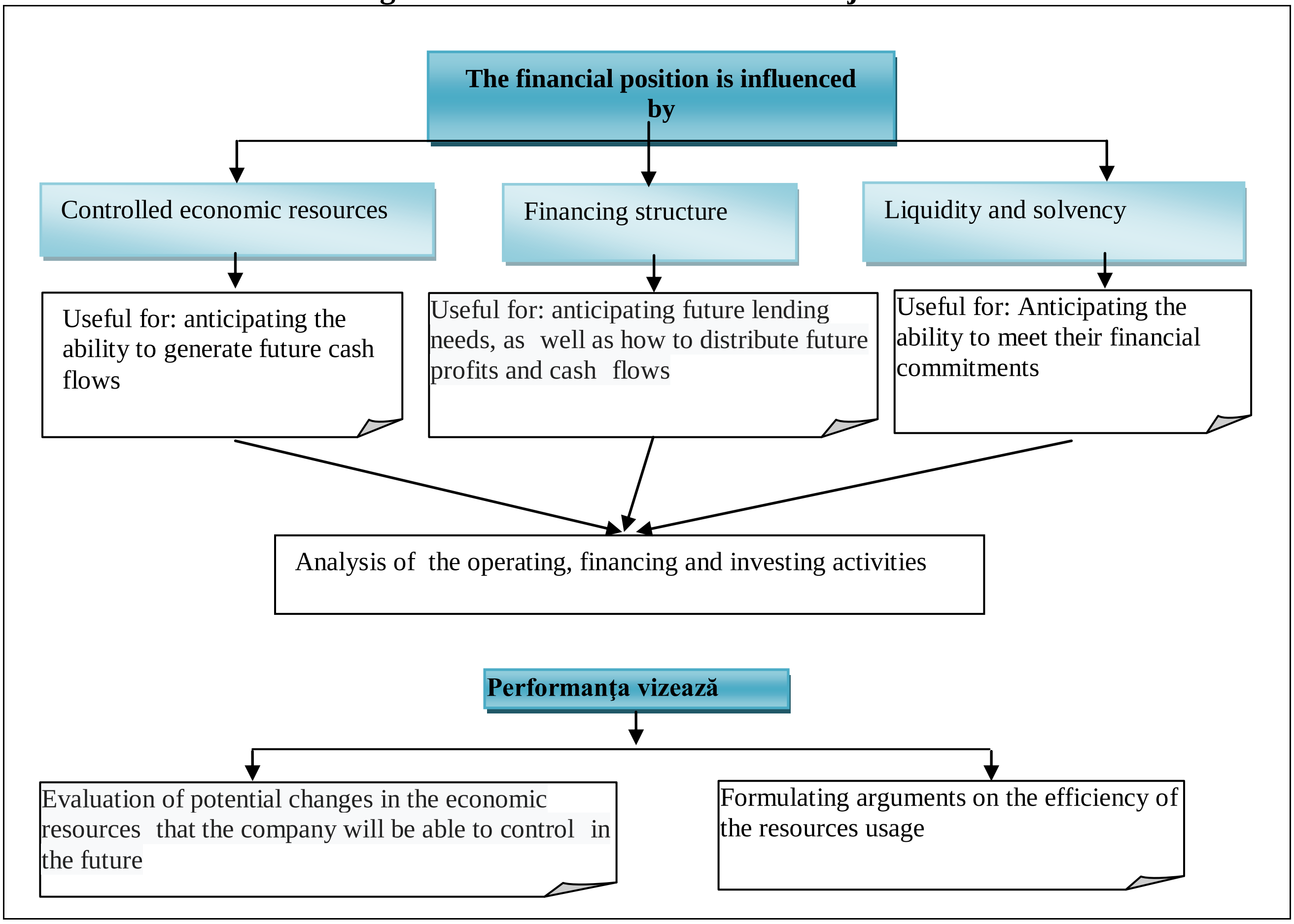
Through the annual financial statements a public interest entity synthesizes information regarding the following aspects*: the achieved performances; financial position; resource management efficiency; the results of the management and administration of the activities; deviations / deviations from the predicted targets.*

