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Corporate Governance Attributes, Audit Quality and Financial Discourser Quality: Case of Tehran Stock Exchange

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ABSTRACT

The aim of this study is to investigate the relationship between financial discourser quality and corporate governance attributes in of Tehran Stock Exchange (TSE). To do so, 590 firms are selected as a sample to be studies during the period between 2004-2011. Board size, board independence, audit size, and institutional ownership are considered as corporate governance attributes and firm's size and firm's age as control variables. The results of the study show that there is not a significant relationship between financial discourser quality and corporate governance attributes in TSE.
KEYWORDS: Financial discourser quality, corporate governance attributes and Tehran Stock Exchange.

1. INTRODUCTION

Recent financial scandals have drawn the attention of regulators and policy makers to corporate governance. Socio-economic and political developments have a great effect on accounting and corporate governance. Accounting and corporate governance mechanisms are embedded practices interrelating with their context. Through access to corporate financial books and records, improved accounting disclosure is proposed as a way of enhancing shareholder rights (Yonekura et al., 2012). Agency theory referring to the separation of ownership and control, provides the theoretical basis for corporate governance research. Agency theory highlights that performance-related incentives can mitigate agency costs, as the manager's interests are aligned with maximizing shareholder value. However, information disclosure is a precondition for monitoring managers and analyzing performance (Gao and Kling, 2012). In addition, according to Accounting Standard (AS) 1 "to ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed".

However, it is expected that firms with high quality of corporate governance have high financial discourser quality. Good corporate governance reduces agency costs through improving discloser quality. Ben Ali (2009), in a market that is characterised by high ownership concentration and poor investor protection, finds a negative association between disclosure quality and family control, double voting shares, and both ownership and control concentration. His results also suggest a positive relationship between disclosure quality and the presence of executive stock options plans, and with the proportion of independent directors in the board as well. His findings shed the light on corporate governance features that enhance incentives for good disclosure under high ownership concentration and motivates discloser quality.

Considering these arguments, in this study we will try to answer the question as to whether high audit quality ad good corporate governance result in more improvements in financial reporting quality and on the other hand, it is expect that audit quality improves financial discourser quality. Khurana and Raman (2004) define audit quality as ‘‘an auditor will (1) detect and (2) correct/reveal any material omission or misstatements in the financial statements’’(p. 475). However, audit with high quality puts pressure on conformity with accounting standards voluntary discloser and if good corporate governance leads to more voluntary discloser.

LITERATURE REVIEW

Gugler (2003) investigated the relationship between dividends and the ownership and control structure of the firm. He finds that state controlled firms engage in dividend smoothing, while family-controlled firms do not and the latter choose significantly lower target payout levels. He shows that state-controlled firms are most reluctant and family-controlled firms are least reluctant to cut dividends when cuts are warranted. His further results show that the dividend behavior of bank- and foreign-controlled firms lies in between state and family-controlled firms.

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Lina and Liu (2009) investigated the impact of corporate governance on auditor choice. Their empirical results show that firms with larger controlling shareholders with smaller size of supervisory board, or in which CEO and board of directors chairman are the same person, are less likely to hire a Top 10 (high-quality) auditor. Their results suggest that when benefits from lowering capital raising costs are trivial, firms with weaker internal corporate governance mechanism are inclined to choose a low-quality auditor so as to capture and sustain their opaqueness gains. On the other hand, with improvement of corporate governance, firms should be more likely to appoint high-quality auditors.

Adjaoud and Ben-Amar (2010) studied the relationship between corporate governance and dividend policy using a sample of 714 firm-years listed on the Toronto Stock Exchange over the period 2002-2005. Their results show that firms with stronger corporate governance have higher dividend payouts. Among the four components of the corporate governance index, they document that board composition and shareholder rights' policy are positively related to payout ratios. They also find a positive association between firm size, the level of free cash flows and dividend payouts.

Ammann et al. (2011) investigated the relationship between corporate governance and firm value. They find a strong and positive relation between firm-level corporate governance and firm valuation.

Lim (2011) investigated the corporate governance attributes association with accounting conservatism. Overall, his results provide only weak evidence that firms with certain governance characteristics report more conservatively. He also shows that such link is restricted to measures of board composition and leadership, and even then the results are sensitive to the method used to measure the extent of conservatism in financial reporting.

