Corporate Governance, Internal Control and the Quality of Accounting Information Disclosure

Qian-Hui CHEN¹,a,*

¹Nanjing University of Science and Technology, Nanjing, Jiangsu, China
²cxzl123456@sina.com
*Corresponding author

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Abstract. Internal control, corporate governance and accounting information disclosure quality are hot topics for scholars. This paper studies the relationship among the three based on the data of Shenzhen A-share main board listed companies from 2014 to 2016. The results show that effective internal controls can make companies disclose accounting information with higher quality. And when internal control is effective, the impact of corporate governance will change from insignificant to significant. Finally, this paper summarizes the research and puts forward some relevant suggestions.

Introduction

Since Chinese capital market’s birth, it has been gradually developed and improved under the promotion of the government and the market. Although remarkable achievements have been made, there are still many unstable factors, among which accounting information disclosure is one of them.

The accounting information disclosed by the listed company is the main source of information for the outsiders of the enterprise, which affects their judgment and decision. Therefore, the existence of disclosure quality problems will cause great harm to the effectiveness of the capital market. However, from the famous American Enron incident to China’s recent Yabaite financial fraud, accounting information disclosure quality problems emerge in an end.

In order to better regulate the accounting information disclosure of listed companies, except for the active exploration of the Chinese government, domestic scholars have also studied how to improve it from various aspects. Internal control runs through the process of generating and transmitting accounting information, as well as corporate governance. There is no doubt that they have an unusual meaning for the disclosure of accounting information. Therefore, this paper studies the relationship among the three, and provides new ideas for solving the worrying accounting information disclosure problem.

Literature Review and Research Hypothesis

Internal control as the process of enterprise to ensure the realization of its goal, one of its main objectives is to ensure the reliability of accounting information. From this point of view, once the effectiveness of internal control cannot be guaranteed, the reliability of accounting information will be greatly reduced. Doyle et al. (2007) believe that accounting manipulation is always more common in companies with weak internal controls [1]. Wang (2015) found that internal control audit is conducive to the timeliness of annual report disclosure [2]. Yao et al. (2016), based on game theory, concluded that improving internal control of enterprises can effectively improve the quality of accounting information disclosure [3].

From the perspective of principal-agent theory and information asymmetry theory, the ultimate goal of corporate governance is to alleviate the conflict between the principal and the trustee brought about by the principal-agent relationship. Information asymmetry is one of the sources of conflicts between owners and operators. In order to achieve its goal, it is imperative to improve the
quality of accounting information disclosure. Antonio (2011) found evidence supporting that the higher the equity balance is, the higher the quality of the disclosed accounting information is [4]. Chinese scholars have also found that we can deal with the problem of low accounting information disclosure quality through corporate governance, such as Liu (2016), Zhou and Zhuang (2016) [5,6].

According to the definitions, we can find that internal control is more focused on the relationship between managers and employees, while corporate governance is more focused on the relationship between owners and operators. They have different emphases and complement each other. Goh (2013) found that after the company disclosed the material defects of internal control, the company's governance structure would be improved with the significant increase in the turnover rate of audit committee members and external directors [7]. Zhu and Liu (2017) found that reasonable corporate governance was very important for enterprises to better repair internal control defects [8]. Liu et al. (2013) studied the relationship between internal control and the quality of accounting information in the context of China, and the results were positive. At the same time, they found that the concentration of executive power had a great impact on their relationship [9].

In conclusion, this paper proposes the following hypotheses:

H1: Other things being equal, the impact of internal control on accounting information disclosure quality is positive.
H2: Other things being equal, the impact of corporate governance on accounting information disclosure quality is positive.
H3: Other things being equal, when internal control is relatively more effective, the influence of corporate governance on accounting information disclosure quality will be stronger.

The Design of the Study
Sample Selection and Data Sources

We selected Shenzhen A-share main board listed companies from 2014 to 2016 as research samples, and excluded ST, *ST companies, companies of financial insurance industry and companies with incomplete or abnormal financial data. A total of 1,170 samples from 390 companies were selected for the study. Our data mainly comes from CSMAR database and the website of Shenzhen Stock Exchange.

Variable Design

Drawing on the research of Wang (2017), Wang and You (2015) and other scholars, the design of the variables in this paper is shown in table 1 below [10,11]. The 9 indicators used in the corporate governance index include the ownership structure (equity concentration, equity balance), board characteristics (board size, independent director ratio, directors’ compensation), the characteristics of supervisory board (the size of supervisory board, the number of special committees) and management characteristics (executive compensation, senior management share).

| Variable code | Variable definitions |
|---------------|---------------------|
| RANK | Quality rating of accounting information disclosure from Shenzhen Stock Exchange. A=1; B=1; C=0; D=0 |
| ICQ | DIB- China listed company internal control index |
| Scores | The composite score obtained by factor analysis of 9 variables |
| ICQ’*Scores | ICQ minus the median, if greater than 0, ICQ’=1; Otherwise, ICQ’=0 |
| SIZE | Size: ln (total assets) |
| LEV | Solvency: total liabilities/total assets |
| ROE | Profitability: net profit/operating income |
| GROWTH | Growth ability: operating income/total assets |
Model Design

In this paper, the following three models are established to test hypothesis 1, hypothesis 2 and hypothesis 3 respectively:

