FINANCIAL REPORTING QUALITY AND CORPORATE GOVERNANCE: THE PORTUGUESE COMPANIES EVIDENCE

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ABSTRACT

The main objective of this paper is to analyze the relationship between the composition and characteristics of corporate governance on the financial reporting quality of Portuguese companies.

The major reference case studies on the relationship between corporate governance and the financial reporting quality are not validated by the results obtained. The results show that the board composition changes and its degree of independence do not produce any influence on the quality of the accounting information.

Our study shows that although the main international guidelines relating to the rules of good governance have been followed closely by Portuguese institutions, the actual implementation of these rules did not occur.
1. INTRODUCTION
The aim of this paper is to contribute to the study of the influence of the type of corporate governance on the financial reporting quality in countries with a tradition of continental accounting. Despite the profuse literature about this topic, adapted to Anglo-Saxon environments, its applicability to companies with different structures, specifically companies in Latin markedly based on Roman law, less flexible and more closed, is still at a very early stage of understanding. The Portuguese state falls within this context and needs to be widely known and understood.

The effect of the introduction of corporate governance rules as results of mandatory application to all companies with securities listed on the Portuguese Stock Exchange was the main stimulus to carry out this research. The research includes the investigation on the type of corporate governance exercised by Portuguese companies during the period when these rules were introduced and the characterization of the relationship between the type of financial information submitted by Portuguese companies and the associated level of accounting discretion.

2. LITERATURE REVIEW
As referred by Cohen, Krisnamoorthy and Wright (2004, 87) one of the most important functions of corporate governance is to ensure the quality of the financial reporting process. According Sloan (2001) the financial information is the first source of independent and true, communication about the performance of company managers. This relevance makes the financial reporting as the main attraction to management influence.

The paper of Bushman and Smith (2001) refers to the dual role of financial accounting systems. On the one hand the financial accounting system provides direct inputs to corporate control mechanisms; on the other hand it provides indirect inputs into corporate control mechanisms, by its contribution to the information contained in stock prices. The financial accounting information is the product of corporate accounting and external reporting systems that measure and publicly disclose audited, quantitative data concerning the financial position and performance of publicly held firms.

The board of directors is regarded as the highest control mechanism that is accountable for monitoring the actions taken by the top executive of the firm (Fama and Jensen (1983b)). Although they satisfy numerous regulatory requirements they exist primarily because of conflicts of interest they help to address (Hermalin and Weisbach, 2003).

The exercise of the function of monitoring by the board of directors is connected with its composition. Fame (1980) and Fama and Jensen (1983b) show that its composition is an important factor to build a council to monitor under effective mode the actions developed by the management. These authors assert that it is natural that the more dominant members of
The board are those who are also inside managers, because they have specific and measurable information about the activities of the organization.

The supremacy of inside members of the board of directors is a factor that can create conditions for the occurrence of wealth transfer from shareholders to managers of the firm (Fama, 1980). Thus, the inclusion of external members to the board of directors permits them to act as arbitrators in disagreements between members that are inside and aims to confirm the decisions involving the agency problems with more complexity. Therefore, Fama (1980), Fama and Jensen (1983b) suggest as hypothesis that the viability of the board of directors as mechanism of internal control is linked to the inclusion of external members.

More innovative results on aspects concerning the composition of the board of directors are described by Beasley (1996, 461). Their results suggest that when the level of ownership of firms owned by outside director’s increases, the likelihood of fraud in financial statements decreases. These results are consistent with the view that the increase in ownership of external directors on the company intensifies the incentives for those administrators to monitor the management, as a means of preventing fraud.

Also the role of CEO is a key aspect of corporate governance. As shown in Hermelin and Weisbach (2003), the major conflict of interest within the boardroom is between the CEO and the directors. The CEO has incentives to “capture” the board; so as to ensure that he can keep his job and increase his flow of rents. Directors have at least some incentives to monitor the CEO and to replace him if his performance is poor. The researchers posit that the evolution of the board over time is dependent of the nature of the bargaining position of each side in this conflict.

The power relationship between the CEO and the board of directors is also discussed in the research of Shivdasani and Yermack (1999), where the role of the CEO in a selection of directors of the board is researched. The results show consistent evidence that firms select directors who are less likely to monitor the CEO, when that member is involved in the selection process.

Another research sector analyses the importance of the independence level of the board. Cheng and Courtenay (2006) provide evidence that firms with a high proportion of independent directors have significantly higher level of disclosure compared to companies with other types of boards of directors. However the paper of Srinivasan (2005) arrives at other kind of conclusions showing evidence that independent directors are subject to higher reputation costs in the event of a fault detected in the financial information submitted by the company.

3. RESEARCH DESIGN
The research was designed with the aim of understanding the effect of corporate governance on the quality of financial information in companies listed on the Portuguese Stock Exchange.

3.1. Research hypothesis

The Portuguese Stock Exchange Commission (CMVM) emphasizes that there is no evidence of a standard pattern for all companies, regarding an optimal size of the board of directors. The optimum size of each board of directors must adjust to the complexity and size of each company. Recognizing this fact, the "CMVM recommendations on corporate governance" specify that the board should be composed of a plurality of members carrying out an effective guidance on the management of the company and its management, but does not set minimum or maximum limit (CMVM, 2006).

The relationship between the type of financial information presented by a firm and the size of its board of directors has been the target of several studies. The association between the size of the board that governs the society destiny and the accounting information quality presented by the company will lead us to formulate the first hypothesis of research. The research developed by Jensen (1993) and Lipton and Lorsch (1992) show that large boards of directors are less amenable to effective monitoring and easier to control by the CEO. The study done by Xie, Davidson and DaDalt (2003) found an inverse relationship between the size of the board of directors and the quality of financial reporting.

The empirical evidence provided by Anderson, Mansi and Reeber (2004) supports the hypothesis that the size of the board of directors will influence the cost of debt financing. The results obtained show that the greater is the size of the board the lower the cost of financing obtained by the firm. Eisenberg, Sundgren and Wells (1998) and Yermack (1996) also found a significant negative relationship between the size of the board and the value of the company. The research of Beasley (1996) also shows that there is an increased propensity incidence of fraud connected to the greater size of the board of directors. But the evidence previously found is not conclusive, as there are several studies that found evidence in the opposing direction.

