The Impact of Corporate Governance on Accounting Information System and Credit Risk: A Literature Review

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Abstract:

The purpose of this paper is to review the literature on how the Corporate Governance of a firm effect accounting information system and Credit risk. This paper reviews how corporate governance has developed over time reflecting different relationships with various contextual factors through analysing and synthesizing extant accounting information systems and credit risk literature. Review of relevant papers reporting empirical results (quantitative and qualitative) published in various accounting journals during the period of 2001 to 2022. The review revealed that most of the studies agreed that corporate governance mechanisms play a role in improving the quality of accounting information by supporting the functions of the board of directors, and audit committee. Insights generated from the current study highlight the critical influence of corporate governance on credit risk because corporate governance had been effective in reducing credit risk. This review contributes to existing corporate governance literature by reviewing and analysing: first, previous studies that have attempted to explain the relationship between corporate governance and the accounting information system from a single perspective (i.e., audit committee, board of directors), Second, the current study explores the impact of corporate governance on credit risk.

Keyword: Corporate Governance, Accounting Information, Accounting Information System, Credit Risk, Corporate Financial Management.

JEL codes: G30, G32, G34

1. Introduction

The economic and financial crises that occurred in a few Middle Eastern and African countries during the 1990s and 2000s, as well as corporate scandals following the 2006 accounting scandal and the financial crisis, demonstrate how accounting and auditing failures can cause firms failure while maintaining investor and capital market confidence (Al Karabsheh,2021). These business failures are not unique to any country or region, nor are they restricted to a specific time; they occur in different countries at different time intervals. In response to these firm accounting scandals, regulators around the world have become more interested in corporate governance practices that could restore investor confidence in accounting information systems and reduce credit risk (Ali et al., 2021).

Good corporate governance leads to a good and efficient accounting information system and accurate information that will build a better business environment, improve investor confidence, and assist the productivity of capital markets. Other reasons for the global financial crisis such as low loan fees, interest rates, misallocation of investment, unacceptable rating practices, high leverage, insufficient management by financial regulators, etc. it is also obvious that lacking corporate governance structures played a significant part in the emergence of the financial crisis, which resulted in extreme credit risk-taking in banks and non-banking institutions (Ko & Akbarian,2019). Because of the nature of their activities Banks and non-banking firms, face serious risks, with the most significant one being credit risk. One of the most fundamental challenges for banks and non-banking firms these days is the reduction in their exchanges. It is the source of many financial crises, adversely influencing these firms, having a lot of economic problems, and on a larger scale, influencing the countries. Credit risk is the most important risk faced by firms, and the outcome of their business relies on accurate estimation and efficient management of this risk to a greater extent than any other risk. This risk has been attributed to bad governance practices (Rose, 2017).

The main purpose of this study concerns the question: Does corporate governance in business affects accounting information system and credit risk? And to answer this question we reviewed the prior literature on corporate governance. The researchers relied on the review of available studies. Based on the review, we concluded that corporate governance leads to an increase in the quality of accounting information system levels and a decrease in credit risk.

This study is expected to contribute to the financial knowledge and literature by first, previous studies that have attempted to explain the relationship between corporate governance in business and the accounting information system from a single perspective (i.e., audit committee, board of directors). Thus, the current study tried to fill this gap by providing a more comprehensive view, rather than using one of these perspectives as a single theoretical basis. Second, the current study explores the impact of corporate governance on credit risk. Finally, the study recommends a range of proposed visions that can contribute to corporate governance literature. The remainder of this paper is organized as follows: section one contains a review of prior studies related to the impact of corporate governance in business on the accounting information system and credit risk. Section two presents the discussion, and finally, the last section presents the conclusion and offers ideas for future research.

2. Literature Review:

The first part of the research studied the relationship between corporate governance and accounting information systems. Most firms are disturbed when governance practices are not applied as per the guidelines of concern about corporate governance failures like Enron and World Com. Corporate governance is useful for investors to give the best return and secure the impact of their accounting information systems investment. The useful governance practices help to spread accurate information in the market and present a bright picture of the company.

