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Exploring the Use of Expatriate Management to Improve the Quality of Earnings being Reported by MNC'S

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ABSTRACT

As organizations have strived to create global footprints and search for economies of scale, there has been a great deal of literature devoted to global expansion. This study is intended to fill a gap in the existing literature relating to the impact that financial expatriate management has had on multi-national expansion and how the quality of earnings being reported have been used as drivers for global expansion. By using the shared experiences of corporate financial executives, responsible for global financial reporting functions, the study of organizational reporting practices will serve to shed light on the procurement of quality information used in support of global strategic initiatives. The conclusions, recommendations, and implications reached are generalizable and appropriate for use in developing best practice staffing solutions.

Keywords: *Globalization, Expatriate Management, Accounting Quality, Earnings Quality Human Information Processing, and Stakeholder Theory*

INTRODUCTION

Globalization by definition generally includes a loosely connected set of objectives which include but are not exclusively limited to expansion, diversification, and brand establishment. These objectives are expected to be covered with profits generated from the targeted global expansion. To the extent that globalism is dynamic, it is often studied and in a contained environment. This enables the business to insure that it is on the optimum strategic path. Lawrence and Weber (2011), noted that in any global organization there are multiple groups of stakeholders. These stakeholders often will have differing and competing informational needs, as well as expectations and desired outcomes. Hunger and Wheelen (2012) noted that that use of expatriate management can be considered to be a vital human resource asset in the implementation and execution of global strategies. Additionally, their argument incorporated the notion that the use of expatriate management can be interpreted as a principal means of achieving the best results and a way to overcome many of the unique challenges and variables associated with cross-border operations in all functional management areas. In absence of qualified local financial managers many global organizations will deploy expatriate financial managers to different regions for the purpose of staffing their respective financial reporting functions. These organizations generally expect financial expatriates to quickly learn and adapt to their operating environment, which often can be problematic. Accounting and accounting information has been defined as the language of business. Strategic and informed decision making in a general global context requires uniform procedure of reporting financial results and metrics so that the intended users can take full advantage of operational options and opportunities.

BACKGROUND

Globalization

The impact of globalization around the world has made an indelible mark in the operations of both domestic and international operating standards. In its current context globalization is often viewed as the capital and goods market integration between different countries as adapted from Akisik and Pfeiffer (2009). Globalism cannot be termed a recent phenomenon, as noted in Bettner, Carcello, Haka and Williams (2012), the acceleration od globalization has mainly been registered in the past two decades. Consequently, there has been an enhanced interdependence among economies which act to function as a process of universalization. In addition, Doupnik and Perera (2012) noted that through the implementation of the policies such as privatization, free trade, fiscal discipline, tax reform and deregulation, the result is economic prosperity for developing and developed nations.

The globalization context as adapted from Akisik et al (2009) can be viewed as the capital and goods' market integration between different countries. Supporting this context Mishkin (2006) indicated that globalization has had a weighty impact on the economies of the world especially within the past few decades.

A divergent theory developed by Irvine and Lucas (2006), advanced the concept that globalism surpasses the economic phenomenon level for developing worlds, with far-ranging impact characterized by both losers and winners. Conversely, the embracement of globalism has been said to disrupt the whole societies by Engardio and Belton (2000). Taken together it can be concluded that embracement of globalization poses threats to countries' cultural uniqueness by technologies and ideas that are potentially Western-dominated.

Accounting Quality

With globalism there has been greater need for the acceptance of the International Accounting Standards (IAS). This coupled with rising attention being focused on Multinational Corporations (MNCs) the need for International Financial Reporting Standards (IFRS) has increased geometrically. Prior to establishment of the IFRS, the United States Generally Accepted Accounting Practice (US-GAAP) were widely used and accepted across the globe. International capital flows and MNCs' quality of earnings are fundamentally the results of foreign direct investments, both of which can be classifiable as direct of portfolio investments (Akisik et al, 2009). Typically, portfolio investments are initiated to benefit from potentially higher returns on financial assets in target host countries, which create a smoothing or diversity of investment portfolios (Kho, Stulz and Warnock, 2006). Navaretti and Venables (2004) contended that direct investments make it possible for investors to possess an effectual voice in investees' management within the host countries. The investors choices model between portfolio and direct investments which was advanced by Goldstein and Razin (2006) exposed that investors normally encounter a tradeoff between the comparative efficiency and control over information asymmetry resulting from obtained private information concerning Foreign Direct Investments (FDIs). Among the principal determinants of the direct investment cost noted by Goldstein et al (2006), is the degree to which true information concerning the company reveals transparency to potential investors (Akisik et al, 2009).