The financial reporting is performed in the context of the existence and application of the International Financial Reporting Standards[1], and the information cumulatively fulfills the following functions:

- the function of information centralized display provided by the financial-accounting system. The financial-accounting information establishes a reliable system of economic-financial indicators, of result and performance reflecting the financing efficiency and the use of the resources available to the public interest entity;
- the function of the results communication. All the other activity areas within a public interest entity are based on the planification, development and reports making on the activities results by sharing information in the financial reports. This fact gives the financial accounting information a privileged position within the information system of the public interest entity.
- the analysis function. The financial statements reflect in the most eloquent way the achievement of the objectives foreseen for the reporting period, in the context of the efficient use of the resources available to the public interest entity together with its ability to attract new resources under advantageous conditions. Therefore it offers an accurate picture of the deviations from the established performance indicators and the best solutions for improving the quality of the carried out activity are also identified considering the respective information.
- the forecasting function. The financial statements provide the basic information in making forecasts on the way the activity will be carried out in the next financial year and on the expected results. The decision-making process is clearly based on financial accounting information and in this context a graphical illustration of the objectives of the financial statements is made in Figure no. 3.

[1] http://www.mf.gov.md/ro/actnorm/contabil/standartraportianuarie2015;

Figure no. 3. Financial statements objectives



Source: apud Ciuhureanu, A.T., Balteş, N., Aspects regarding the accounting Information offer through the financial statements, Studia Universitatis „Vasile Goldiş din Arad", nr. 1/2009

The impact of the financial reports in the context of the demands of corporate governance is shown itself especially long term, consisting of:

- increasing the possibilities of comparing the economic position and performances of public interest entities, which allows it to be observed on the market under conditions similar to any other entity;
- increasing transparency and credibility of accounting financial information in the context of resizing the number of users;
- stimulating the access to finance with reasonable costs for those public interest entities that improve their quality level of financial reports addressed to all interest groups;
- ensuring the investors' protection of interests relying on the application of the corporate governance principles and on meeting their expectations regarding the relevance and quality of the information provided through the financial reports.

6. Valencies capitalization of the financial-accounting in achieving corporate governance

In the long run, a public interest entity resists and develops when its ability to make a profit is high. In this case, we refer to a "*satisfactory profit*" in the context of the influence of internal and external factors.

Gaining profit becomes both the engine that sets in motion a public interest entity but also the result of its good administration. The quality of the profit made by a public interest entity must be measured by the management or by the interested specialists in the context of the information provided by the financial-accounting system (Crecană, 2000, pp.28-29).

The public interest entities are compelled to create their own manual of accounting policies and procedures in compliance with the specific activities carried out, the organizational culture, the management requirements and especially with the shareholders' expectations. These rules, regulations and procedures can influence the increase or decrease of the patrimonial result. As the accounting policies and procedures are individualized on a case-by-case basis, there are encountered situations when, within the public interest entities, the provisions of the above-mentioned manual prevail, the specialists in the financial-accounting field either fail to make substantiated forecasts or they apply alternative accounting treatments or approach an original way of using accounting techniques, all of them being at the limit of the legal provisions in force. Thus, both the reality of financial reporting and the principles of corporate governance are seriously harmed, in terms of affecting the performance of the public interest entity.

The decision-making system based on the financial-accounting information must be coherent, correct and in accordance with reality in order to find the optimal solutions for the deficiencies arising in the activity of the public interest entity (Ișfănescu, Stănescu, Băicuși, 1999, p.17). Moreover, the good corporate governance depends on the quantity and quality of financial-accounting information as well. Hence, in order to be useful for the promotion a modern management model, financial-accounting information is characterized by the fact that it concretely and correctly presents the economic phenomena going to positively or negatively affect the public interest entity. The information is highly accurate and defines the size of the flows availability.