The papers of Klein (1996) and Peasnell, Pope and Young (2005) show results that document a positive relationship between the size of the board of directors and the accounting quality. This evidence is explained as resulting from the fact that a greater number of directors allow a greater capability for monitoring on the part of administrators, resulting in lower accounting discretionary represent a higher accounting quality.

In a study related to the U.S. market, Hermalin and Weisbach (2003) found results suggesting that the composition of the board of directors and the corporate performance are not connected. Also Bhagat and Black (1999) and Roman (1996), when analyzing the
relationship between the composition of the board and company performance, did not get conclusive results about the existence, or not, of a causal relationship.

The subject of corporate governance, in Portugal, has just begun to attract attention since 1999. Only recently has there been an attempt to implement the formal type of corporate governance. The use of the “board size” as measure, in absolute terms, may however raise a few problems. Indeed, a number of board members may be excessive for a particular company, with a reduced activity, and the same number of board members may be insufficient in companies with substantially higher levels of business. The research done by Anderson, Mansi and Reeber (2004) also emphasizes these limitations, suggesting as a solution the assumption of the size in relative terms, measuring the board size of in proportion with the company.

The Portuguese economy characteristically of a continental nature shows that the idea of business secrecy is still dominant. Based on this, we suggest that the mechanism limiting the dissemination of the business secrets may be a possible explanation for the usually reduced board size.

As a result of increasing the number of members of the board of directors, the business of the company grows and the ability to monitor the board should also increase. This in turn creates the conditions to avoid greater accounting discretion and thus promote a higher quality of accounting information of the company. Based in this, we can state our first research hypothesis as follows:

\[
H_1 - \text{The boards of directors with a greater number of members are positive in terms of financial accounting quality.}
\]

However, the growth of the board size cannot be unlimited. Although it is necessary to monitor the company’s growth, there is a limit to the number of members required for the functioning of the board. The research developed by Monterrey and Sanchez-Segura (2007) draws attention to the non-linearity of the relationship between the board size and the accounting quality, suggesting the existence of a quadratic relationship. Thus, it is acceptable that with the growing of activities of the firm, the board size also shows an upward trend in order to monitor the performance of the company’s management. However, after a certain number of members in the board the relationship between company size and the size of the board begins to decline. Thus, we are lead to make the following research hypothesis:

\[
H_2 - \text{As from a certain size of the board of directors, the relationship between the board size and the financial accounting becomes negative.}
\]
The importance of the CEO as a contribution to the quality of governance has been studied in association with corporate governance features. The literature on the change of the CEO is primarily used to understand this change as an internal control mechanism. The CEO change is normally associated with a low performance of the firm. Denis and Denis (1995) show that, in general, the firm’s performance shows an improvement after a change in the CEO of the company. This finding is further enhanced when the CEO do not leave voluntarily but is, rather, coerced to leave the firm.

The paper of Engel, Hayes and Wang (2003) shows the effect that the various measurements of performance and CEO change produces on the characteristics of financial reporting. This research showed that the accounting information has high importance to CEO change, whenever measurements based on the financial accounting are more accurate and sensitive. Hermelin and Weisbach (2003) shown that the change of CEO is the result of the monitoring procedure carried out by the board of directors. In effect, when the CEO's performance reaches levels lower than predicted, the board is likely to conclude that the CEO does not achieve the minimum requirements and recommends its replacement.

The study by Weisbach (1988) analyses the relationship between the board compositions and the company performance besides the CEO change. Their results indicate that when the board of directors is dominated by outside directors, the change of CEO is more sensitive to the performance of the firm than when the board is dominated by internal directors. These results are consistent with the view that proclaims that the external members of the board play their monitoring role in a more independent way than the internal directors.

More recently, Huson, Malatesta and Parrini (2004) shown that the CEO change is associated with the financial performance of the firm. The results show that the degree of improvement is positively related with the level of institutional investors of the company, and with the fact that the board members classified as external are in a dominant position and with the nomination of an external CEO.

According Francis, Khurana and Pereira (2003) there is a higher demand for timely information and higher transparency of accounting information in countries belonging to the sphere of common law (Anglo-Saxon), where the financial markets are more developed. Pressure is put on to timing and transparency of the information provided in order to correct information asymmetries between internal and external investors. The study was conducted to compare the characteristics of the countries of the common law and those who were named as countries belonging to the sphere of civil law. Thus, firms in countries with a strong system of investor protection have a higher likelihood of developing systems of governance that can achieve a better success to stop the CEO mandates that present lower performance (DeFond and Hung, 2004). According to the evidence found, we can postulate the following research hypothesis:
H3 - The CEO change will mean a reduction in the level of accounting discretion exercised on the financial statements.

Apart from the impact of the CEO change, the board of directors composition change can lead to changes on the accounting discretion exercised over the company's financial reports. The greatest number of references on this subject is found through studies based on evidence from the United States. These studies show that changes in top executives are negatively associated with the stock market performance of the firm or with company performance measured on accounting basis (results, sales, etc.). The Weisbach (1988) research shows that this negative relationship is stronger when the board of directors is dominated by independent directors. Also Denis, Denis and Sarin (1997) obtained evidence of that relationship being strongest when we are in the presence of blocks of shareholders. This relationship was also the object of study in case studies on the realities of countries like Japan and Germany. Kaplan (1994), using a large sample of companies in Germany, shows evidence that a change in the board is negatively related to performance and shareholder of the firm with its results. Based on this research, Kaplan concludes that the likelihood of change in the board of directors increases significantly for a firm with a low performance of listed shares and, essentially, with a low performance results (negative results) but is not related to growth in sales or results growth. Kang and Shivdasani (1995) examine the relationship between performance and the board of directors' change in Japanese companies, also found a negative relationship. Note that these are realities traditionally classified as substantially different from the reality in the United States, where the system is primarily oriented to a market protecting small investors, while the German and Japanese markets are primarily targeted at large investors.

There are also some studies on the influence of board changes in the case of the so called “continental type” economies. In the Belgian case, presented in Renneboog (2000), shows that the occurrence of a poorly performing in Belgium listed companies increases the likelihood of change of executive directors, members of the management committee and the CEO. The case of large Spanish listed companies is investigated in Gispert (1998), which shows a significant negative relationship between the performance of the firm and change of members of the board of directors.

