

# Study On the Relation Between Accounting Informationization and Corporate Governance Structure

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**Abstract:** The implementation of accounting standards is designed to ensure the validity and reliability of corporate accounting information, and improve the quality of accounting information, which is conducive for corresponding decision-makings for achieving good corporate governance. There are still a range of problems in corporate governance structure in China, such as unreasonable ownership structure, imperfect director system, inadequate supervision by the board of supervisors, and unsound incentive mechanism. The present paper explores the relation between accounting information quality and corporate governance structure, and based on which, demonstrates the problems existing in corporate governance structure, and their relation with accounting information quality, and finally brings forward the factors to improve corporate governance and accounting information quality, as well as the corresponding implementation suggestions and specific measures.

## 1. Introduction

Accounting information is a general term for various comprehensible and acceptable information, materials and data reflecting the movement of funds by virtue of accounting, scientific forecasting and actual records. It is a significant carrier for recording the accounting process, and a significant basis to reflect corporate financial position, business performance and movement of funds, and evaluate corporate operating performance and investment decision-making. It is the provision of business performance and financial position of a corporate to investors, creditors or information users through financial statements, financial reports or notes. It is one of the most significant bases for decision-makers to make decisions. However, at present, the accounting information quality of enterprises in China, especially the listed companies, is particularly worrying, having seriously affected the operating efficiency of assets. Accounting information quality is to comply with the needs of accounting information users under the principle of cost-effectiveness by virtue of accounting policies, laws, regulations, and accounting products and services. It is a kind of corporate governance problem. The study of accounting information quality will be conducive for seeking effective ways, and there is a diversity of evaluation method in this research field. However, the quality evaluation of accounting information is relatively backward in China since there is still no accounting information quality evaluation system. The corporate governance structure is composed of three governance institutions, including ownership structure, board of directors and board of supervisors. Exploring the relation between corporate governance and accounting information quality is conducive to the improvement of measure governance structure for accounting information quality, which can be carried out through dividing it into internal and external governance structures in accordance with the role of accounting information quality. A good internal governance structure with powerful supervision and appropriate governance can lead to the accurate and high-quality accounting information. Consequently, the financial accounting reports become more valid and reliable. In accordance with the principle of cost-effectiveness, corporate economic profitability index can meet the impact of corporate governance structure on the quality of accounting information, and improve market efficiency.

Accounting information quality is a significant part of corporate governance structure. The high-quality accounting information lays an effective foundation for corporate governance. The

implementation of accounting standards is designed to improve the validity and reliability of corporate accounting information, so as to make conducive decisions for the good corporate governance. The accounting standard system converging and connecting with international accounting standards is composed of one accounting standard and 38 specific standards. Without the high-quality accounting standards, the quality of accounting information cannot be guaranteed and it is also impossible to establish a governance structure suitable for the corporate. Therefore, the correlation between accounting standards and accounting information quality can highlight the comparability, relevance, reliability and other features of accounting information. Corporate governance structure can be optimized and perfected only through the improvement of accounting information quality, optimal allocation of corporate control and strategic management rights, and improvement of contract mechanism. By exploring the relation between accounting information quality, and corporate governance and corporate profit, the present paper attempts to seek the influencing factors of accounting information quality in the hope of providing suggestions and measures for the improvement of accounting information quality, so as to provide theoretical support and practical guidance to normalize corporate governance.

## **2. The effectiveness of accounting standards in improving accounting information quality in corporate governance**

In accordance with *Accounting Standards for Business Enterprises* (1993) and *Enterprise Accounting System* (2001), the requirement of accounting information quality in China includes the characteristics such as validity, relevance, comparability, consistency and clarity. In the new accounting standards, there are the explanation on accounting information quality, and amendments on the principles of prudence, significance and substance over form. In addition, both accrual basis and historical cost are no longer used as the basis of accounting, while the principles of comparability, consistency and clarity continued to be highlighted therein.<sup>[1]</sup> As the development of national economy and continuous development of listed companies, the implementation of accounting standards is closely related to the immediate interests of investors in corporate governance structure. Their implementation in corporate governance plays a significant role in the improvement of the effectiveness of accounting information in corporate governance and profitable efficiency of the corporate, and the promotion of corporate progress and development. Therefore, there is an inseparable correlation between the implementation of accounting standards and corporate governance structure. It is of great research value to explore the implementation of accounting standards, in-depth improvement of corporate governance structure, reduction of agency costs, improvement of ownership structure and accounting information quality, and promotion of corporate core competitiveness, so as to improve corporate business performance and make enterprises achieve sustainable development in the competitive market.