Accounting quality has a significant role in MNC operations which is caused in part by the regulatory structures of industrialized countries and the international accounting companies' prevalence (Cahan, Perera and Rahman 2003). US-GAAP as well as IFRS is globalization manifestations and a technology through which mobilization of globalism occurs. Restating that accounting is the language of business and the medium in which the results and consequences of economic transactions are reported, accounting and its quality are considered an integral part of that technology. Understanding the component accounting systems is paramount to the extension of globalism through the information and earnings reporting process. This study will explore the reasons for the use of expatriate financial managers in staffing MNC reporting functions in order to assure the quality of earnings being reported and is not intended as a cost benefit analysis.

Earnings Quality

In general literature related to global accounting contains many studies that investigate varying facets of quality of accounting. In spite of the divergent definitions of quality of accounting, there has been operationalization of various perspectives of this construct. Perhaps the most common characteristic of such studies is the rampant development of quality measures using elements of earnings and reported earnings (Hribar, Krayet & Wilson, 2008) and the sustainability of earnings (Hunger & Wheelen, 2012; Berger & Shrivastava, 2010). A review of the salient literature indicates that most of the early studies define accounting quality in terms of accruals quality and earnings quality. Prempanichnukul and Sangboon (2008) reviewed various definitions of earnings quality and concluded that that it has been defined to involve the persistence of high earnings over time. Conversely, Hunger and Wheelen (2012), contend that the quality of earnings can also be expressed as earnings with the accurate representation of the economic implications of essential transactions. In addition, there are researchers who argue that earnings quality refers to the earnings' portion that relate to operational cash flows or the extent to which accruals of working capital map into future, present and current cash flows.

In research conducted by Dechow and Dichev (2002), the measure of accrual quality (AQ) whose essence is on how well accruals translate into the actual cash flows that they define has since become a famed proxy for quality of accrual. According to the AQ measure, accrual quality is synonymous with the error variance that results from a working capital accruals' regression on lagged, past and current cash flows. As noted in Callen et al (2009) other measures or proxies of accounting and earnings quality include the frequency of generated losses, earnings surprises and special items. From a practical standpoint, the difficulty in sustaining consistent losses simply makes those losses unusual. Literature revolving around the management of earnings suggests that managers exercise discretion vigorously to evade losses (Jenzarli, Joseph and Pergola, 2009). Therefore, an inference can be made that losses signify an uncommon economic event for a company which most likely associate with increased asymmetry of information and the uncertainty of parameter.In a study conducted by Dempster (2008) it was noted that institutional investors form a significant supply source in the market of share lending and suggested that both positive and negative earnings surprises raise the levels of uncertainty. Adding to this, Callen et al, (2009) suggested that these surprises are indicators of expected occurrences that are too adverse to be smoothed. Consequently, situations where the occurrence of an earnings surprise becomes inevitable are more likely to be linked to bias in financial statements

Human Information Processing

The information-process approach emphasizes the encoding, storage and retrieval of information. When the human element is introduced the approach becomes more complex. Interpretation, motivation and judgment play key roles in the prioritization of information and in a business context, policy making. According to Jochim, Jones, and Workman (2009) information processing theory is grounded in the behavioral theory of choice. Amato, Driver, Pate, and Svensson (1996) defined choice or rational choice theory as a conceptual framework for understanding and modeling social and economic behavior. The major drawback to the application of rational choice theory to accounting information is the general lack of understanding developmental motivations. Marianne (2009) advances the argument that accounting principles and practices that are developed from existing conceptual frameworks restrict the usefulness and clarity of information when they are subject to constant amendment.