In the light of this evidence on the subject of the influence of changes in the composition of the board of directors and its relationship with the performance of the firm, in the case of Portuguese companies we are led to test following hypothesis:

H₄ – The change of composition of the board of directors is positively associated with the increasing quality of accounting presented by the company.
The issue of board independence is one of the most widely discussed in academic literature on corporate governance. One of the first studies that highlight the importance of the board’s independence is a study by Fame and Jensen (1983b). According to these researchers, independent non-executive directors, have greater incentives to perform monitoring tasks over the management activities, acting to protect the wealth of shareholders.

The study by Beasley (1996) was one of the first to empirically demonstrate that the boards of directors with greater number of external directors had a lower propensity for accounting fraud. Also the research developed by Dechow, Sloan and Sweeney (1996) finds evidence that the percentage of external directors on the board is negatively correlated with the probability of fraud. Wright (1996) finds evidence of an inverse relationship between the likelihood of being sanctioned by the regulator (SEC) for violations of financial reporting and the percentage of external directors on the audit committee. Evidence of a direct link between the financial reporting quality and the percentage of external directors on the audit committee, was found.

The results obtained by Anderson, Mansi and Reeber (2004) provide the statistical evidence that the debt cost of the company is inversely related to the proportion of external directors on the board of directors. The work of Klein (2002a) shows that the independence of the audit committee decreases with the opportunities for growth of the firm (through performance or via the cash flows) and when firms report repeated losses.

Farber (2005) also shows that there is an association between the credibility of the financial reporting system and the quality of corporate governance mechanisms. Specifically, firms in which the boards of directors have fewer members and a greater proportion of external members have a lower propensity for the occurrence of fraud. Based on the facts found are led to state the following research hypothesis:

**H5 - An increased level of independence of the board of directors favors the financial accounting quality.**

As is the case with the upper limit of the size of the board of directors, there is also a maximum level of independence of the board, from which the virtues of independence no longer apply.

However, board of directors composed entirely of independent members is not possible. Thus, similarly to what is suggested for the board size, the relationship between the level of independence of the board and the financial information quality should not be a linear relationship, but a nonlinear concave function as recommended by Chen and Nowland (2007). We will therefore test the following research hypothesis:
H_6 - From a certain level of independence of the board, a positive relationship between the level of independence of the accounting and the quality of financial statements submitted by the firm, ceases to exist.

3.2. Measuring the quality of financial reporting
To measure the accounting quality of the firms under study in the sample, the discretionary accounting accruals (DAA) used by management, was chosen. Based on this view, the higher the level of discretionary accruals accounting, the greater the distance between the economic performance and results shown in the financial reporting. Thus, the higher the accounting manipulation the lower the quality of the financial information presented by the company.

Three models were used to determine the discretionary accounting accruals: the model of Jones (1991), the model of Dechow and Dichev (2002) and the model of Francis, LaFond, Olsson and Schipper (2005).

The model Jennifer Jones (1991) is usually highlighted in the literature as the frame of reference on the measurement of the quality of results produced by a firm. This model is characterized by introducing a distinction between non-discretionary accruals and discretionary accruals, where the discretionary accruals being used as the measure of the quality results. Indeed, a greater level of the discretionary accruals signals a greater accounting manipulation and hence a lower quality of financial information presented.

The model of Jones (1991) is based on the model used by DeAngelo (1986), which uses the total discretionary accruals from the previous period as the measure of total normal accruals. In this model, the total abnormal discretionary accruals are defined as the difference between the total current increments and the total normal discretionary accruals. These accruals may still be split into discretionary accruals and non-discretionary accruals. Thus, the error predicted by the model represents the level of discretionary accruals (Jones, 1991, 212).

One of the biggest criticisms related to this model is to consider that the accounting accruals are associated with cash flows in a systematic way (Dechow (1994) and Dechow and Dichev (2002)).

In the model of Dechow and Dichev (2002) the researchers developed a model of working capital accruals where accruals correct the timing problems of cash flows at the cost of including errors in estimation. Based on this model they derive an empirical measure of accrual quality as the residual from firm-specific regressions of changes in working capital on past, present, and future operating cash flow realizations. This model overcomes the limitations of the model of Jones, with a link between the cash flows and the accruals. However, this model has limitations in as it does not represent with reliability the relationship between the manipulation of the earnings and the market efficiency. Another criticism to this
The model is that it does not separate between discretionary accruals and unintentional poor performance. For McNichols (2002), the applicability of the model is also limited as it uses short-term accruals.

The paper of Francis et al. (2005) also sought to find a measure of the accounting quality in order to prove that the effects of the type of results based on the price area according to the quality of results.

This model will add to the model of Dechow and Dichev (2002) the essential variables present in the model of Jones, as the annual revenue variation and the value of gross property, plant and equipment. It should be noted that this combination has already been proposed in the research of McNichols (2002), in which the researcher showed that adding these variables to the cross-sectional regression of Dechow and Dichev (2002), increased significantly the explanatory power of the model, reducing the error of measurement.

3.3. Regression Model

In the multivariate analysis we used the residue of the regression models, in absolute value, as a measure of the accruals' quality. In spite of the study of Dechow and Dichev (2002) and Francis et al. (2005) used as the standard deviation of errors in estimation of accruals to measure the accruals quality, we have chosen to use only the absolute value of such residue. This choice is justified by the circumstances that to calculate the standard deviations, many elements are necessary to obtain a reasonable period of time. Because our model will be tested on a limited size sample, we have chosen to use the absolute values. Thus, the absolute value of errors in the accruals estimation is negatively correlated with the accruals quality. That is, a higher level of estimation errors of the accruals means a lower accruals quality.

To test the previously defined research hypothesis, the basic form of the regression model is presented as follows:

\[ DAA_{it} = \alpha + \sum_{k=1}^{K} \beta_k \text{ExperimentalGovernance}_{kit} + \sum_{q=1}^{Q} \theta_q \text{ControlVariables}_{qit} + \epsilon_{it} \]

The DAA\(_{it}\) represents the abnormal accounting accruals, or discretionary accounting accruals, for the \(i\) company for the economic year \(t\). This measure is used in absolute values, representing the dependent variable of the model, which means is used as the measure to assess the accounting quality.