The significance of accounting information to enterprises has always been a topic of concern for regulators, listed companies and market participants. Some scholars believe that the improvement of accuracy and timeliness of accounting information released by enterprises is conducive to the improvement of corporate value, which is mainly reflected in the following three aspects: firstly, the improvement of accounting information quality is conducive to the discovery and prevention of earnings manipulation, and the improvement of corporate governance level. Secondly, the improvement of accounting information quality can reduce the capital cost of enterprises, so as to alleviate the information asymmetry among investors, enhance the liquidity of stocks, attract more investors and reduce equity financing cost. In addition, the refinancing cost can be reduced through improving the prediction of investors' risk return level by accounting information. Thirdly, the improvement of accounting information quality is conducive to the efficiency and performance of the capital market. Corporate governance structure is a structural institution arrangement of the restrictive relation between ownership and management right based on fiduciary responsibility. The corporate organization is mainly composed of three parts, including the board of directors performing the function of strategic decision-making, the general manager performing the function of operating

management, and the board of supervisors performing the function of discipline supervision. The board of directors is mainly responsible for the decision-making of corporate investment and other important matters, and is the highest authority of the corporate. The general manager serves as the decision-maker of the corporate or enterprise's daily economic activities, that is, the executive department of the corporate specific matters. Accounting information quality is a concept covering a wide range. In fact, it is the amount of information needed to make judgement and decisions for decision makers and information users. As the corporate development pays more and more attention to accounting information quality, in the market competition, the good corporate business order requires enterprises to provide high-quality accounting information for accounting information users, and its main form is financial report. Based on the accounting information quality researches at home and abroad, it is found that there is a significant correlation between corporate governance structure and accounting information quality. It is generally believed that a perfect corporate governance structure should be composed of external governance structure and internal governance structure. The former mainly refers to national policy, capital market, product market and competitive market. With respect to the current situation of listed companies in China, the external market of enterprises is not perfect and is still in the development stage. The latter is the distribution mechanism of responsibilities, rights and interests of each management within the corporate, including the accountability to shareholders, board of directors, board of supervisors, management, and stakeholders, and distribution and balance of their rights. Therefore, the accounting information quality is in urgent need of improvement due to the imperfect internal governance of enterprises.

### **3. The relation between accounting information quality and corporate governance structure**

#### **3.1 Accounting information quality and its characteristics**

With respect to its concept, accounting information is a kind of special-purpose information with the general characteristics of information, such as transmission, timeliness, shareability and objectivity. Information is the reflection of changes and characteristics of various objective things, and the representation of the relation between objective things and the interaction after transmission. Accounting is defined by American Accounting Association (AAA) in the basic accounting theory as the procedure for determining, measuring and transmitting economic information formulated for the purpose of enabling accounting information users to make valid judgement and decisions. Based on that, accounting information can be defined as an economic information, that is, a kind of data used to explain the business state, cash flow and financial situation of an enterprise. Accounting information has two characteristics: it can be measured and it is an economic information. AAA proposed in the basic accounting theory description in 1966 that accounting information should contribute to the formulation of decision-making and objectives, and the management and control of resources to achieve objectives. In addition, AAA brought forward reliability (truthfully reflect verifiable neutrality), and relevance (timeliness, feedback value and predictability) in the characteristics of accounting information quality. Reliability and relevance are the two major characteristics of accounting information. Reliability is that accounting information can truly reflect the actual situation of enterprises, and can provide reliable, accurate and true information for accounting information users. Relevance is that information users can obtain information related to decision-making. Accounting information will be lack of relevance when it is reliable, since relevance simply shows the correlation between each other while cannot have reliability at the same time. Therefore, only one of the two can be satisfied.

In accordance with provisions of *The Corporation Law* implemented on January 1, 2006, “the financial report of a joint stock company shall be made available for shareholders’ inspection twenty (20) days prior to the annual meeting of the shareholders’ general meeting”, and “a limited liability company shall submit its financial accounting report to shareholder within the time limit prescribed in the articles”, and “the joint stock company that has publicly issued shares must release its financial accounting reports”. In accordance with the *Regulations on Financial Accounting Reports of*

*Enterprises* issued by the Ministry of Finance, annual and semiannual financial accounting reports include accounting statements, notes to accounting statements, and financial situation statement. Accounting statements include balance sheet, income statement, cash flow statement and relevant schedules, all of which shall be provided in accordance with various laws and articles. <sup>[2]</sup> Corporate accounting information is the accounting information disclosed to the public. Therefore, accounting information shall be defined as financial reports in scope. Accordingly, the detailed, accurate and high-quality financial reports can also illustrate the high-quality of accounting information.