Therefore, improving the quality of accounting information systems is important, as is an understanding of corporate governance mechanisms that affect a company’s financial statements. Accounting information systems consist of data inputs and outputs. When data is entered into the system, the data is sorted into outputs called information that a firm can use to record and analyze a variety of business activities. Sales, purchases, employees, and inventory are all examples of items an accounting information system can track and produce reports on, so accounting information is the final output of accounting information systems (Gerwing et al., 2022). Several studies have discussed this relationship, in the Middle East including the study (Hamdaoui,2020; Ibrahim et al.,2020), the objective of those studies was to shed light on the influence of corporate governance on the exactness of accounting information systems in Biskra banks, and the researches were conducted in Jordanian commercial banks, and the studies found a positive effect of corporate governance on accurate of information as the final output of accounting information system.

Uyar et al. (2017) reached that corporate governance and accounting information systems are two parts of a single interaction that impact and are impacted by each other. The accounting information system of a firm is one of the main parts needed to make financial choices, and they are given to the board of directors so they can make such choices. However, regardless of the study's effectiveness, the study's primary concern was the destructive effect of low-quality external audit reports on accounting transparency and corporate governance. There was an emphasis on how to build confidence in external audit reports in the research. A major objective of that study was to decide whether the nature of external audit reports impactedaccounting information systems and corporate governance. This study found that external audit reports had a low impact on accounting information systems but a huge impact on corporate governance.

Al-Jali (2010) examined the relationship between corporate governance and accounting information systems from another perspective. It studied how to apply corporate governance through accounting disclosure, besides the advantages of doing so in terms of improving the quality of accounting information, as well as the expected advantages of applying corporate governance in Khartoum's stock market, and its effect on deciding the fair cost of shares. The study found that Khartoum Stock Exchange public joint stock firms apply the standards and mechanisms of governance, and it affected the quality of accounting information as there was a fair disclosure of accounting information. Also in Sudan, Farid (2019) sought to examine corporate governance, including its standards and objectives in improving government institutions' capacity and accounting disclosure to optimize economic assets, and decrease risks, the study found that corporate governance mechanisms had a hugely positive effect on accounting disclosure and decrease risks, but it had a low effect on optimizing economic assets. Although the application of corporate governance is subject to many questions in Middle Eastern firms, as the application of corporate governance is imposed by the force of law when it is applied, it leads to improvement in accounting information systems.

Marwan et al. (2011) tested that a failure of corporate governance leads to a failure in financial reporting in Malaysian firms, and corporate governance records connected to the board of directors, ownership, and audit committee were the focal points of this study. The study found the impact of corporate governance on accounting information disclosure is uncertain. We think the study reached this result conclusion because it relied on previous studies without conducting a practical study.

The board size is one of the most important internal mechanisms for corporate governance because the bigger the board, the greater the scope of expertise to make better choices in corporate governance. In the U.S.A a study examined by (Karamanou & Vafeas,2005) on the relationship between corporate boards, audit committees, and management earnings estimates as considered as an accounting information disclosure, it was found that firms with additional productive boards and stronger audit committees prompted the issuance of additional accurate accounting information forecasts by the board. In China (Gao & Kling,2012) also found that there is a positive relationship between board size and voluntary disclosure; as the board of directors plays an important role in developing corporate governance because if they fulfill their commitment obligations successfully, the company's performance will be improved, and the board size influences a company's compliance with the disclosure requirements. On the other hand, few studies found that size had no relationship with accounting information disclosure for example (Ho & Wong, 2001) didn’t find a relationship between the quantity of outside non-executive directors and the degree of voluntary disclosure. We believe that they reached this conclusion because the sample of companies was family companies, and these companies have a special structure, therefore the results cannot be generalized.

Regarding the board of directors' size and its effect on the quality of accounting information, In Romania (Gajevszky, 2016) stated that there is a significant positive effect of the board of directors' size and independence of the board directors on the quality of accounting information system as good corporate governance will produce good ethical behavior which will eventually produce a reliable and faithful financial report., Kukah et al., 2016 found the same results in Ghana, also in Nigeria (Akeju & Babatunde,2017) measured the qualitative characteristics of the board of directors' size using an ordinary least square (OLS) regression and Pearson correlation matrix. The measurement tools employed are internal validity, inter-rater reliability, and internal consistency. The evidence of the findings revealed that the measurement tools are significantly positively related to the quality of financial reporting information. However, a conflicting view, (Anastasia & Friday, 2016) reported that both the qualification and experience of board members have nothing to do with the quality of accounting information, we think they reached these results as they tested extra corporate governance measures “board versatility”. Shareholders, in their bid to increase their confidence in the financial reports, ensure that only well-experienced directors in the board. Inboard versatility, they examined the qualification and experience of the director on the board about ensuring financial reporting quality.