\(\text{ExperimentalGovernance}_{kit}\) joins the \(k\) variables representative of corporate governance characteristics, of company \(i\) in the \(t\) year

\(\text{ControlVariables}_{qit}\) adds the \(q\) control variables linked with the companies characteristics that are potentially related to the accounting information quality, of company \(i\) in the \(t\) year
In order to control the extent of the specific variables to firms that are associated with the earning manipulation and the accounting quality, we use as control variables the firm size, the leverage and the growth rate of total assets.

4. SAMPLE, MEASUREMENT OF VARIABLES AND STATISTICAL ANALYSIS

The empirical study was realized based on a sample obtained in the non-financial companies listed on the Portuguese Stock Exchange, for the period between 1996 and 2001. The data was obtained from annual reports, on paper, issued by these entities, the necessary elements were collected by hand because there was no registration information with this information for the required period.

Thus the sample is composed by 234 firm observations per year, obtained by way of evidence relating to 39 firms for 6 years, with all the data related for the period of the sample. Companies that did not meet the requirements were excluded from the sample. The average representativeness of the sample is 64%, ranging from a minimum of 57% to a maximum of 75%, from non-financial companies.

The explanatory variables of the model were chosen to enhance the explanatory power of the model given the specific characteristics of the type of corporate governance. To assess the impact of the characteristics of corporate governance we use the board size, taking into account the total number of directors on the board of the company (BOARD). The board size is also used in relative terms, since it would be natural for a larger company to pursue larger activities, therefore, requires more elements to carry out its tasks. Thus, following the recommendations by Anderson, Mansi and Reeber (2004), the board size is obtained by dividing the number of directors on the board by the natural logarithm of total assets (BOARDSIZE).

The CEO change (CEO) during an economic exercise can characterize a change in the pattern of corporate governance followed until then. In these circumstances, used as a dummy variable that is one if the CEO, at the annual reports approval date, is not the same as in the course of the previous year and zero otherwise.

The level of independence of the board of directors is, traditionally, described as one of the main instruments for measuring on the model of governance practiced in company (Beasley, 1996). To measure the level of independence (INDBOARD) the proportion of independent directors on the company board was determined against the total number of directors on the board of directors. This distinction was based on information obtained in the annual reports which includes information about independent or non-executives directors of the company.

Similarly to what happens to the CEO replacement, the level of change in the board of directors (BOARDCHANGE) may also reflect a change of model of corporate governance. So, we measure the change in the board of directors as a percentage of directors who have
changed when compared with the board composition in the previous year. The aim is to capture the effects of this change on the level of discretionary accounting accruals. The same feature is used as a dummy variable (BOARDCHAN) that is one if in the board of director’s composition changes have occurred during the year and zero otherwise. The data obtained from the sample permits an analysis based on descriptive statistics. The results of this approach are contained in Table 1.

Table 1.
Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Std. Des.</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOARDSIZE</td>
<td>6.49</td>
<td>2.86</td>
<td>3.00</td>
<td>23.00</td>
<td>6.00</td>
</tr>
<tr>
<td>INDBOARD (%)</td>
<td>16.97</td>
<td>25.00</td>
<td>0.00</td>
<td>88.89</td>
<td>0.00</td>
</tr>
<tr>
<td>BOARDCHANGE (%)</td>
<td>15.59</td>
<td>19.54</td>
<td>0.00</td>
<td>100.00</td>
<td>11.00</td>
</tr>
<tr>
<td>SIZE</td>
<td>19.08</td>
<td>1.67</td>
<td>15.63</td>
<td>23.59</td>
<td>18.91</td>
</tr>
<tr>
<td>GROWTH (%)</td>
<td>0.16</td>
<td>0.26</td>
<td>-0.23</td>
<td>1.60</td>
<td>0.09</td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>0.61</td>
<td>0.20</td>
<td>0.09</td>
<td>0.96</td>
<td>0.64</td>
</tr>
</tbody>
</table>

When analyzing the data obtained through descriptive statistics, we found that the characteristics of the board of directors are within the usual standards in most countries. In terms of average size of the board, it is about the six elements. Note that the minimum size is 3 members while the larger board is composed by 23 members. The average size is in line with the values presented in the study realized by Boone et al. (2006) and Lehn, Patro and Zhao (2003). We noted that, despite our intuition to assume that the average size of the board was lower, this is not the case. It therefore appears that that there is no difference between the size of the board of directors, in Portugal and other countries.

Regarding the proportion of non-executive directors (independent) it is, relatively, low, on average 17 percent, in comparison with a study realized in Spain, where the average of independent directors is almost twice (30 percent), according to Monterrey and Sanchez-Segura (2007b). As for the degree of change in the board we got an average of 16 percent.

Regarding the inherent characteristics of the company structure, we found an average of total assets of 19.08 percent. This figure is similar to those found in studies carried out in the Spanish scenario (Monterrey and Sanchez-Segura (2007)), which used the same measure to know the companies size in the sample.
The average asset growth rate was 0.16, which is also in line with the results of the study mentioned above. The leverage ratio achieved an average of 0.61. This figure is in line with the values obtained in research on UK companies realized by Peasnell, Pope and Young (2001) or Monterrey and Sanchez-Segura (2007b) with reference to Spanish companies.

5. EMPIRICAL RESULTS

5.1. Univariate analysis

The correlation between the quantitative independent variables were analyzed based on Pearson's correlations (Table 2) and Spearman's correlations (Table 3), which are based on the distribution of variables by categories.