### 3.2 Actual situation of accounting information quality in China

As shown in accounting information quality announcement disclosed by the Ministry of Finance in recent years, it is in the urgent need to improve the actual situation of accounting information quality in China. The relevant materials released by the Ministry of Finance in *Accounting Information Quality Announcement* are as follows:

Table. 1 Accounting information quality announcement from 1999 to 2013

The accounting information year examined	1999	2000	2001	2002	2003
Number of enterprises examined	159	320	192	152	55
Enterprises with unreal assets	147	160 (above 1%)	36 (above 5%)	23 (above 5%)	10
Enterprises with unreal profits	157	182 (above 10%)	103 (above 10%)	82 (above 10%)	---
Unreal assets	43.23	73.15	115	85.88	---
Unreal owner's equity	37.53	---	24.2	41.88	---
Solid profits	34.15	35.11	24.2	28.72	---

The Ministry of Finance regularly organized financial supervisors to conduct sampling inspection on accounting information quality of enterprises in the previous year, and found that the distortion of accounting information had a serious impact on the normal development of capital market in China. Therefore, it is necessary to analyze and explore various factors affecting accounting information quality to solve the problems of accounting information quality and promote the development of capital market and economy.

### 3.3 Perfection of accounting information and corporate governance structure

Corporate governance is an increasingly important issue in the development of enterprises. It is the basis for providing environment and governance for accounting information, and it seriously affects the integrity of corporate governance structure.

Corporate governance under the British and American style mainly centers on the external governance mechanism such as capital market and securities market, while with respect of the governance way, stakeholders mainly concentrate on the internal governance forms, for instance, governing the enterprise from the perspective of ownership structure, board of directors, board of supervisors and managers. The management right and ownership of enterprises are separated from each other. However, it is inseparable from the scientific and technological information provided by the agent then they entrust the authorized agent to realize their interests. In the whole process of operation and management, the agent is committed to maximize the personal interests and solve the problem of market transmission. Enterprise authorizers may improve the accounting information contradiction between the management and the decision-making level through adopting two mechanisms of encouragement and supervision. After the empowerment of the management right to the agent, authorizers will conduct full supervision and evaluation on corporate internal governance, and operation and management by the agent in accordance with the accounting information. Both encouragement and incentive mechanisms provide reference and support for the corporate to make

reasonable design, evaluation and supervision, so as to obtain high-quality accounting information and provide suggestions for decision-makers to reasonably evaluate the performance of managers at work.

### **3.4 The relation between accounting information quality and ownership structure**

The common control of large shareholders is conducive to the improvement of accounting information quality, in the sense that the more concentrated the quality, the higher the quality of accounting information.

### **3.5 The relation between the governance of board of directors and accounting information quality**

The more professional the background of independent directors, the more guaranteed the supervision power of independent directors, and the more reasonable the proportion of board of directors, and the stronger their initiative. In addition, the stronger the independence of independent directors, the more responsible they will be and the higher the accounting information quality of enterprises.

### **3.6 The relation between board of supervisors and accounting information quality**

The wider the scope of supervision, the stronger the independence of board of supervisors will be and the higher the quality of accounting information.

### **3.7 The relation between accounting information quality and the management**

The more complete the rewards and punishment system of the management, the higher the accounting information quality will be. Specifically, with respect to accounting information quality:

a. High-quality accounting information will produce high performance for enterprises, and enable board of directors and shareholders to truthfully evaluate the performance of managers. In the meanwhile, the improvement of salary system in corporate governance structure also plays a promoting role in corporate pursuit of high-quality performance.

b. Accounting information plays a role of communication and feedback in corporate governance through connecting external market, capital market and product market together, which is conducive to the improvement of external governance structure.

c. The relation between earnings management and corporate governance. Earnings management is conducive to the reduction of contract cost and appropriate earnings management has a positive effect on the development of companies. Through appropriate management of internal control and reduction of earnings to the minimum, the productivity of the corporate can be determined in line with economic behavior, and we can obtain a value by virtue of available technology and price constraints. Moreover, the effectiveness of corporate earnings can be obtained by the distance measure of correlation between the corporate entity and the minimum or maximum value, that is, the earnings based on market price, accounting ratio and comprehensive income factors.