RANK = α_0 + α_1ICQ + α_2SIZE + α_3LEV + α_4ROE + α_5GROWTH + ε_1 (1)

RANK = β_0 + β_1Scores + β_2SIZE + β_3LEV + β_4ROE + β_5GROWTH + ε_2 (2)

RANK = γ_0 + γ_1ICQ'*Scores + γ_2ICQ + γ_3Scores + γ_4SIZE + γ_5LEV + γ_6ROE + γ_7GROWTH + ε_3 (3)

Empirical Analysis

Descriptive Statistics

Table 2 is the descriptive statistical results of sample companies in different years. It is found that the mean of RANK decreases year by year while the standard deviation increases year by year, which indicates that further attention should be paid to accounting information disclosure quality in China. The mean of ICQ decreases obviously, and its standard deviation increases. It can be seen that China's listed companies still pay insufficient attention to internal control. In recent years, the internal control level of different companies presents great differences. The mean of Scores also shows a downward trend year by year.

| year | N   | Mean | Std. Deviation | Minimum | Maximum |
|------|-----|------|----------------|---------|---------|
| 2014 | RANK | 390  | 0.864          | 0.343   | 1.000   |
|      | ICQ  | 390  | 630.436        | 154.365 | 870.670 |
|      | Scores | 390  | 30.301         | 13.205  | 100.000 |
|      | ICQ'*Scores | 390  | 15.486         | 18.635  | 100.000 |
|      | RANK | 390  | 0.828          | 0.378   | 1.000   |
|      | ICQ  | 390  | 614.714        | 161.513 | 866.620 |
|      | Scores | 390  | 27.161         | 13.545  | 100.000 |
|      | ICQ'*Scores | 390  | 14.288         | 17.723  | 100.000 |
|      | RANK | 390  | 0.810          | 0.393   | 1.000   |
|      | ICQ  | 390  | 585.822        | 190.625 | 830.550 |
|      | Scores | 390  | 19.361         | 9.231   | 100.000 |
|      | ICQ'*Scores | 390  | 9.944          | 12.595  | 100.000 |

Logistic Regression Results

Before the regression analysis, we did a Pearson correlation coefficient test first. The test results showed that RANK is significantly positively correlated with ICQ, Scores and ICQ'*Scores at the level of 0.01, which was consistent with the hypotheses of this paper. The model used in this study does not have multi-collinearity problem, and regression analysis can be carried out in the next step. Binary logistic regression on sample data was conducted according to model 1, model 2 and model 3 respectively. Regression results are as follows.
Table 3. Results of Binary Logistic Regression.

|            | Model (1) | Model (2) | Model (3) |
|------------|-----------|-----------|-----------|
|            | B        | Sig.      | B        | Sig.      | B        | Sig.      |
| ICQ        | 0.003    | 0.000     | -        | -        | 0.003    | 0.000     |
| Scores     | -        | -         | 0.011    | 0.138    | 0.005    | 0.581     |
| ICQ'*Scores| -        | -         | -        | -        | 0.019    | 0.019     |
| SIZE       | 0.434    | 0.000     | 0.543    | 0.000    | 0.401    | 0.000     |
| LEV        | -1.432   | 0.001     | -1.986   | 0.000    | -1.366   | 0.001     |
| ROE        | 0.083    | 0.676     | 0.209    | 0.236    | 0.082    | 0.678     |
| GROWTH     | -0.046   | 0.733     | 0.109    | 0.419    | -0.076   | 0.580     |
| Constant   | -9.171   | 0.000     | -9.807   | 0.000    | -8.471   | 0.000     |
| -2 Log likelihood | 899.208\(^a\) | 955.573\(^a\) | 891.473\(^a\) |
| Nagelkerke R Square | 0.205     | 0.132     | 0.215     |
| Hosmer and Lemeshow test Chi-square | 9.510     | 6.891     | 8.503     |
| Sig        | 0.301    | 0.548     | 0.386     |

From the test results of binary logistic regression, the fitting degree of model (1) and model (3) is better than model (2). The addition of internal control effectively improves the fitting degree of model (2), indicating that internal control positively adjusts the relationship between the other two. In model (1), the regression coefficient of ICQ is 0.003, which is significantly related to RANK at the 1% statistical level, indicating that the improvement of internal control makes the information disclosed by the company more reliable. Hypothesis 1 has been verified. The regression coefficient of Scores in model (2) is not significant, so hypothesis 2 has not been verified. In model (3), the coefficients of ICQ and ICQ'*Scores are significantly positive, while Scores is positively correlated with RANK but not significantly. From the analysis results, the higher internal control effectiveness enhances the improvement of corporate governance on the quality of information disclosure. Hypothesis 3 has been verified.

Summary

Our research results show that internal control can effectively improve accounting information disclosure quality, but for corporate governance we has not found sufficient evidence. However, when the internal control is effective, the promoting effect of corporate governance will be significantly enhanced. According to this conclusion, in order to better solve the problem of low quality of accounting information, strengthening the effectiveness of internal control is the top priority. Under effective internal control, corporate governance can better play its due role and achieve the effect of one plus one greater than two. Of course, due to my limited ability, there are still some shortcomings in this study. Firstly, the sample used in this paper has certain limitations. Secondly, the calculation of the corporate governance index of this paper still needs further improvement.

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