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CORPORATE GOVERNANCE AND STRENGTH OF AUDITING AND REPORTING STANDARDS: A CROSS-COUNTRY SURVEY

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ABSTRACT. *The purpose of this cross-country empirical survey is to investigate the relationship between the strength of auditing and reporting standards and some corporate governance characteristics such as efficacy of corporate boards and ethical behaviour of firms. All three variables were captured through the indicators included in the report of World Economic Forum entitled "The Global Competitiveness Report 2012-2013" selected for 144 countries from all over the world. The findings validate the research hypothesis concerning the significant influence of some of the corporate governance dimensions on the strength of auditing and reporting standards, from a cross-country perspective.*

Keywords: *Auditing standards, reporting standards, corporate governance, efficacy of the corporate boards, ethical behaviour of companies*

JEL Codes: *M40, M41, M42*

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Introduction

The aim of this paper is to empirically analyse the influence of some corporate governance elements such as efficacy of the corporate boards and ethical behaviour of the companies on the strength of auditing and reporting standards in 144 worldwide countries using country level data, available in the World Economic Forum's report "*The Global Competitiveness Report 2012-2013"*. All the variables included in this study are based on scores computed by World Economic Forum, by using a seven-point Likert scale where 1 means the weakest and 7 the strongest.

The reports issued by World Economic Forum on national and global competitiveness from all over the world represent a respectable source of data for more than three decades, highlighting the main factors that influence the competitiveness at each country's level. World Economic Forum measures the competitiveness through a global competitiveness index (GCI), a comprehensive tool that includes 12 pillars with more than 115 variables included. The variables included in Global Competitiveness Report 2012-2013 are based on two main sources of data. First is given by a set of statistical data such as enrolment rates, government debt, budget deficit, and life expectancy, which are obtained from internationally recognized agencies. The second dataset used in the computation of GCI index is given by the results of surveys of chief executive officers *(World Economic Forum's Annual Executive Opinion Survey)* from entities from 144 countries from all over the world. Three of these variables presented within this report are given by the strength of auditing and reporting standards, efficacy of the corporate boards and ethical behaviour of firms and they are included in the first pillar referring to *Institutions*, and more exactly to the *private institutions*, from the perspective of their corporate ethics and their accountability.

Using country-level data from 144 countries for the variables mentioned above, this study intends to find the answer at one significant question: *Does corporate governance influence the strength of auditing and reporting standards at global level?*

The remainder of this paper is organised as follows. The next section briefly present a review of main findings in areas related to the main objective of the study. In the following section it is described the research methodology used, while within Section 4 the empirical results are presented and discussed. Finally, the Section 5 concludes, summarizing the main findings of this study. In the author's opinion, the results provided by this study could provide a valuable context for issuing constructive debates about the real influence of corporate governance's elements on the strength of auditing and reporting standards.

Background Literature

As Booklay and O'Leary (2011) remarked the international auditing standards and international financial reporting standards continue to be applied worldwide, but the major difference is the pace of adoption which in each countries varies. Watts and Zimmerman (1986) cited by Booklay and O'Leary (2011) admits that audit function has a fundamental role for increasing the efficiency of capital markets due to its contribution in reducing the agency risks, opinion also shared by Khurana and Perera (2003) and Gates *et al, (*2007). During time, the academic literature emphasizes the fact that auditing had been received significant attention from scholarships, in this regard relevant proof being the existence of increasing number of studies focused on various aspects related to audit function.