Similarly, Ismail & Alsa'aidah (2010) indicated that there is no statistically significant relationship between the number of non-executive directors on the board of directors and the quality of accounting information. However, they proved that the number of board meetings had a statistically significant relationship with the quality of accounting information, also in Portugal (Cristina, 2009) found that there was no relationship between the board of directors and its independence and the quality of accounting information, showing 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.

The separation between the Chairman of the Board of Directors and the Executive Director also affected the quality of accounting information. Zia (2017) mentioned that the separation between the Chairman of the Board of Directors and the Executive Director had a weak adverse effect on the quality of accounting information, while Ismail & Alsa'aidah, (2010) noted that there is no relationship between the Chairman of the Board of Directors and the quality of accounting information. We noticed that in the countries of the Middle East, there were some negative results because of the weak application of corporate governance rules, On the contrary, Gajevszky (2016) concluded that there is a positive significant relationship between the Executive Director and the quality of accounting information.

The audit committee also has an impact on the quality of accounting information. The audit committee is a fundamental part of a strong corporate mechanism (Fülöp 2019), According to (Gajevszky, 2016) audit committee has been known to play an important part in enhancing corporate governance by improving the quality of accounting information to assist users in making ideal choices. Furthermore, (Akeju & Babatunde, 2017) stated that there is a strong positive relationship between audit committees and the quality of accounting information. And, with the same strength of relationship and direction, (Anastasia & Friday, 2016) found that the size of a committee also positively affects the accounting information quality.

(Namakavarani et al., 2021) discovered a strong relationship between audit committee mechanisms and accounting information quality, as well as between financial knowledge and financial information quality; audit committee independence also affected accounting information quality (Kukah et al., 2016). The internal auditor had a high impact on the quality of accounting information. They emphasized that there is a relationship between the function and competence of the internal auditor and the quality of accounting information

(Oyebisi et al., 2017). While in terms of the independence of the audit committee, there is no relationship between them and there is no effect of the number of committee meetings on the quality of the financial reports. In addition to that, external auditors affect the quality of accounting information (Habib & Jiang, 2015). As well as (Anastasia & Friday, 2016) stated that the appointment of an external auditor from the big four offices affects significantly positively the quality of accounting information. while (Zia,2017; Paulinus et al., 2017) found no relationship between audit committee mechanisms and accounting information quality, we believe these studies reached these results because the review committee's role is not fully activated in Pakistan and Nigeria.

The second part of the research studied the relationship between corporate governance and firms' credit risk. Credit risk is a basic possibility that a lender (an investor) would suffer a loss if a borrower fails to meet their financial commitments. Lost interest /or principal payments, as well as higher collection fees, may be included in an investor's losses. Credit risk develops any time a loan is approved based on a borrower's unpredictable future cash flows. By receiving interest payments from the borrower, lenders are compensated for taking on credit risk. In addition to the likelihood of default, the strength of the protection offered to lenders in the form of debt covenants and restrictions affects debt rates and ratings (Postnova,2012; Rose, 2017).

To analyze and manage credit risk, various tools have been developed. Many businesses have credit risk departments whose responsibility is to evaluate the financial stability of their clients. Using credit scorecards, lenders analyze current and new clients based on their risk levels and then select the best risk management techniques. Some people rely on their knowledge, while others use credit scores from CRAS (Akbarian et al.,2019).

Each business director in a firm management relationship faces the dilemma of keeping a balance between adopting riskier strategies to increase shareholders' wealth and protecting their interests and human resources invested in the firm. This leads to organizational problems in any company. This issue of risk-taking as an organizational issue is more articulated in the financial industry. After the worldwide financial crisis, various studies were conducted to examine credit risk in financial institutions (Ali, et al., 2015). On the other hand, directors should work within regulatory constraints that require financial institutions to maintain a minimum amount of capital and liquidity.