Table 2.
PEARSON RANK CORRELATIONS BETWEEN VARIABLES

<table>
<thead>
<tr>
<th></th>
<th>BOARDSIZE</th>
<th>BOARDCHAN</th>
<th>CEO</th>
<th>INDBOARD</th>
<th>SIZE</th>
<th>LEVERAGE</th>
<th>GROWTH</th>
<th>DAAJones</th>
<th>DAADD</th>
<th>DAAFrancis</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOARDSIZE</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BOARDCHAN</td>
<td>0.000</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO</td>
<td>-0.108</td>
<td>0.332**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INDBOARD</td>
<td>0.258**</td>
<td>0.019</td>
<td>-0.094</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>0.442**</td>
<td>0.087</td>
<td>-0.131</td>
<td>0.085</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>0.228**</td>
<td>-0.046</td>
<td>-0.184*</td>
<td>0.102</td>
<td>0.393</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GROWTH</td>
<td>0.129</td>
<td>0.006</td>
<td>-0.124</td>
<td>0.041</td>
<td>0.325**</td>
<td>0.205*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DAAJones</td>
<td>0.360**</td>
<td>-0.047</td>
<td>0.008</td>
<td>0.232**</td>
<td>0.342**</td>
<td>0.017</td>
<td>0.317**</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DAADD</td>
<td>-0.050</td>
<td>-0.047</td>
<td>-0.134</td>
<td>-0.027</td>
<td>0.052</td>
<td>-0.258**</td>
<td>0.134</td>
<td>0.223**</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>DAAFrancis</td>
<td>0.101</td>
<td>0.080</td>
<td>-0.092</td>
<td>0.050</td>
<td>0.176</td>
<td>-0.207*</td>
<td>0.177*</td>
<td>0.451**</td>
<td>0.737**</td>
<td>1</td>
</tr>
</tbody>
</table>

Asterisks (** and *) indicate statistical significance at the 5% and 10% levels or higher, respectively.

When examining the values of correlations obtained in accordance with the criteria of Pearson, we did not find any particularly strong correlation, with the only significant correlation between the size of the company (SIZE) and the size of the board of directors (+0.442) and between the board change and the CEO change (+0.332). This relationship is in line with results found in Chung, Firth and Kim (2002).

When analyzing the correlations between different variables we found that there was no significant value, which allows us to exclude the possibility of multicollinearity among the variables. On the other hand, contrary to what would be expected, we did not find any strong correlation between the board size and the percentage of independent directors.
Table 3.

SPEARMAN RANK CORRELATIONS BETWEEN VARIABLES

<table>
<thead>
<tr>
<th></th>
<th>BOARDSIZE</th>
<th>BOARDSIZE</th>
<th>BOARDCHAN</th>
<th>CEO</th>
<th>INDBOARD</th>
<th>SIZE</th>
<th>LEVERAGE</th>
<th>GROWTH</th>
<th>DAAD Jones</th>
<th>DAAD Da</th>
<th>DAAD Francis</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOARDSIZE</td>
<td>1</td>
<td>0.010</td>
<td>-0.096</td>
<td>0.215**</td>
<td>0.273**</td>
<td>0.174*</td>
<td>0.171*</td>
<td>0.134</td>
<td>-0.017</td>
<td>-0.095</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>0.235</td>
<td>0.000</td>
<td>0.001</td>
<td>0.029</td>
<td>0.033</td>
<td>0.105</td>
<td>0.643</td>
<td>0.235</td>
<td>0.008</td>
<td></td>
</tr>
<tr>
<td>BOARDCHAN</td>
<td>1</td>
<td>0.296**</td>
<td>0.046</td>
<td>0.111</td>
<td>-0.028</td>
<td>0.022</td>
<td>0.004</td>
<td>-0.126</td>
<td>0.089</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>0.570</td>
<td>0.169</td>
<td>0.728</td>
<td>0.789</td>
<td>0.958</td>
<td>0.117</td>
<td>0.282</td>
<td>0.000</td>
<td>0.570</td>
<td></td>
</tr>
<tr>
<td>CEO</td>
<td>1</td>
<td>-0.092</td>
<td>-0.135</td>
<td>-0.139</td>
<td>-0.168*</td>
<td>0.052</td>
<td>-0.151</td>
<td>-0.041</td>
<td>0.202</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.255</td>
<td>0.002</td>
<td>0.004</td>
<td>0.016</td>
<td>0.528</td>
<td>0.069</td>
<td>0.282</td>
<td>0.282</td>
<td>0.016</td>
<td>0.528</td>
<td></td>
</tr>
<tr>
<td>INDBOARD</td>
<td>1</td>
<td>0.103</td>
<td>0.095</td>
<td>0.022</td>
<td>0.041</td>
<td>0.023</td>
<td>0.048</td>
<td>0.048</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.202</td>
<td>0.240</td>
<td>0.019</td>
<td>0.623</td>
<td>0.777</td>
<td>0.777</td>
<td>0.562</td>
<td>0.562</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>1</td>
<td>0.103</td>
<td>0.095</td>
<td>0.022</td>
<td>0.041</td>
<td>0.023</td>
<td>0.048</td>
<td>0.048</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.202</td>
<td>0.240</td>
<td>0.019</td>
<td>0.623</td>
<td>0.777</td>
<td>0.777</td>
<td>0.562</td>
<td>0.562</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>1</td>
<td>0.151</td>
<td>-0.077</td>
<td>-0.252**</td>
<td>-0.157</td>
<td>0.059</td>
<td>0.355</td>
<td>0.001</td>
<td>0.656</td>
<td>0.656</td>
<td></td>
</tr>
<tr>
<td>GROWTH</td>
<td>1</td>
<td>0.340**</td>
<td>0.254**</td>
<td>0.095</td>
<td>0.000</td>
<td>0.001</td>
<td>0.251</td>
<td>0.251</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>DAAD Jones</td>
<td>1</td>
<td>0.129</td>
<td>0.297**</td>
<td>0.119</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>DAAD Da</td>
<td>1</td>
<td>0.268**</td>
<td>0.001</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>DAAD Francis</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Asterisks (** and *) indicate statistical significance at the 5% and 10% levels or higher, respectively.

The correlations obtained according to the Spearman typology show similar conclusions as based on the Pearson correlations. Standing out are those relations between the board change and the CEO change (+0.296) and between the leverage and the firm size (+0.328) found the figures that are slightly below those achieved in the Pearson correlations, although above the average of the relevant correlations found. We found that the firm size and the leverage are positively correlated and this relationship is statistically significant. This relationship is consistent with the results presented by Bennett and Donnelly (1993), Michael, Chittenden and Poutziouris (1999) and Ferri and Jones (1979).