Financial indices are the most widely used corporate earnings evaluation way based on accounting ratio, such as asset-liability ratio and net profit margin of shareholder's equity. It is mainly to evaluate the profit performance of companies in accordance with eight indices, which specifically include profit growth rate and total revenue in one year, and profit growth rate, net profit, return on equity, and total revenue in three years. 93% of all kinds of enterprises and 80% of private enterprises take the financial indices based on profit as the performance evaluation standard, while more than 40% of enterprises take the operating income, and 70% of enterprises take the hedging and proliferating ratios as indices for performance examination. Comprehensive performance evaluation of listed companies also serves as the financial index for enterprises, which mainly includes their profitability, and ability of growth, asset management, equity expansion and solvency, as well as descriptions of main business status. Based on the principle of preliminary efficiency and in combination with accounting information quality, the profitability index has been adopted to examine the performance of enterprises. Profitability index includes a variety of financial indices such as gross margin, net profit margin on operating income, return on assets, profit revenue growth of main operation, and net profit

margin to shareholders, [2] through which the average value at the end of the period and the beginning of the period can be obtained. The specific calculations of profitability indices are as follows:

Gross margin = main operating profit / income from main operation

Net profit margin on operating income = net profit / income from main operation

Return on assets = (total profit + financial expense) / total average assets

Net return on assets = net profit / average balance of total assets

Net profit margin of shareholders' equity = net profit / average balance of shareholders' equity

Revenue growth of main operation = (income from main operation for the current year - income from main operation for the previous year) / income from main operation for the previous year

d. The relation between earnings management and cost of debts and agent cost. The high-quality earnings can reduce the agent cost of the corporate and enable the corporate to obtain low debt financing, so as to have stronger financing ability.

As an important part of the corporate management system, accounting information quality system is restricted by both exterior and interior environment of the corporate. An effective governance structure will improve the disclosure of corporate accounting information, and has a direct impact on the quality level of accounting information. The usefulness, comprehensibility, timely disclosure, accuracy, and reliability of accounting information play the role of mutual cooperation and supervision for all departments with respect to the improvement of accounting information quality. Affected by corporate governance structure, the improvement of external market will provide a favorable environment for the flow of accounting information, while the improvement of internal governance will be conducive to output of accounting information quality.

#### **4. Factors affecting the improvement of corporate governance structure and accounting information quality**

##### **4.1 External governance structure**

In China, there is still no perfect relevant legal system and lack of strong supervision, and the market mechanism cannot come into full play, which has seriously restricted the development of corporate governance structure. Therefore, the governance of product market shall take the legal supervision as the point of departure, strengthening the legal protection of fair trade in product market, and preventing the malicious control of prices and the disturbing of market fair competition. The competitiveness of product in the market has a direct impact on operating profit of the corporate. With respect to the improvement of external governance mechanism, it is necessary for product market, capital market and managers market to work together, which shall be ensured by the open product market. Investors transfer their management rights through act of purchase and sale, and financing activities in the capital market. For the purpose of running enterprises better, managers market should restrict the managers' behavior through a fair and just talent mechanism. It is necessary to establish a professional file system for managers, a corresponding talent evaluation system and an authoritative human resource evaluation agency, so as to make and ensure the full use of talents.

##### **4.2 Internal governance structure**

firstly, it is the role of accounting information disclosure in the internal corporate governance. With respect to the responsibility, right and interest of accounting information, corporate governance is the correlation between responsibility, right and interest of the general meeting of shareholders, board of directors, and managers within the corporate. The improvement of corporate articles and regulations will clarify the factors restricting their rights, responsibilities and interests. In terms of the corporate governance, for the purpose of ensuring their interests and objectives, shareholders serve as the investors to directly or indirectly participate in the supervision and management of the corporate. Board of directors fully and directly participates in the management and decision-making of major financial management matters of the corporate, and exercises the supervision and direct management right of the legal person, thus forming the financial management level with the operator as the main management.

Secondly, it is the financial management level with managers as the main management, which exercises the execution and daily management power of decision-making matters. With respect to the management and governance, the concept of corporate finance is no longer simply the traditional financial work by the financial department, but the different division of responsibilities and rights of the financial body. Corporate finance is a kind of management behavior with well-defined responsibilities in which all positions participate. The relation between diversified functions is conducive to the clarification of responsibilities, rights and interests, and the management mode of separation of decision-making power, execution power and supervision power. It is conducive to the internal restraint mechanism of the corporate, allowing the ideological body of financial management to be closely associated with modern enterprise system.