Generally accepted accounting principles (GAAP) provide for the disclosure of relevant financial information. GAAP does not provide for the form in which the information needs to be disclosed. In many cases, excluding the basis financial statement, organizations are free to choose the form and use judgment to determine the substance of the disclosure. This suggests that differences in interpretation, motivation and judgment will result in different disclosures. In principles-based accounting there is more leeway than in rule-based accounting to use alternative disclosure techniques. For example tables, charts and text may differ in presentation value but still satisfy the same disclosure requirements. Interpretation of data forms is as subjective as the preparation and submission. The context in which the financial information is communicated affects the meaning and interpretation of the communication by the users. With the technological advances in the recent decades Hunton (2002) noted that the channel through which financial information is communicated has become almost as important as the information itself.

Stakeholder Theory

There Stakeholder theory was first introduced in the nineteen eighties and later consolidated in the Nineties particularly through the works of many researchers. are two significant models of stakeholder management theory. As noted in Fort and Schipani (2000) the Stakeholder model describes corporate governance as the top management process that manages and mediates value creation for value transference among the various corporate claimants. Bettner et al. (2012) describes the Caux Principle or model as the responsibility of corporation is beyond shareholders and towards stakeholders. In a research study Travis (2002) noted that by combining these two theories advances the notion that there are many linkages between the components of globalization and positive and negative change are driven by the assessment of the stakeholders interests can develop into a void between the stakeholders. Considering that multinational corporations are the instruments of economic integration, they are further responsible for the positive productivity related wealth effects of globalization. From this argument it is advanced that the dominant forces which shape both corporate governance and peace prospects are those related to the economic integration, democratization and stakeholder mediation linkages. Business organizations do not exist for their own purpose; they exist for a specific social purpose. They are not an ends they are a means (Drucker. 2008).Within the organization that specific social purpose is economic performance.

Based on this wide theoretical ideology, the modalities employed by diverse groups of stakeholders during interaction with the organization can be clearly delineated.

Andriof et al (2002). Stakeholders are therefore considered likely to generate significant resources and contributions since they are in continual associations with the organization. The analyses of stakeholder participatory roles in the improvement of the quality of earnings being reported by MNCs cannot and should not be overlooked in the face of globalism and the expectations GAAP. Moreover, it is necessary in this context to review literature concerning expectations gap from a stakeholders' perspective including disclosure, audit and the regulatory environment as done in the next section.

METHODOLOGY

Hypothesis

This study initially considered six sets of hypotheses that were developed to investigate the research question posed in this study. The first two look at determining is if there are causal relationships between the use of expatriate financial management and reported financial abuses. The second two hypotheses look to determine if there are causal relationships in compensation differences that impact the decisions to employ expatriate financial management. The fifth hypothesis attempts to determine if global differences in accounting principles and practices have a causal effect on reported financial information and the related financial reporting abuses. The last hypothesis looks to determine if stakeholder reporting and performance requirements have a causal effect on international staffing.

[H0] *There is a positive relationship between expatriate financial management and reported financial abuses.*

[H1] *There is no relationship between expatriate financial management and reported financial abuses.*

[H2] *There is a positive relationship between expatriate compensation and reported financial abuses.*

[H3] *There is no relationship between expatriate compensation and reported financial abuses.*

[H4] *Differences in accounting principles and disclosure policies have an impact on the quality of information being reported for organizational decision-making.*

[H5] *Diverse stakeholder information requirements place stress on organizational information reporting and flows.*

Data and Analysis

The research methodology consisted of four separate phases. Each phase was designed to isolate data and patterns as well as helping to build the subject matter and context for each subsequent phase of inquiry. Phase one consisted of review of existing literature. The second phase consisted of the initial data gathering and used a researcher designed web-based survey. Data collected from the initial measurement instrument was used as a screening mechanism to accept or reject respondents as well as to determine the impressions of the research subjects relating to the rationale for utilizing expatriate financial managers. Using the survey responses and respondent impressions a baseline was developed to narrow the focus for the third and fourth phases of the research study. In both the third and fourth phases an exhaustive review of public documents was accomplished using a researcher designed audit program. Data collected from the audit programs allowed the researcher to further explore and validate the research subject's observations and experiences as well as how any reporting issues were remediated.

