

## Enhancing financial reporting: challenges and opportunities in corporate governance statements

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### 1. Introduction

Qualitative, non-numeric information makes up an important part of accounting disclosures. (Asay *et al.*, 2018, p. 3)

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In the past few decades, at a rapidly accelerating pace, accountants have started to analyze voluntary/narrative disclosures to understand in a more comprehensive manner the accounting phenomena (Teoh, 2018). This rising academic interest in narrative disclosures has been triggered by the necessity of finding new information beyond “traditional” that would help them to go one step further and answer more complex research questions (Francis *et al.*, 2002). On this direction, to make corporate governance (CG) mechanisms much more visible, a new narrative report was introduced, either as a part of annual report or as a separate document to inform investors about the CG practices, known as corporate governance statement (CGS) (Nerantzidis, 2017).

This CGS is based on the dynamic procedure of the “comply or explain” principle (Nerantzidis, 2015), a framework that allows companies either to comply with soft law rules or to deviate and explain the reasons for their “non-compliance” (Sergakis, 2015). This in turn allows the recipients of this information to understand the way they are governed. Considering that scholars have put more emphasis on compliance studies without considering the noncompliance, this special issue is intended to provide advanced knowledge regarding the role, the impact, the challenges and opportunities of CGS in financial reporting.

For this reason, a total of 30 papers were submitted to the special issue and after a year of systematic consideration and follow-up and multiple rounds of revisions and reviews, 11 papers met the requirements of *Corporate Governance: the International Journal of Business in Society* (the accepted papers are depicted on Table I). The accepted papers reflect a normal distribution among research topics, countries and methodologies that have been used by authors. More specifically, the special issue covers a wide diversity of themes motivated by theoretical underpinnings such as agency, signal and institutional theory. In particular, the 11 papers on this Special Issue address ongoing issues such as the efficacy of “comply or explain” approach, the potential role of audit market in CG statement, new ways to supervise the information disclosed and strengthen the “comply or explain” regime.

As can be seen in Table I, the second column (entitled “Region”) shows the countries where CG practices have been analyzed. The majority of studies, 3 out of 11 have focused on European Union (Cash, 2018; Tampakoudis *et al.*, 2018; Vasilakopoulos *et al.*, 2018), whereas the rest are distributed among different continentals and are country specific

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**Table I**

<i>Author(s)</i>	<i>Region</i>	<i>Topic</i>	<i>Methodology</i>
Mgammal, Bardai, Ku Ismail	Malaysia	Corporate governance and tax disclosure phenomenon in the Malaysian listed companies	Content analysis and OLS
Lepore, Pisano, Di Vaio, Alvino	Italy	The myth of the “good governance code”: an analysis of the relationship between ownership structure and the comply-or-explain disclosure	Content analysis and OLS multiple regression models
Djokić, Duh	Slovenia	The “comply or explain” principle in the Republic of Slovenia	Multiple-case study approaches (i.e. content analysis, the Eisenhardt’s method)
Zaman, Bahadar, Kayani, Arslan	Pakistan	Role of media and independent directors in corporate transparency and disclosure: evidence from an emerging economy	Two-step system generalized method of moment
Bueno, Marcon, Pruner-da-Silva, Ribeirete	Brazil	The role of the board in voluntary disclosure	Fixed-effects regression model
Thanasas, Kontogeorga, Drogalas	Greece	Does the “capstone” of the “comply or explain” system work in practice? Evidence from Athens Stock Exchange	Content analysis
Vasilakopoulos, Tzovas, Ballas	European Union	The impact of corporate governance mechanisms on EU banks’ income smoothing behavior	OLS analysis
Cash	European Union	Can credit rating agencies play a greater role in corporate governance disclosure?	Normative methodology
Tampakoudis, Nerantzidis, Soubeniotis, Soutsas	European Union	The effect of corporate governance mechanisms on European M&As	Content analysis, event study, univariate and multivariate cross-sectional regressions
Roudaki	New Zealand	Corporate governance structures and firm performance in large agriculture companies in New Zealand	Generalized least square regression analysis
Koutoupis, Drogalas, Pazarkis	Greece	Auditing corporate governance statements in Greece—the role of internal auditors	Questionnaires

(Bueno *et al.*, 2018; Djokic and Duh, 2018; Koutoupis *et al.*, 2018; Lepore *et al.*, 2018; Mgammal *et al.*, 2018; Roudaki, 2018; Thanasas *et al.*, 2018; Zaman *et al.*, 2018). Moreover, the fourth column denotes the methodologies that have been used. The majority of studies, 7 out of 11, have used regression analysis (in conjunction with other methodologies), 2 out of 11 have used content analysis and the rests questionnaires and normative methodology. In addition, what should be mentioned is that the plethora of the accepted papers have analyzed the CGS, as it provides insights about the CG mechanisms that each company applies, a fact that can best be explained by the obligation of listed companies in many countries to disclose an annual CGS.