5.2. Multivariate analysis

In this section, we will apply the regression models previously defined for the purpose of assessing the nature of the relationship between corporate governance features and the accounting level of discretion exercised on the financial information, namely on the quality of accounting information. Using an empirical model, it is known to what extent corporate governance characteristics listed on the Portuguese Stock Exchange will influence the accounting discretion level exercised on the financial information provided by these firms.
Discretionary accruals accounting (DAA), the dependent variable of the models, are the residues resulting from the application of the model of Jones (Jones), the model of Dechow and Dichev (DD) and the model of Francis, LaFond, Olsson and Schipper (Francis). These residues represent the level of discretion exercised on the financial accounting reporting. As the value of discretion can be positive or negative, we use the absolute value of that variation, namely, the module of the value the accounting discretionary accruals.

As shown in the research of HRIBAR and Nichols (2007), the estimation of measures to earning manipulation without signal, in absolute values, can be useful because it allows researchers to test the differences in the tendency to earnings manipulation without identifying the particular incentives used, the time period to which they relate or the expected direction of earnings manipulation. For these researchers the importance of the use of this measure is even more helpful in situations where the number of data used is limited, such as the Portuguese.

For the stated reasons above, the use of discretionary accruals in absolute values is justified because we want to measure the accounting manipulation level and not its direction. Thus, we just aim to measure the extent of the accounting manipulation.

5.2.1. Model 1

The basic model (Model 1) is intended to measure the impact of control variables over the explanation of the discretionary accounting accruals. This model aims to explain the impact of variables such as firm size, measured by natural logarithm of total assets (SIZE), the leverage (LEVERAGE) and the growth assets rate (GROWTH) on the level of discretionary accruals. The Model 1 shows the results from the regression model as follows:

\[ \text{DAA}_t = \alpha + \beta_1 \text{SIZE}_t + \beta_2 \text{LEVERAGE}_t + \beta_3 \text{GROWTH}_t + \varepsilon_t \]

<table>
<thead>
<tr>
<th></th>
<th>DAAFrancis</th>
<th>DAAJones</th>
<th>DAADD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coef.</td>
<td>t</td>
<td>Sig.</td>
</tr>
<tr>
<td>Intercept</td>
<td>0.011</td>
<td>0.306</td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>0.003</td>
<td>1.503</td>
<td></td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>-0.065</td>
<td>-3.858 ***</td>
<td></td>
</tr>
<tr>
<td>GROWTH</td>
<td>0.021</td>
<td>1.810 *</td>
<td></td>
</tr>
</tbody>
</table>

\[ R^2 = 10.30 \quad 13.60 \quad 11.70 \]

Where:
- SIZE – firm size measure by the natural logarithm of the value of total assets;
- LEVERAGE - is obtained through the ratio between liabilities (assets less equity) over the assets;
- GROWTH - variable that shows the growth rate of total assets of the company over the past year;
Despite the various measures of accounting quality used, we find that the nature of the coefficients obtained show a very similar behavior. The most significant coefficient is the relationship between the leverage and discretionary accruals, which shows a highly significant and negative relationship in all three measures. Also the coefficient associated with the growth variable shows a significant and positive relationship according to the different measures of discretionary accruals. Finally, the coefficient associated with the firm size also has a positive nature in the three measures, even if only to be significant in accruals calculated with the model of Jones.

Our findings go in the opposite direction as is predicted in the literature. According to the research developed by Christie (1990) and Hope (2003), the larger the size of the firm size the greater is the likelihood of presenting financial information with quality. But our results do not confirm this prediction, they showed a greater accounting discretion which means lower financial reporting quality.

Similarly, whatever the measure used, we found a negative relationship, and significantly, between the leverage and the level of discretionary accruals. Also about this subject, the literature (Watts and Zimmerman (1990); Bowen, Rajgopal and Venkatachalam (2005)) predicts a signal contrary to this relationship, presenting the argument that when the leverage is high, there is a greater likelihood of the managers exploiting the accounting discretion.

Achieving these findings can be explained in line with the characteristics of the Portuguese stock exchange, which is characterized as a market with a low liquidity, which is far from the characteristics of a perfect market. Therefore, in order to maintain an image of reference, in the Portuguese economy framework, decisions are taken that do not favor the quality of financial information presented by the companies.

5.2.2. Model 2

The second version of the model incorporates the variables associated with the corporate governance characteristics. Thus, in this regression model we used the following function:

$$DAA_F = \alpha_F + \beta_{F_SIZE}F_SIZE + \beta_{F_LEVERAGE}F_LEVERAGE + \beta_{F_GROWTH}F_GROWTH + \beta_{F_BOARDSIZE}F_BOARDSIZE + \beta_{F_INDBOARD}F_INDBOARD + \beta_{F_BOARDCHAIN}F_BOARDCHAIN + \beta_{F_CEO}F_CEO + \varepsilon_F$$
Table 5. - Model 2

<table>
<thead>
<tr>
<th></th>
<th>(DAA_{\text{Francis}})</th>
<th></th>
<th>(DAA_{\text{Jones}})</th>
<th></th>
<th>(DAA_{\text{DD}})</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>0.014</td>
<td>-0.092</td>
<td>0.028</td>
<td>0.75</td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>0.003</td>
<td>0.010</td>
<td>0.004</td>
<td>1.72 *</td>
<td></td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>-0.068</td>
<td>-0.077</td>
<td>-0.076</td>
<td>-4.35 ***</td>
<td></td>
</tr>
<tr>
<td>GROWTH</td>
<td>0.019</td>
<td>0.088</td>
<td>0.021</td>
<td>1.81 *</td>
<td></td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>-0.015</td>
<td>0.073</td>
<td>-0.023</td>
<td>-0.83</td>
<td></td>
</tr>
<tr>
<td>INDBOARD</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>-0.07</td>
<td></td>
</tr>
<tr>
<td>BOARDCHAN</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>-0.31</td>
<td></td>
</tr>
<tr>
<td>CEO</td>
<td>-0.019</td>
<td>0.036</td>
<td>-0.023</td>
<td>-1.96 *</td>
<td></td>
</tr>
</tbody>
</table>

| \(R^2\)  | 12.10                    | 17.20    | 14.90                    |

Where:
- SIZE – firm size measure by the natural logarithm of the value of total assets;
- LEVERAGE - is obtained through the ratio between liabilities (assets less equity) over the assets;
- GROWTH - variable that shows the growth rate of total assets of the company over the past year;
- BOARDSIZE – is the number of directors on the board of the company divided by natural logarithm of total assets;
- INDBOARD - is measured by the proportion of independent directors on the total number of board of directors;
- BOARDCHAN - a dummy variable that is one if have occurred during the year changes in the board of directors composition and zero otherwise.
- CEO – a dummy variable that is one if have occurred during the year changes in the CEO and zero otherwise.