To mitigate the internal validity threat related to the use of a self-designed measurement instrument, a pretest was preformed prior to the survey being issued. The pretest was conducted using a sample population of five respondents and revealed a level of respondent data that was sufficient to validate the reliability of the measurement instruments. For the purposes of this research study the facts, financial values, control processes and motivations are all stipulated and a matter of either securities filings or court records. By using Securities filings and case stipulated data, the data will by definition be consistent, comparable, free from bias and reliable thereby mitigating any potential validity issues either internal or external. In addition, the use of readily available audited financial data from Security Exchange Commission sources will enable other researchers to use and replicate this study using similar standardized instruments for validation purposes.

Data Collection Process

The sample which consisted of two hundred and twenty-five MNC's consisted of seventy-five invitations sent to executives in MNC's, whose organizations had less than $75 million in market capitalization, seventy-five invitations were sent to organizations whose market capitalization was between $75 million and $700 million of market capitalization and seventy-five invitations were sent to organizations that had in excess of $700 million in marketization. The initial research plan was designed around a sample size of twenty-five from a population of two hundred and fifty or a 10% response rate. Foreign filers were eliminated due to the different disclosure requirements afforded foreign corporation which would have made comparative analysis problematic. To limit the sample to the approximately twenty-five subjects stipulated in the initial research plan, a random sample of two hundred and twenty-five participants was selected to test. In the instant research study a 12% response rate might suggest an 88% nonresponse rate. According to Hess and Kish (2004) the following mathematical formula can be used to calculate bias.

Bias (yr) = pn {E(yr – yn)}

Where:

yr = The estimated bias characteristic based on the respondents only.

pn = The nonresponse rate.

yn = The estimated bias characteristic based on the nonrespondents only.

E = The expectation operator for averaging over the entire population.

Using the above formula and the current research design where the yr and yn values are considered to be equal, a nonresponse bias of zero would result. The zero nonresponse bias would serve to confirm the validity of the study despite the overall 12% response rate. Central to the zero bias rates is the notion that both the yr and the yn are the same. This is predicated on the fact that the survey invitations were submitted to a population of respondents that had the same characteristics. As noted in Kemmerling and Wagner (2010) when the respondent and non-respondent characteristics are similar the overall response rate would not invalidate the survey results. This suggests that the non-responsiveness in this research study does not create a bias that would fatally flaw the outcomes. In addition, the lack of response bias would serve to validate the findings and would indicate that the results should remain constant across a wider range of response.

RESULTS

The study involved 225 survey invitations to senior financial executives of publicly MNC's, the review of twenty-five SEC annual reports and five ATCA cases. Of the 225 survey invitations twenty-seven positive responses were received. Of the twenty-five SEC annual reports and the five ATCA cases fifteen and three were used to collect and correlate data. Data collected from the initial measurement instrument was used as a screening mechanism to accept or reject respondents as well as to develop baseline impressions of the research subjects relating to the rationale for utilizing expatriate financial managers.

Relationship between Expatriate Financial Management and Financial Abuses

The sample data collected from the survey responses suggests there is a relationship between expatriate management and both reported and alleged financial abuses. The review of the survey responses as summarized in table 7 indicates twenty-two (81.5%) of the respondents reported one or more of the measureable governmental inquiries. Additionally, the responses summarized in table 8 indicate 9 (33.33%) of the respondents reported their respective firms employed expatriates. The SEC document review, summarized in table 15, reflects 5 (33.3%) of those firms had reported weakness remediated. Consistent with the review of the SEC documents, the review of the ATCA case documentation, summarized in table 16, indicates the recurring theme of lack of centralized control.

Data was collected independently, and is mutually exclusive. This suggests there is an inference that a strong relationship exists between expatriate management and financial abuses form both a cause and remediation standpoint. This conclusion is supported by the data collected in survey responses, document reviews of the SEC annual reports, and the ATCA cases that is consistent with the limited research uncovered in the literature review. Due to the limited sample size, the conclusion cannot be generalized to reflect the entire population of SEC filers. Additional research with an expanded sample would be necessary in order to generalize this conclusion. During the course of the review, additional implications were discovered.