The role of corporate governance elements in raising (decreasing) credit risk is still an open subject in the field of financial firms because organizations can explain financial instability to the financial system. The fundamental job of corporate governance is to solve the organizational problems between supervisors (managers) and principals (investors) by adjusting their interests. Unreasonable checking may result in a decrease in firm worth (Ghozali et al,2020). Moreover, the proof suggested that investor-positioned governance components may force directors to face extreme risk, which prompts a more elevated level of credit risk. However, there is a lack of research on this specific phenomenon for financial organizations, particularly during the crisis period (Acharya et al., 2015).

The impact of corporate governance on credit risk, in general, is very important. A company’s credit risk is replaced by a credit rating. A company's credit rating reflects a rating organization's opinion of an entity’s general creditworthiness and its ability to fulfill its financial commitments (Standard and Poor's, 2014). Credit risk and corporate governance are connected because weak governance can hinder a company's financial health and leave debtholders powerless. Weak corporate governance can cause companies to afford high debt financing expenses (Ali et al.,2021). The literature, Bhojraj & Sengupta (2003) examined the percentage of outside managers as a proxy for corporate governance. They found that firms with a higher percentage of outside managers on the board and those with a greater percentage of institutional ownership had lower credit risk (as replaced by credit scores).

Corporate governance is based on the firm hypothesis that businesses prioritize their interests over others. Corporate governance consists of a structure, framework, cycles, and perspectives to improve value, reputation, and company sustainability. Corporate governance can increase the confidence of creditors in companies. The quality of components is determined by internal components for corporate governance execution (Mutamimah, 2020). Corporate governance in companies can decrease the risk of debt effectively. Transparency is a form of corporate governance whereby companies' directors should report the financial performance exactly, rapidly, and accurately to banks, different partners, and other stakeholders (Fülöp, 2019).

(Ansong,2016) argued that improper company transparency results in credit risk. Companies' transparency is required for creditors, and companies' financial management should be better. When directors conduct occasional monitoring and assessment of all company practices, it can be quickly determined that there are no problems in the management and that companies can work according to plans so that they take care of obligations on time. If companies can execute corporate governance successfully, they can manage risk well.

An important theory called the Resource-Based Theory - one of the theories which explain corporate governance- shows that corporate performance and sustainability are determined by an internal asset's financial literacy as an internal asset turns into an important resource: knowledge, abilities, experience, and reputation. According to (Lusardi & Mitchell,2014), financial literacy is defined as financial management knowledge to accomplish success. (Nini et.al.,2011) found that if a company's board of directors does not have financial literacy, it causes danger in their business. Financial literacy can direct information gaps and further develop professional financial administration, it can also decrease credit risk. (Lusardi & Scheresberg,2013) Stated that financial literacy can limit loan expenses and those who have information and knowledge, understanding, and abilities of financial administration in estimating, examining, choosing, comparing, and choosing various types of credit will get excellent credit to improve the expense of debt. Moreover, if the manager doesn't have the information and abilities of financial administration in calculating, analyzing, choosing, comparing, and picking different kinds of credit presented by different financial organizations, then they will get bad quality credit, so the expense of debt is enormous (Mutamimah, et al., 2020).

This is explained by Fatoki (2014), who assumed that the financial literacy of business managers allows them to pursue exact and productive financial decisions. Companies' directors that know, understand, and have skills in financial management can improve their ability to produce information in an ideal, correct, and precise manner for banks, other partners, and stakeholders. He also expressed that by having great financial abilities, organizations should make financial choices suitably so that they can pay their loans on time. He also conducted that to get a better financial choice, company directors should have good financial literacy. Wise (2013) added that financial literacy permits directors to prepare financial statements that can work with managerial decision-making. The capacity to monitor financial statements directed by companies can decrease credit risk.

Financial literacy can support the company's directors in their accountability to decrease credit risk. (Adomako et al.,2015) found that a company's director must-have information, understanding, and skills in choosing different alternative financial choices as a type of company's responsibility. Information, understanding, and abilities of a company's financial management can reinforce companies' financial reports and comply with the regulations and guidelines as a type of accountability to the financial foundation and others so that it can decrease credit risk. (Mutegi et al.,2015) found that company directors who have good financial literacy can pay the loan at the scheduled time and raise the creditworthiness of companies. Also, companies can make decisions dispassionately so that credit risk can be decreased. According to (Hussain et al.,2018), financial literacy can reduce information asymmetry, guarantee deficits, and prevent companies from engaging in bad business practices.

