Financial Reporting and Corporate Governance

Essays on the contracting role of accounting and the effects of monitoring mechanisms

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The governance and transparency in firms constitute the major concerns in today's business. Contracts are fundamental aspects of corporations and in order to be efficient they should be designed and monitored using high quality information and well-functioning corporate governance. This thesis covers the role of accounting in the contractual context and the effects of monitoring mechanisms in firms in enhancing the quality of financial reports.

The need for accounting information in contractual relationships comes from the limitations of relevant information for monitoring managerial behavior, which is fundamental for efficiency of contracts. In this respect, this study concerns two important issues: first, the role that accounting plays in increasing the effectiveness of contracts for resolving agency problems in firms; and second, the effect of a firm's governance mechanisms as well as a country's legal environment for ensuring high quality financial reports.

Regarding the first issue, the essays examine the use of accounting performance in CEO compensation contracts. The general conclusion is that compensation contracts are used as an alternative monitoring mechanism in firms with greater agency problems. The evidence for the use of accounting performance-based compensation in family firms with dual-class shares indicates that, due to the excess voting rights by controlling shareholders in these firms, agency problems arise and CEOs receive higher performance-based compensation. Furthermore, findings show that with an improved transparency due to the changes in accounting standards, the link between accounting performance and CEO compensation becomes stronger.

With respect to the second research issue, the essays examine the role that governance mechanisms play in enhancing the quality of financial reports and the contracting role of accounting in designing an efficient compensation contract. The results indicate that governance regulations and the mandatory compensation disclosures enhance the efficiency of compensation contracts and the pay-performance relation. Furthermore, the monitoring performance of the board of directors and specifically the role of employee representatives is found to be important in improving the earnings quality of firms. Overall, the results from the essays conclude that financial accounting information plays an important role in CEO compensation, as reflected in the pay-performance relation. However, for playing this role, both the firm's governance mechanisms and the country's legal environment must be effective.

Keywords: monitoring, compensation contracts, accounting performance, earnings quality, ownership structure, board of directors, governance regulations.

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