The Impact of Differing Accounting Principles on Financial Reporting

Data suggests there is an impact on financial reporting caused by differing accounting principles. As noted in a study by Meghna et al (2011), material weaknesses can only exist where inappropriate use of GAAP reporting has occurred. Further, in many instances differing international accounting principles are inappropriate under GAAP. The survey questions did not address the substance of individual weakness; rather they were used to develop the existence of weaknesses and other related financial abuses. The review on the SEC documents reflected in table 15 indicates 9 (60%) of the reported weakness related to either identified or unidentified GAAP issues. The data further indicates of the reported weakness, all were remediated by either training, additional oversight, or seconding experienced expatriate financial managers. Similar results were discovered in the ATCA document review. Taken together, there is an inference that differing accounting principles can have an adverse impact on financial reporting. This conclusion is supported by the data collected in document review of the SEC annual reports, and the literature review that is consistent with the limited research uncovered in the ATCA cases and survey responses. Due to the limited sample size, the conclusion cannot be generalized to reflect the entire population of SEC filers. Additional research with an expanded sample would be necessary in order to generalize this conclusion.

IMPLICATIONS

The basic premise of the qualitative research method is that it continues to develop as research continues. During the data collection phase of this study, additional implications that were outside of the initial research questions evolved. These implications fell into two distinct categories, those that relate to practice, and those that relate to future research.

Implications for Practice

By inference, this study is meant to highlight the benefits incurred from the adherence of accounting standardization. It further established there is an advantage realized from employing expatriate financial management in the non-domestic operations of multinational corporations. In addition, the study also clarified the accounting expectation gap related to convergence and provided a useful platform for best practices. The data collected from the survey responses suggest the larger the organization is, the more likely they are to employ expatriate managers. This result is consistent with the arguments advanced in Meghna (2011) and Lawrence and Weber (2011) that larger organizations have greater resources to apply to staffing solutions. Additionally, data suggests that expatriate compensation and operational performance may be linked, and organization performance and control were generally applied as a function of top down management. The data further suggests the quality earnings and financial reporting are linked. Data collected during the SEC review further suggested there is an equal chance that remediation was accomplished utilizing employee training, employing expatriate managers, and reorganizations without employing expatriate managers.

Implications for Future Research

A review of literature to date indicated there are few authoritative works devoted solely, and collectively to the impact of multi-national expansion, as well as how the quality of earnings being reported have been used as drivers for expansion. With global expansion costs falling into two distinct categories, those costs are a function of employment, and they are a resultant from employment. The survey responses and SEC review looked at the costs as a function expatriate employment. The ATCA case review looked at costs not as a function of employment but as a function of sustainability where sustainable earnings are considered to be quality earnings and where organizational actions create intangible costs. The data from the ATCA review suggests that economic, environmental and social costs associated with sustainable operations occur twice as frequently in countries where international operations are managed locally and organization performance and control was applied as a function of top down management.

RECOMMENDATIONS

The research and observations generated from this study form a basis for recommendations relating to operational performance, control and the role of expatriate management in achieving those firm level initiatives within the global environment. It was clear from the financial executive responses that metrics of performance and control are interrelated at all organizational size levels. From the responses and document reviews, it was also clear the financial resources available at the individual firm level directly impact staffing decisions. Based on the research results there are lessons that have been learned that can be applied in the form of recommendations. These recommendations fell into two distinct categories, those that relate to practice and those that relate to future research.

Recommendations for Practice

Considering the severity of the financial and non-financial consequences of reported weaknesses, and ATCA litigation, research findings consistently indicate the control environment is extremely important in practice. The findings further indicate the control environment is organizationally specific and a variety of internal controls are created, at the firm level. These controls generally include controls over financial reporting, as well as the staffing solutions are considered necessary in order to execute the overall control function. There was no significant impact noted on financial reporting and earnings quality caused by differing stakeholder requirements. This leads to the following recommendations for improving the control environment.

The first recommendation is that organizations consider increasing the centralized control over international subsidiary financial reporting by increasing oversight and review over their accounting documentation. This would have the effect of mitigating potential accounting issues before they surface. The second recommendation is global organizations consider creating a compensation system where performance goals are not pushed down but developed by consensus and monitored. Data obtained from the survey respondents indicated that there was no strong preference to the form that incentive compensation took. The last recommendation is international organizations create a training program for host country financial managers and only where necessary staff their respective locations with expatriates. Consistent with the survey responses, as well as the SEC and ATCA case reviews suggest that employee training particularly in the financial area was preferred to seconding expatriate managers.