3. Discussion

In the financial literature, corporate governance is used to improve the performance of companies and give confidence to investors and stakeholders to invest in the company by giving them appropriate, correct, and timely information (Hamdaoui,2020; Ibrahim et al.,2020). There was a gap in previous studies where one of the mechanisms of corporate governance was used to improve the quality of accounting information systems (Uyar et al.,2017) or to improve accounting information as the final product of accounting information systems (Gerwing et al., 2022). As there is a good level of awareness regarding accounting information systems applications and corporate governance, respondents held positive attitudes towards statements of study along with its variables.

This review investigated first: how corporate governance affected accounting information systems in accounting literature during the period between 2011 and 2021. The review focused on the most important corporate governance literature. First, studies concluded the degree of accounting disclosure had a positive impact on the quality of the accounting information system. Studies used different Methodologies in relation to its adoption and implementation in different contexts. A major reason for this as users agreed about the important role of accounting disclosure in how to help them in good making decisions and enhance awareness.

The inconclusive findings relating to the impact of corporate governance on accounting information systems were depicted by Marwan et al., (2011) suggesting that there was no impact on the information system.

This review examined board size as it is one of the mechanisms of corporate governance. most of the studies agreed on how board size had a positive impact on accounting information systems, whereas factor studies focus on the board of directors' size and independence. On the other hand, (Ho & Wong, 2001; Anastasia & Friday, 2016; Ismail & Alsa’aidah 2010; Cristina, 2009) didn’t find a relationship between the board size, qualification, and experience of board members and accounting information systems as that large board size tends to be slow in making decisions and qualification, and experience didn’t have much impact on the degree of voluntary disclosure.

The audit committee has been measured from different perspectives in literature; these perspectives can be viewed as dimensions of information systems success where factor studies focus on the size of a committee audit committee independence, the number of committee meetings, and experience, most studies found a positive impact on accounting information systems as there is a relationship between the function and competence of audit committee and these dimensions for accounting information system measurement as follows: System quality, Information quality, System use, and User satisfaction. on the other hand, (Zia,2017; Oyebisi et al., 2017) found no relationship between them as they thought the influence of the audit committee is less effective in the governance process.

This review investigated second: how corporate governance affected credit in accounting literature during the period between 2001 and 2021. Extant literature has focused on Transparency and financial literacy as related to corporate governance. most studies found a positive impact on reducing credit risk as it will improve financial discipline and develop financial management and assets resource management transparency. However, (Kang & Xu, 2019; Acharya et al., 2015) had conflicting views that governance practices may encourage directors to make riskier corporate arrangements which may, increase credit risk in bank administrations, maybe they reached these results because it has been applied in banks, which differs from the organizational structure in companies.

This review made numerous contributions to the literature on corporate governance. To highlight the topic of each set of articles, the various contextual effects, and the features of reviewed papers, it first divided the articles into various literary streams. Second, secondary techniques for data collection and concentration of studies in developing countries were selected based on the findings of the review, constraints, and gaps in various sections of the literature.

4. Conclusion

The main purpose of this study was to review the literature on corporate governance in business through accounting disclosure, the board size affects audit committee the accounting information, and accounting Information. Based on the review, we concluded that mechanisms of corporate governance had a significant positive impact on the quality of the accounting information system. Additionally, the literature review found that firm financial management and firm performance are positively affected by the degree to apply the director's principles of corporate governance. The literature offered different causes for the positive influence on accounting information systems. One proposed cause was board size, other studies have argued the independence of the board of directors had the most influence, the second Cause was the audit committee, which also has a positive impact on the quality of accounting.

The second main purpose of this theoretical background was to review the literature on how corporate governance affects credit risk. Based on the review, we concluded that most of the studies proved that corporate governance decreased credit risk. The literature offered different causes for the positive influence of corporate governance in business on credit risk. One proposed cause was financial literacy; the second proposed cause was Transparency. On the contrary governance practices may encourage riskier corporate arrangements, which may lead to higher bankruptcy risk in financial firms.

The current study provides many insights for further research, but it also has some limitations. First, this study focused only on the impact of accounting disclosure, the board size, and the audit committee on the accounting information system. Expanding the study to include The management of internal audits and external audits can affect the accounting information system. Second, this study focused only on the impact of financial literacy, Transparency on credit risk. Expanding the study to include directors' shareholdings and stock option plans can affect credit risk.

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