\(DAA_{\text{Francis}}\) - discretionary accounting accruals obtained using the model of Francis et al. (2005);
\(DAA_{\text{Jones}}\) - discretionary accounting accruals obtained using the model of Jones (1991); and
\(DAA_{\text{DD}}\) - discretionary accounting accruals obtained using the model of Dechow and Dichev (2002).

Based on the general analysis of the results found with the implementation of the second model concluded that the effects found or are not statistically significant or nonexistent or contradictory. On a first analysis, these results show that the effects of the of the company's corporate governance characteristics over the quality of financial reporting of Portuguese companies are irrelevant.

The regression coefficient on BOARDSIZE shows the relationship found between the board size and the level of discretionary accounting accruals. According to the research hypothesis H1, there should be a positive relationship between the board size and the quality of financial accounting. Thus, the BOARDSIZE coefficient should show a negative value, a sign that the greater board size implies lower level of discretionary accruals. However the results based on the sample used do not find the predicted results. The values found are different depending on the measure used. It should also be noted that in none of the models statistically significant figures were found. Therefore we have to refute the H1 hypothesis that
predicted the existence of a positive relationship between the board size and the quality of financial accounting.

The regression coefficient on INDBOARD is quite clear on the impact of one of the main features of corporate governance on the accounting quality in the companies listed on the Portuguese Stock Exchange. This is the most important reference from the research developed by Beasley (1996) or Dechow, Sloan and Sweeney (1996). So when we analyze the results, we found that the effect of this variable is zero on the level of accounting discretion, irrespective of the model used. The results allow us to say that, for Portuguese firms, the level of board independence does not raise any effect on the quality of financial statements. For the reasons previously stated, the $H_5$ hypothesis must be rejected because there is no evidence of a positive relationship between the level of board independence and the quality of financial accounting. Similar to what happened to the previous relationship, the regression coefficient on BOARDCHAN, which measures the relationship between the level of change in the board of directors and the level of discretion accounting, shows a zero effect. Thus, we are led to conclude that the $H_4$ hypothesis should be rejected. It has not confirmed that a change in board composition is positively associated with an increase in financial information quality.

Finally, when analyzing the impact of regression coefficient on CEO, which is a dummy variable that measures the impact of the change of CEO, we find contradictory values, when using the model of Jones or the model of Dechow and Dichev (2002), although in both models the values are statistically significant. For this reason we are once again led to reject the $H_3$ hypothesis, according to which a CEO change would signify a reduction in the level of accounting discretion exercised on the financial statements, in line with the evidence found in the work of Hermalin and Weisbach (2003) or Engel, Hayes and Wang (2003).

When we analyze the explanatory power of the second model, obtained with the introduction of explanatory variables associated with the characteristics of corporate governance, we found a significant increase of explanatory power of the models. This increase in explanatory power is particularly significant in the measure based on Jones model, where its explanatory power increases 26 percent.

5.2.3. Model 3

The third version of the model (model 3) is complementary to an analysis performed with the model 2, by introducing two variables quadratic on the characteristics associated with corporate governance. In this model was used the following regression:

$$
DAA_t = \alpha_t + \beta_1 \text{SIZE}_t + \beta_2 \text{LEVERAGE}_t + \beta_3 \text{GROWTH}_t + \beta_4 \text{BOARDSIZE}_t + \\
+ \beta_5 \text{INDBOARD}_t + \beta_6 \text{BOARDCHAN}_t + \beta_7 \text{CEO}_t + \beta_8 \text{BOARDSIZE}^2_t + \beta_9 \text{INDBOARD}^2_t + \epsilon_t
$$
Table 6. - Model 3

<table>
<thead>
<tr>
<th></th>
<th>DAA_{Francis}</th>
<th></th>
<th>DAA_{Jones}</th>
<th></th>
<th>DAA_{DD}</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coef.</td>
<td>t</td>
<td>Sig.</td>
<td>Coef.</td>
<td>t</td>
</tr>
<tr>
<td>Intercept</td>
<td>0.113</td>
<td>2.585 **</td>
<td></td>
<td>-0.001</td>
<td>-0.017</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.000</td>
<td>-0.103</td>
<td></td>
<td>0.007</td>
<td>1.695 *</td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>-0.059</td>
<td>-3.465 ***</td>
<td></td>
<td>-0.057</td>
<td>-2.002 **</td>
</tr>
<tr>
<td>GROWTH</td>
<td>0.018</td>
<td>1.646</td>
<td></td>
<td>0.079</td>
<td>3.887 ***</td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>-0.200</td>
<td>-3.596 ***</td>
<td></td>
<td>-0.136</td>
<td>-1.458</td>
</tr>
<tr>
<td>INDBOARD</td>
<td>0.000</td>
<td>0.430</td>
<td></td>
<td>-0.001</td>
<td>-1.931 *</td>
</tr>
<tr>
<td>BOARDCHAN</td>
<td>0.000</td>
<td>0.470</td>
<td></td>
<td>0.000</td>
<td>-1.608</td>
</tr>
<tr>
<td>CEO</td>
<td>-0.021</td>
<td>-1.818 *</td>
<td></td>
<td>0.036</td>
<td>1.874 *</td>
</tr>
<tr>
<td>BOARDSIZE^2</td>
<td>0.001</td>
<td>3.800 ***</td>
<td></td>
<td>0.001</td>
<td>2.453 **</td>
</tr>
<tr>
<td>INDBOARD^2</td>
<td>0.000</td>
<td>-0.783</td>
<td></td>
<td>0.000</td>
<td>2.394 **</td>
</tr>
</tbody>
</table>