Recommendations for Research

This research in this study was limited to the experiences and perspectives of sample multinational corporate financial executives and was supported by an SEC and ATCA document review. Most multinational organizations treat their financial reports as confidential unless approved for public use thus making it difficult for researchers to access such information. The two significant challenges encountered in conducting a study of this nature were the Securities Acts of 1933 and 1934 that respectively regulate the disclosure of financial information which means that full disclosure and transparency may be restricted (Drake et al, 2010) and the retrieving of data from distorted or manipulated financial reports and cases.

In addition, this study was further limited to and relied on the shared experiences of financial executives from United States multinational corporations. International or non-domestic multi-national financial executives are not being considered due to the lack of regulatory oversight afforded in many countries as well as the diverse cultural variables associated with non-domestic multi-national organizations and their related employment practices. It is believed that these limitations in scope combined with a small sample size, as discussed in Chapter 4, will not adversely affect the study. Other stakeholders and governmental officials are also not being considered on the basis of their respective diverse and variable interests.

Due to the limited sample size the conclusion cannot be generalized to reflect the entire population of SEC filers. Additional research with an expanded sample would be necessary in order to generalize this conclusion. Based on the research study results and the limitations, the recommendations for future research in this area would be for future studies to include financial managers from non-domestic multinational organizations into the test sample as well as adding and an interview phase where the researcher would be able to collect data in an open and fluid format. It is expected that these modifications could greatly enhance the results and expand the research view.

It is believed that using the qualitative phenomenological research design was the appropriate method for this research study since it allowed for flexibility and research to develop directionally as the process continued. During the analysis phase of the research other topics emerged which will allow for expansion and additional topics. Those areas of renewed interest would include but not be limited to:

1.) Expatriate financial staffing and the impact on sustainable business models.

2.) Expatriate financial staffing and the impact on strategic alliances.

3.) Expatriate financial staffing and the impact on corporate responsibility.

4.) Expatriate financial staffing and the impact on economic freedom.

CONCLUSION

Globalism is dynamic and as such the dynamics are studied critically, often and in a contained environment to ensure the business in general is on the right path. Most researchers generally consider expatriate management to be a vital human resource asset in the implementation and execution of global strategies. They further consider that expatriate management contributes to the success of any multinational organization globalization initiatives. This research study was successful in that it provided the following conclusions and insights that were reached from the testing of the focal research question and the initial set of six hypotheses.

1.) Insight into the types and nature of reported weaknesses, ATCA issues, SEC inquiries and other international governmental inquiries.
2.) Insight into how the reported weaknesses, ATCA cases, SEC inquiries and other international governmental inquiries were remediated.
3.) Support for the development best practices in increasing internal control activities relative to accounting documentation, staffing solutions and incentive compensation.
4.) Support for conclusion that there was relationship between expatriate management and reported financial abuses.
5.) Support for the conclusion that there was no significant impact noted on financial reporting and earnings quality caused by differing stakeholder requirements.
6.) Support for the conclusion that there is an impact on financial reporting caused by differing accounting principles. These results support the study by Meghna et al (2011) where it was noted that material weaknesses can only exist where inappropriate use of GAAP reporting has occurred and that in many instances differing international accounting principles are considered inappropriate GAAP.
7.) Identification of future areas of expatriate management that could be examined to enrich the base of existing literature. This includes use of additional interviews of senior financial executives in non-domestic organizations, increasing the sample size and looking at the demographics of the respondent data for additional themes.

Phenomenological research is a qualitative strategy of inquiry wherein the researcher attempts to identify the essence of a phenomenon using the shared experiences as described by the study participants. By using the shared experiences of multiple participants, this study tells a story that is built on common themes and experiences to gain a deeper understanding of the phenomena. With any research study there are limitations that need to be considered when applying the data. Those limitations above relate primarily to the availability of restricted financial data and potential of results distortions related to sample size. Using the data that was collected and analyzed in the various phases of this research study, recommendations and implications for practice and further research relating to the use of expatriate management in a global context have been isolated.

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