Last but not least, the investment performance is closely correlated with the qualitative level of financial-accounting information (Tiessen and Waterhouse, 1983, pp.251-267). The latter is the instrument used by the investors in the public interest entity and also by the potential ones to make their calculations and forecasts and to consequently make the decisions for their expected benefits. Therefore, the financial-accounting information becomes a reliable companion for all investors, whether they are present or prospective.

7. Connections between the decision-making process and the financial accounting information

The financial-accounting information helps the public interest entity identify the inappropriate activities and take the optimal steps to obtain the best results in future. The efficient use of human, material and financial resources in the accounting financial information is revealed by the knowledge of the past and present activity of the public interest entity as well as by identification of the causes that generated the accomplished results.

The importance of accounting financial information is significant because *it can influence the entire economic policy adopted at the level of the public interest entity*, relying on its value assessment and acting as key elements in streamlining the decision-making process.

Considering this information as an essential source of data useful to managmenent and other interest groups, it provides well defined purposes, as regards:

• reporting;
• estimation of economic potential;
• achieving efficient management of assets, liabilities and equity;
• relation to the external environment.

As a basic element in the decision-making process, the financial-accounting information helps management to properly plan activities for the future financial year, predict the evolution of the public interest entity and take preventive measures to adjust the gaps, as well as find optimal solutions for the performance improvement.

Based on the accounting financial information provided by financial reports, a system of useful indicators is set up in assessing the activity of the public interest entity and in making appropriate decisions.

From this point of view, the result indicators are the most interesting ones as they reflect in the best way the performances at the same time achieving the evolution in time. Here there are enumerated some of them:

- sales volume;
- gross profit;
- the operational activity result;
- the result of financial activity;
- the result of the investment activity;
- the net profit.

Another category of indicators is represented by the efficiency indicators and on its basis there are assessed the results in relation to the used resources, they actually measure the available resources that can bring profit. The most relevant are:

- the rate of economic profitability;
- the rate of return on income;
- the rate of financial return;
- the rate of consumed resources' return.

The third category of indicators consists of management indicators assessing how efficiently the public interest entity uses its assets. These are:

- the number of current assets rotation;
- the period of avarage income;
- the number of stocks rotation;
- the number of total assets rotation.

The performance of the public interest entity depends on its ability to make profit. The measurement of its level and evolution is carried out by the profitability indicators that consist of:

- the profitability of production - the ratio between the production income and its volume represents the value of the total receipts related to direct expenses;
- the net profitability - the ratio between the net profit and the volume of the accomplished production and represents the capacity of the public interest entity to make profit from the whole performed production;
- the assets return - the ratio between the net profit and the average value of the assets represents the efficiency of capital used by the public interest entity
- the financial profitability- the ratio between net profit and the average equity value represents the satisfaction degree of shareholders.

Taking into account the interpretation of the value indicators resulted from the public interest entity activities, the management can make decisions focused on the problems generating distortions in the economic activity.

8. The relationship of corporate governance with the SIFC of public interest entities

In order to achieve its objectives in the most efficient conditions, a public interest entity must take into account the existence of a financial-accounting information system to carry out the following operations:

- recording, processing, conveying and maintaining information in compliance with the trend of resources available to the public interest entity and deviations from the established targets;
- creating conditional connections between the decision-making system and those responsible for execution;
- balancing the influences of internal and external factors on the public interest entity evolution.

The decision is the conscious choice between several possible actions of the modality to be taken so that the results are as expected. In order to make the right decision for the situation faced by the public interest entity, it is necessary for a financial-accounting information system to operate within it and there is required an ability to provide complete, real and timely information.

Therefore, for making decision, it is necessary to know the achievable objectives, their accurate circumstances, to identify a number of options and to take into account the possible situations that will contribute to the objectives' achievement.

The financial-accounting information system of the public interest entity must support its functioning through three ways of acting, such as:

- *the execution system*, where the operative activities are carried out;
- *the management system*, which includes all decision-making centers, including their action on the execution system;
- *the information system*, which ensures the connection, in both directions, between the management system and the execution system, on the one hand and between them and the external environment, on the other hand.