Accounting is the process of recording, judgement, calculation, analysis, control and decision-making, and a system used to transmit information system. High-quality accounting information helps the information users' market correct decisions and judgement. Internal control implementation demonstrates the objective authenticity of things to a certain extent, and will bring benefits and development to accounting information users, allowing them to determine whether the quality awareness of corporate accounting staff has been improved, and whether these staff have contributed to the development of the corporate and the industry. Internal governance refers to the improvement of corporate accounting information quality, and value efficiency, effect and level of accounting information utilization. The formation of quality in each working link has an impact on information quality, since accounting information quality has certain advantages and rationality. The accounting control system requires enterprises to formulate the suitable financial accounting system in accordance with accounting standards, accounting systems, and accounting laws and regulations, and clarify their polices and financial treatment procedures, and make good records, numbering, review and keep of such procedures, and implement the post responsibility system and internal audit system for accounting staff. Since accounting information has an impact on decision-making ability, it demonstrates the relevance of decision-making ability is that any mistake in any link will affect the quality of accounting information. [3] Accounting information is a kind of economic information that reflects the value movement of the subject and an interpretation of economic events. Accounting information is the sum of its characteristics to meet the needs of users. With respect to the characteristics, they are the attributes of accounting information quality to meet the needs of users, such as authenticity, reliability, compliance, and relevance. There is an interdependent and complementary relation between reliability and relevance, indicating that relevance requires the quality of accounting information must be related to "decision-making", which is mainly composed of two aspects, that is, feedback and prediction. Such influences of decision-making are mainly reflected as two points. Firstly, accounting information can help users, playing the role of prediction and decision-making. The second is that accounting information requires effective experience and verification, and can constantly modify the expected results, that is, playing the role of feedback. Such two roles can ensure the usefulness of accounting information to users through working together. [4]

### **4.3 Management and control agency**

The effective running of management and control agent has a direct impact on the development of the corporate, and a close correlation with corporate governance structure and accounting information quality. Profitability has become the need to measure the development of an enterprise since the implementation of contract system. The establishment and implementation of an effective incentive mechanism in the premise of taking accounting profits as the supervision basis, and the establishment of stock option incentive model by combining the long-term development of enterprises with the personal interests of managers will avoid the behavior of short-term interests and improve accounting information quality, thus making operators and managers establish a mechanism of benefit sharing and risk sharing. [5]

## **5. Suggestions for the improvement of corporate governance structure and accounting information quality**

### **5.1 Improving the formation of board of directors and promoting the role of independent directors.**

We shall endeavor to establish the certification system of reputation, ability and qualification, and performance evaluation system, and create an environment for independent directors to play an effective role and an effective operation mechanism, so as to improve the operation and management of then enterprise and provide a favorable atmosphere for independent directors. In addition, we shall strictly check the formation and disclosure of corporate information to achieve the long-term development of the corporate.

### **5.2 Optimizing the shareholding structure**

Enterprises shall attempt to established a diversified shareholding structure, cultivate structural investors and expand their types and scale, so as to promote the optimization of the shareholding structure of listed companies, and structural optimization of securities market. In the meanwhile, the operation mechanism shall also be optimized while improving the corporate governance structure. We shall enhance the development of merger market, encourage listed companies to carry out acquisitions and mergers, so as to improve the acquisition procedure and informational disclosure mechanism of listed companies.

### **5.3 Improving the supervision function of board of supervisors**

For the purpose of ensuring the independence of both supervisory structure and supervisors, and ensure that all supervisors can live up to their duties and rights, it is necessary to regularly report to and provides suggestions for the board of supervisors. The improvement of supervisors' quality and reinforcement of supervision and evaluation by independent supervisors are conducive to the construction of the board.

### **5.4 Establishment of effective incentive mechanism**

We shall establish and improve the internal incentive mechanism to increase the work enthusiasm of staff, encouraging them to make greater contributions at an established position. It is necessary to provide appropriate material motivation and honor support for them when making achievements in the job.

Based on the management investigation analysis on the economic market, it is found that the low accounting information quality is a problem to be solved in business circles. However, there are certain one-sidedness and limitations on the research results due to different contexts and backgrounds, the limitations of selected samples and relevant empirical analyses. Therefore, it is difficult to draw a comprehensive and correct conclusion. There is a deep connection between accounting information quality and corporate governance structure, while the improvement of corporate governance will drive the improvement of accounting information quality to be in constant change. The reason is that the inherent connection and influence of the characteristics of accounting information quality will not change. In the future researches, in combination with the economic market and corporate operating management, we shall analyze and formulate corresponding accounting standards for the effectiveness of accounting information in corporate governance, and develop regulations and reinforce supervisions, so as to provide valuable accounting information for decision-makers, and furthermore improve the core competitiveness of enterprises. We shall also constantly improve the corporate governance structure while improving the quality of accounting information, which is of great realistic significance to the development and growth of enterprises.

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