The literature of auditing is focused on certain areas where it has been prove there is a relationship between audit and these issues. Thus, there are many studies which analyse the auditing from theoretical perspective to practical one, discussing the effectiveness of various audit practices (Heckman, 1979; Asare and Wright, 2001; Blokdijk et al., 2003; Nikkinene and Sahalstrom, 2004). Others many papers are dedicated to audit fees (Davis et al., 1993; Jubb *et al.*, 1996; Cobbin, 2002; Ireland and Lennox, 2002; Hay *et al.,* 2006; Gonthier-Besacier and Schatt, 2007; Kealey *et al.,* 2007; Van Caneghem, 2010). Also, another research themes well developed by various researchers was audit quality (Palmrose, 1988; Datar *et al.,* 1991; Teoh and Wong, 1993; Piot, 2001; Francis, 2004; Vander Bauwhede and Willekens, 2004;), audit independence (DeAngelo, 1981; DeFond *et al.,* 1999; Vinten, 1999; Hemraj, 2002; Wines, 2006; Zhang and Emanuel, 2008; Zerni, 2012) and auditing and corporate governance (Dewing, 2003; Khurana and Perera, 2003; Francis *et al.,* 2003; Fan and Wong, 2005; Newman *et al.,* 2005; Yatim *et al.,* 2006; Chan *et al.,* 2008; Adelopo *et al.,* 2012).

The literature review proves the major research activity dedicated to auditing from various perspectives. But one thing is clear, there are many factors which influence the accounting and auditing systems and practices, like regulation, the characteristics of financial markets, rule of law, regulatory environment, this opinion being also shared by Booklay and O'Leary (2011). In fact, Booklay and O'Leary (2011) go forward and try to identify a predictive model for evaluating the determinants of strength of auditing and reporting standards in the context of Africa, and later in the European space (Booklay, 2012).

In this context, a stringent necessity for a country is to have an appropriate environment for the applying and implementation of auditing and reporting standards, this concept being also promoted by Lennox (1999) and Carson (2009). One factor with significant impact on the strength of auditing and reporting standards is the effectiveness of corporate governance framework.

The present paper aims to extend the analysis of the main determinants of the strength of auditing and reporting standards, from the corporate governance perspective, but with a much larger sample, including in the regression analysis country-level data for 144 countries, for which data were available in source report mentioned above.

Research Design and Data Used

Starting from the model developed by Booklay (2012) for 41 European countries, the present study intends to extend the analysis to the all 144 countries that Global Competitiveness Reports present country level data.

The *Global Competitiveness Report* issued by the World Economic Forum is regarded as being one of the most comprehensive assessment reports on global competitiveness, including a range of significant indicators that highlight very important information about the economic development and the necessary conditions for ensuring long-term prosperity. The advantages of using the information provided by this global report are various and some of them are:

- This report provides information for a significant number of variables (approximately 115 variables) grouped on 12 pillars that influence the level of competitiveness at each country-level.
- All the indicators and variables are computed by using the same methodology which ensures for researchers the necessary conditions for developing comparative studies.
- Finally, another relevant advantage is the significant number of countries included in the assessment report, which provides information for the same range of indicators, which allow developing comprehensive cross-country studies including larges samples of countries from all over the world (Global Competitiveness Report, 2012).

Considering the major objective of this study, the analysing the influence of strength of auditing and reporting standards on some corporate governance dimensions such as efficacy of corporate board and ethical behaviour of firms, from the *World Competitiveness Report 2012-2013* there were extracted data for all these three indicators and the multiple regression statistical method was applied trying to obtain the premises in order to validate or invalidate the research hypothesis:

H_0: Corporate governance, through its dimensions, efficacy of corporate boards and ethical behaviour of companies statistically influences the strength of auditing and reporting standards.

The variables used and data sources for these variables are disclosed within Table no.1.

Table 1. Variables and data sources

Variable Name	Type of variable	Description	Source	No. of countries
Strength of auditing and reporting standards	Dependent Variable	It ranges from approximately from 1 = extremely weak to 7 = extremely strong	*World Competitiveness Report 2012-2013*	144 countries
Efficacy of corporate boards	Independent variable	It ranges from approximately from 1 = management has little accountability to investors and boards to 7 = investors and boards exert strong supervision of management decisions	*World Competitiveness Report 2012-2013*	144 countries
Ethical behaviour of firms	Independent variable	It ranges from approximately from 1 = among the worst in the world to 7 = among the best in the world	*World Competitiveness Report 2012-2013*	144 countries

Source: author's projection

The regression analysis was developing starting from the next regression model:

$$\textbf{Aud\_Rep\_Stand} = \alpha + \beta_1\textbf{Efficacy\_Board} + \beta_2\textbf{Ethic\_Behav} + \varepsilon \qquad (1)$$

where:

- **Aud_Rep_Stand –** represents the scoring for the indicator of „*Strength of auditing and reporting standards”* from *World Competitiveness Report 2012-2013.*
- **Efficacy_Board –** represents the scoring for the indicator of “*Efficacy of corporate boards”* from *World Competitiveness Report 2012-2013.*
- **Ethic_Behav -** represents the scoring for the indicator of “*Ethical behaviour of firms”* from *World Competitiveness Report 2012-2013.*

Results and Discussions

A cross-country regression was developed in order to empirically research the validity or non-validity of the research hypotheses formulated above. The ranks assigned to the strength of auditing and reporting standards were regressed on the ranks of the independent variables such as efficacy of the corporate boards and ethical behaviour of firms.

The main results of regression analysis are reported within Table 2 and 3. The *adjusted* R^2 of the model is 68% which from statistically point of view means that the variance of dependent variable (strength of auditing and reporting standards) is explained in proportion of 68% by the independent variables considered in the regression model (efficacy of the corporate boards and ethical behaviour of the companies). The statistic F test reveals that the regression equation is highly significant with an F= 152,946, p<0,001 which means that is very unlikely that the regressions results to be determined by a sampling bias.

Analysing the regression coefficients it can be noticed that the influence of independent variable - *ethical behaviour of firms* (coefficient beta = 0,560) is bigger than those of *efficacy of the corporate boards* (coefficient beta = 0,309). However, it would be wrong to consider that based on comparing these beta coefficients the ethical behaviour explain almost twice the variance of dependent variable than the efficacy of corporate boards. Such a comparison is allowed only on the part correlations squared **(r^2_{sp})**. Thus, $r^2_{sp\ \text{ethical behaviour}}$ = 0,115, while for $r^2_{sp\ \text{efficacy of corporate boards}}$ = 0,034, which allows to draw the conclusion that the influence of *ethical behaviour* on the *strength of auditing and reporting standards* is about three times higher than the influence of *efficacy of corporate boards*.

Proceeding to checking for possible outliers (that might affect the stability of regression model in the sense that eliminating these extreme cases, the regression coefficients may change significantly) it can be noticed that the Cook's distance value is not greater than 1 (0,334). Thus, this test confirms that there were no outliers before processing to the multiple regression analysis.

Finally, the empirically findings obtained allow us to validate the research hypothesis formulated above, that corporate governance's characteristics such as efficacy of corporate board and ethical behaviour of firms significantly influence the strength of auditing and reporting standards.

Table 2. Descriptive statistics

Variables	Mean	Std. Deviation	N
Aud_rep_Stand	4,6062	0,83081	144
Efficacy_Board	4,5132	0,54532	144
Ethic_behav	4,1549	0,97614	144

Source: author's calculations by using SPSS Software

Table 3. Multiple regression results concerning the influence of corporate governance characteristics on the strength of auditing and reporting standards

Variables	Coefficient	t-value	Part correlations squared (r^2_{sp})	p-value
Constant		1,390		0,167
Efficacy_Board	0,309	3,963	0,034	0,000
Ethic_behav	0,560	7,193	0,115	0,000
R^2				0,684
Adjusted R^2				0,680
F				152,946
Cook's Distance				0,334
P				<0,001
n				144

Source: author's calculations by using SPSS Software

Conclusions

This study developed a model in order to evaluate the influence of some of the corporate governance dimensions (such as efficacy of corporate boards and ethical behaviour of firms) on the strength of auditing and reporting standards. The findings reveal the significant impact of those two coordinates of corporate governance on the auditing and reporting standards, these results being also consistent with the ones obtained by Booklay and O'Leary (2011) for sub-Saharan Africa zone and by Booklay (2012) for Europe.

By developing such a study and presenting an overview of the main results, the author do hopes to stimulate further research on this problematic issue for a much larger samples, provoking constructive debates within this field, with the perspective of including some other relevant variables that might affect the strength of auditing and reporting standards.

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