9. The impact of corporate governance in the evolution of a reliable and optimal financial-accounting information system

The efficient communication of financial-accounting information highlights the business stodginess, the sales growth level and implicitly the increase of the people's trust. In practice, the total and partial lack of a public interest entity transparency, with regard to financial reporting, leads to suspicion on the users' behalf as well as to an unfavourable entity image.

The communication of financial and accounting information shall also be with the shareholders of the public interest entity. For any entity, the maintenance of interest in its own activities is valid both for shareholders and for customers and investors.

On the one hand the role of publishing financial-accounting information is to protect the shareholders' interests, especially the minority ones, and on the other hand it has to increase the value of the entity shares. In this respect, the communication of financial-accounting information represents an investment in informing shareholders and investors and an opportunity to identify the perceptions of the target audience, actions that ultimately lead to increasing the value of the public interest entity.

As for the communication of financial accounting information, one can state that (Pantea, 2009, p.19): *"the financial communication provides accounting and financial information such as two different products both as a source of use and as a purpose; the information sources are provided by the financial statements for accounting information and the systems of economic-financial indicators for financial information; the information destination is represented by the external environment of the enterprise, made up of the owners of enterprises, employees, state, etc. on the one hand, and of the financial institutions providing their capital on the other hand".*

By setting up an Audit Committee at the level of the public interest entity, there can be ensured an increasing transparency of accounting financial information. This is a mechanism able to act on improving the quality of financial-accounting information for both internal and external users, as it uses the skills given by the Board of Directors, whose consultant is a representative of internal audit and control.

Nowadays, the transparency is increasingly demanded and promoted in business relations. The investors, as well as other interest groups, claim to be allowed the increasing access to financial-accounting information as well as to those regarding the administration of public interest entities. For an accurate image on the public interest entity, on the official websites or in the public information, the entities must include information regarding the ethical, social and any other performance besides the information about the economic performance.

In the current trend we can include the reports on the social, environmental and sustainable development policies of the public interest entities, specially yet not exclusively requested by the government institutions. They are of great importance in assessing the potential of a public interest entity, meaning that they must be as safe and credible as financial reporting. In this respect, reporting criteria have been defined in the three segments (social, environment, development).

The transparency is the mechanism used to explain the way of acquiring financial-accounting information and to provide their interpretation. The transparency creates an environment in which information on existing conditions, the decisions and actions are accessible, visible and easy to understand for everybody concerned. The transparency is translated into the open and sincere character of the public interest entity as follows:

- it improves the decision-making process based on the possibility of forecasting;
- it compels the public interest entity to face the reality of a situation;
- it determines the management to responsibly act, to justify its decisions and to explain the actions;
- it encourages accountability, strengthens discipline and increases the value of corporate governance at the level of the public interest entity.

The public interest entities must be sure that transparency is not threatening and the ensuring is not compulsory. When they overcome these barriers, they will learn how to use it for their benefit and will enjoy the confidence, performance and credibility of the large audience.

10. Conclusions

The working coordinates of accounting in the new information age aims at giving up many of the traditional tools and accepting others imposed by corporate governance codes and principles, as well as recognizing the quality of reporting and financial-accounting information as a necessity in decision making.

In this approach, for most public interest entities it is imperative to redesign an information system that corresponds to the accounting information demands, since the accounting information system of the public interest entities in Romania currently proves its imperfection altered by redundancy, inefficiency and overloading. Communication channels, circuits and accounting information flows, as incorrectly defined, still generate malfunctions and deficiencies with negative impact on the performance of the accounting information system and implicitly on the management process of these entities.

Situated within the scope of the information-decision-action relationship, the usefulness of the financial - accounting reports depends on the qualitative characteristics of the financial - accounting information as every public interest entity must have information that reflects reality. Whether we refer to the information provided by financial accounting and / or the information generated by managerial accounting, the public interest entities must be able to make the correct decisions taking the above mentioned into account.

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