\[ R^2 \]  20.40  21.60  18.50

Where:
- SIZE – firm size measure by the natural logarithm of the value of total assets;
- LEVERAGE - is obtained through the ratio between liabilities (assets less equity) over the assets;
- GROWTH - variable that shows the growth rate of total assets of the company over the past year;
- BOARDSIZE – is the number of directors on the board of the company divided by natural logarithm of total assets;
- INDBOARD - is measured by the proportion of independent directors on the total number of board of directors;
- BOARDCHAN - a dummy variable that is one if have occurred during the year changes in the board of directors composition and zero otherwise.
- CEO – a dummy variable that is one if have occurred during the year changes in the CEO and zero otherwise.
- BOARDSIZE^2 - variable that expresses the board size, through a quadratic variable;
- INDBOARD^2 - variable that expresses the independence of the board, through a quadratic variable;
- DAA_{Francis} - discretionary accounting accruals obtained using the model of Francis et al. (2005);
- DAA_{Jones} - discretionary accounting accruals obtained using the model of Jones (1991) and
- DAA_{DD} - discretionary accounting accruals obtained using the model of Dechow and Dichev (2002).

In this model the only variables relate to the board size and its degree of independence assumed a quadratic value (second-order), because it is using absolute values.

The regression coefficient on BOARDSIZE^2 represents the quadratic variable that measures the importance of the relationship between the board size of the company and the level of discretionary accruals. In all models for measuring the quality accounting, this regression coefficient takes a positive value or zero, and significant, which allows us to conclude that as from a certain number of elements composing the board of directors this composition ceases to be effective. Thus, the results allow us to validate the research hypothesis H2, which
predicted that as from a certain board size there is a negative relationship between the board size and quality of financial accounting.

The assessment of the optimal level of independence of the board is shown to us by the regression coefficient on INDCONS$^2$, which is also strongly related to the coefficient on BOARDSIZE connected to the degree of independence of the board. However, similar to the case in second model, there is no effect on the accounting quality. Based on this background, we are once again led to reject the $H_6$ hypothesis.

Model 3 offers a higher explanatory power than the second model, the $R^2$ rose from 12.1 to 20.4, as in the case of the model that uses the residues of the model of Francis et al. (2005).

One explanation for our findings may result from the peculiarities of the Portuguese reality. Contrary to what is suggested in the key academic studies, with Anglo-Saxon inspirations, the results of our study show an absolute lack of impact of different features of corporate governance on the level of accounting discretion.

Regarding the board size of the company, which is linked to the research hypothesis $H_1$, it was not possible to prove its connection to the accounting quality. One explanation for the results may come from a relatively ordinary size of the council in response to growing social demands on the position of a listed company, but actually the number of directors with executive functions is, in Portugal, substantially reduced and a strong power concentration still exists.

One of the most surprising findings was the irrelevance of the level of independence of the board of director’s on the quality of financial reporting. Indeed, this feature is a major justification for the flags of the implementation of the corporate governance recommendations around the world. One explanation for the results found in our study, may come from many of the independent directors who comprise the board of directors are neither independent nor directors.

It is common practice amongst large Portuguese companies integrate among its directors former politicians who assure a strong connection to the government through their political connections. These members do not perform the duties of independence and supervision of the board of directors. Their presence is merely representative, generally, has no effect on how the firm is run.

5.3. Robustness

Several additional analyses were conducted to test the robustness of the results$^1$. We test whether the results in prior sections are sensitive to alternate sample sets.

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$^1$ These regression results are not presented in this paper in the interest of conserving space but are available from the corresponding author.
To ascertain the robustness of the results was replaced initially control variables used in regression models for other variables in the recommended literature to perform equal measurements. To determine the company size the natural logarithm of the value of total assets (SIZE) was replaced by the size of the sales and the market capitalization value. The new results show relationships qualitatively similar to the ones obtained initially. The sample of the study deals with a period of six years, which went from a period without corporate governance recommendations (1996-1998) to a period in which these recommendations should have already been implemented (1999-2001). We applied the regression models to each of the periods, using the same three measures of accounting quality. The results show that the reality described has not changed with the passage from one period to another and it was found in each period that the same results were found as in the initial models.

6. Discussion and conclusions

The main objective of this paper is analyzing the relationship between the composition and characteristics of corporate governance on the financial reporting quality of Portuguese companies. The empirical study is realized based on a sample of the non-financial companies listed on the Portuguese Stock Exchange. To identify the relationship between the quality evidenced by non-financial corporation and the characteristics of the government of such companies a research model based in the main theoretical references was built. The major reference case studies on the relationship between corporate governance and the financial reporting quality are not validated by the results obtained. Specifically our results show that the board composition changes and its degree of independence do not produce any influence on the quality of accounting information in the Portuguese listed companies. The board size was the only variable that presents a relationship with the level of accounting discretion, being moderately associated with an increase in the quality of financial reporting. We thus conclude that these results provide the evidence that, although in formal terms the Portuguese institutions (Portuguese Stock Exchange Commission) have accompanied the main international guidelines related to corporate governance recommendations, the actual implementation of these rules did not occur. Indeed, the constraints in an economy such as Portugal, Continental type, prevent that the practical implication of the best practice implementation of corporate governance recommendations, will be influenced into a positive effect on the financial reporting quality. The fact of the Portuguese Stock Exchange show a low level of efficiency means that the disclosure and transparency practices of financial information are of little interest. The effects
expected by the theoretical references of the Anglo-Saxon corporate governance do not produce consequences in the Portuguese scenario.

Note that the above findings are limited by some of the constraints of this study. A first limitation results from the sample referring to a period of 6 years, where during the first three years (1996 to 1998) there was no guidance in corporate governance subject and in the second period (1999 to 2001) the recommendations on corporate governance were already applied. In consequence, this new reality cannot be captured by our research because the recommendations were only guidelines. A second limitation arises from difficulties in obtaining the necessary information to realize the study. Unlike at present, listed companies were not required to provide their financial statements in a public way, so only a few companies provided corporate information.

The limitations to the study justify the need to develop new research, to correct the limitations now announced. It is necessary to undertake a new study covering the period in which the new guidelines are of mandatory application. Another area of research is to investigate the corporate governance characteristics, which previously were not in the public domain. This new source of information will enable a more detailed research on the corporate governance subject.

References