All in all, the 11 accepted papers posit a promising future for researchers worldwide to understand the real contribution of CGSs as a communication tool for stakeholders. The first article in the Special Issue, entitled “Corporate governance and tax disclosure phenomenon in the Malaysian listed companies” by Mahfoudh *et al.* (2018), examines the impact of CG internal mechanisms on tax disclosure in nonfinancial firms in Malaysia. The authors, using signal and agency theory and analyzing 286 nonfinancial listed companies on Bursa Malaysia for the years 2010-2012, find that managerial ownership and incentive compensation do not significantly influence tax disclosure. In addition, they find that company-specific characteristics are important factors that affect corporate tax disclosure. This result is quite interesting, as it provides some insights about the importance of CG practices from the companies’ perspectives, whereas it also contributes significantly to the debate about tax disclosure in relation to “comply or explain”.

The second article in the Special Issue, entitled “The myth of the ‘good governance code’: an analysis of the relationship between ownership structure and the comply-or-explain disclosure” by Luigi *et al.* (2018), analyzes the relationship between ownership, structure and the “comply-or-explain” disclosure. The authors, using a sample of 75 nonfinancial companies listed in Italy in 2016, find that companies with more concentrated ownership tend to disclose less information about compliance with CG codes and to explain less about noncompliance. In addition, they find that firms characterized by higher counterweight power are more adherent to the comply-or-explain principle. Moreover, results reveal that when there is a dominant financial shareholder in the ownership of the company, the negative relationship between ownership concentration and comply-or-explain disclosure is stronger. This illustrates that legislators, regulators and managers should not ignore the characteristics of the firms’ ownership structure when self-regulating initiatives are designed and implemented.

The third article in the Special Issue, entitled “The ‘comply or explain’ principle in the Republic of Slovenia” by Danila and Mojca (2018), provides an overview of the quality of CGSs in Slovenia. Using qualitative analysis based on a variety of sources, they find a gradual improvement of transparency in Slovenian public companies, from 63.8 per cent in 2011 to 71.7 per cent in 2014, on “comply or explain” principle. However, the authors expose and critically question how in some cases companies do not present deviations from the code recommendations. This remarkable observation helps in turn to meet our third inclusion criterion for the Special Issue and notes how greater surveillance as well as regulatory authority could help to strengthen the comply or explain regime.

The fourth article in the Special Issue, entitled “Role of media and independent directors in corporate transparency and disclosure: evidence from an emerging economy” by Zaman *et al.* (2018), examines the role of media and independent directors in corporate transparency and disclosure. Using a sample of 99 Pakistan-listed financial firms over the period 2007-2012, they find that media and independent directors on audit committees play a significant positive role in promoting corporate transparency and disclosure. The authors’ results highlight the vital role that media can play in reducing the information asymmetry between management and shareholders. The findings suggest that companies can use the media as a tool to enhance corporate transparency, disclosure and corporate reputation.

The fifth article in the Special Issue, entitled “The role of the Board in Voluntary Disclosure” by Giovana *et al.* (2018), examines the characteristics of the board of directors that can influence the voluntary disclosure of listed companies in Brazil. Using a sample of 285 companies and 575 reports from 2011 to 2014, the authors show that the presence of women as members of the board positively influences voluntary disclosure and that chief executive officer and chairman of the board positions have a negative effect. Their findings have important implications for the improvement of both regulatory and accounting regime in emerging countries, where the lack of transparency of information and corruption in these environments stand out.

The sixth article in the Special Issue, entitled “Does the ‘capstone’ of the ‘comply or explain’ system work in practice? Evidence from Athens Stock Exchange” by Thanasas *et al.* (2018), investigates whether companies listed in the Greek Stock exchange tend to imitate one another in the deviation depicted in CGSs. The authors find that 96 companies deviate from the Code (56.3 per cent) and provide explanations so as to be legitimate. Their results demonstrate that managers of these companies adopt a mimetic behavior, not for task related reasons but to send a signal to the market that they are “lawful.” The findings suggest that scholars need to give greater attention on studies that consider the explanations of noncompliance. This may help to better understand the efficacy of “comply or explain” approach in practice.

The seventh article in the Special Issue, entitled “The impact of corporate governance mechanisms on EU banks’ income smoothing behavior” by [Vasilakopoulos et al. \(2018\)](#), investigates the impact that CG mechanisms have on European Union banks’ income smoothing behavior. By using a sample of 98 banks from 23 European Union countries for the period of 2010-2013, the authors present evidence that there is a positive association between the level of loan loss provisions and accounting income. In addition, they indicate that bank managers’ decision to smooth income may differ in terms of board structure, level of leverage and provision of disclosure for remuneration of chief executive officer. They conclude by highlighting the concerns of the European Committee regarding the weaknesses of bank governance mechanisms and implying the importance of regulators and accounting setters to work toward the improvement of CG disclosures.

The eighth article in the Special Issue, entitled “Can credit rating agencies play a greater role in corporate governance disclosure?” by [Cash \(2018\)](#), presents his viewpoint regarding the way that credit rating agencies (CRAs) can influence the CG disclosures. Using a normative methodology, the author exposes and analyzes how CRA and proxy advisory firms can adapt their methodologies to incorporate the quality of CG statement disclosure into their methodological processes. He also emphasizes that private endeavors may have a greater impact to disclosure proceedings rather than the purely public regime being envisioned.

The ninth article in the Special Issue, entitled “The effect of corporate governance mechanisms on European M&As” by [Tampakoudis et al. \(2018\)](#), investigates the effect of CG on the economic impact of mergers and acquisitions (M&As) for European acquirers. Using a sample of 349 completed M&As between European firms from 1 January 2003 to 31 December 2017, the authors present evidence that acquirers realize significant positive excess returns upon the announcement of M&As. Moreover, they document that boards in excess of eight directors are negatively related to announcement-period abnormal returns. In contrast, they noted that the wealth effects for acquiring firms are positively related to shareholders’ voting rights and/or to the number of anti-takeover provisions. The article concludes by offering practical implications regarding the effectiveness of certain CG provisions.

The 10th article in the Special Issue, entitled “Corporate governance structures and firm performance in large agriculture companies in New Zealand” by [Roudaki \(2018\)](#), explores the role of CG characteristics on the financial performance of large agricultural companies in New Zealand. A novelty of this survey is that it investigates an industry that has not been considered by scholars so far. The author first discusses the unique features of CG in New Zealand and agricultural companies, and then she examines the impact of CG characteristics on firms’ financial performance. Specifically, the author presents a negative relationship between firm performance and board ownership and gender diversity. The article also goes one step further and highlights the auditors’ role in scrutinize CG disclosures in more depth.

The 11th article in the Special Issue, entitled “Auditing corporate governance statements in Greece - the role of internal auditors” by [Koutoupis et al. \(2018\)](#), examines the role of Internal Audit with respect to Auditing CGs. Using a structured questionnaire in 45 listed companies, the authors provide evidence that internal auditors limit their role in verifying compliance with the relevant laws and regulations rather than adopt a consulting role toward the improvement of the content and quality of CGSs information. Moreover, they document that the effectiveness of internal controls contributes to sound CG practices. The article concludes by highlighting the potential role of internal auditors in preparing, reviewing and auditing in CGSs.

## 2. Directions for future research

Taking into account the argumentation that CG reports should be improved (Shrives and Brennan; 2015), I believe that there are still lots to learn by further challenging the opportunities in CGS. Scholars need to go beyond compliance and uncover current situation.

This means that further research is still required to go one step further and address this “issue” using new theoretical insights (i.e. by combining different theoretical lenses) as well as new methodologies.

All in all, the “comply or explain” regime can be seen as a two-edged sword in terms of transparency: on one hand, the compliance, and on the other, the noncompliance. However, as the “comply or explain” concept is at the crossroads for many reasons (Nerantzidis, 2015; Sergakis, 2015; Shrives and Brennan, 2015; Keay, 2014; Magnier, 2014), I firmly believe that academic community have to pay attention on the reasons of noncompliance. This may help to solve the problem of badly crafted explanations and elevate the system of soft law that has been emulated worldwide.

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