Jiraporn et al. (2012) investigated the relationship between capital structure and corporate governance quality. Their empirical evidence reveal a robust inverse association between leverage and governance equality, that is, firms with poor governance are significantly more leveraged. Further, controlling for endogeneity, they show that poor governance quality likely brings higher leverage.

Chhaochharia et al. (2012) investigated the relationship between local investors and corporate governance. They show that local institutional investors are effective monitors of corporate behavior, that is, firms with high local ownership have better internal governance and are more profitable. They also show that these firms are also less likely to manage their earnings aggressively or backdate options and are less likely to be targets of class action lawsuits. Further, managers of such firms exhibit a lower propensity to engage in “empire building” and are less likely to “lead the quiet life”. Examining the local monitoring mechanisms, they find that local institutions are more likely to introduce shareholder proposals, increase CEO turnover, and reduce excess CEO pay.

Gaoa and Kling (2012) investigated the impact of corporate governance and external audit on compliance to mandatory disclosure requirements in China. Their findings show that auditor opinions increase the compliance to mandatory disclosure requirements. They also find that improved internal governance led to higher compliance to disclosure requirements. Their further results show that the external governance environment, measured by the degree of institutional development, had a positive effect on firms' compliance to disclosure requirements.

Liu et al. (2012) investigated the relationship between corporate governance and firm value during the global financial crisis and find that Chinese state-owned enterprises that performed poorly before the global financial crisis performed better during the crisis, especially when they relied on bank debt. They also find that managerial ownership is positively associated with crisis-period performance of state-owned enterprises suggesting that managerial ownership mitigates expropriation problems in state-owned enterprises. Finally, they show that Chinese firms that adopted a reputable accounting auditor experienced a small reduction in firm value during the global financial crisis.

Hypotheses development

Main hypothesis: there is a significant relationship financial discourser quality and corporate governance attributes in TSE.

Sub-hypotheses:

H_1: There is a significant relationship board size and financial discourser quality in TSE.

H_2: There is a significant relationship board independence and financial discourser quality and in TSE.

H_3: There is a significant relationship institutional ownership and financial discourser quality in TSE.

H_4: There is a significant relationship firm's size and financial discourser quality in TSE.

H_5: There is a significant relationship firm's age and financial discourser quality in TSE.

H_6: There is a significant relationship audit quality and financial discourser quality and in TSE.

METHODOLOGY

Since the aim of this study is to examine the relationship between financial discourser quality and corporate governance attributes in TSE, the methodology of the study is correlation-descriptive. To obtain financial discourser quality, the annual scores of firm's financial discourser quality which is given by TSE based on weighted average of timeliness and reliability of disclosed information is used. In addition, to test the hypotheses, firstly data transformed from financial statements and notes to Excel worksheets and then analyzed by Eviews software.

Sample and data collection

The research population consists of all companies listed in TSE during the period of 2005 to 2010. The sampling method is the systematic elimination and the sample firms must have following conditions:

1. Information must be available for the past 8 years.
2. Fiscal year must be ended at the end of year.
3. Transaction intervals must not be more than 6 month.
4. Data must be available for testing hypotheses.

As a result of these conditions a sample of 74 firms was obtained. Literature and conceptual framework were gathered by documental method. Financial statement and notes issued by TSE were used as a research tool.

Model and variable definition

In order to examine the relationship between financial discourser quality and corporate governance attributes in TSE following model is used.

DSI= BRD+ BRODIND+ INS+ AGE+ AUDIT+ SIZE+ εi

Where scripts of firm and year is omitted:

Board size (BRDSZE): number of board members.

Board independence (BRDIND): number of board outsider members of firm i in year t divided by total number of board members.

Institutional ownership (NSTOWN): total shares belonged to banks, insurances, financial institutions, holding companies and governmental institutions.

Audit size (AUDIT): if a firm is audited by Iranian audit organization, it takes 1, otherwise 0.

DSI: disclosure quality.

Control variables:

Firms size (SIZE): natural logarithm

Firm's age (AGE): distance between the times of firm establishment to studied period.

εi: error term

Empirical results

Descriptive statistic only portraits variables distribution of studied firms which is shown in Table 1.

Table 1. Descriptive statistic

	AGE	AUDIT	BRDSZE	BRDIND	DSI	INS	SIZE
Mean	36.44915	0.274576	5.059322	3.391525	1056.261	1.194471	2675546.
Median	38.00000	0.000000	5.000000	3.000000	740.5000	0.664500	388638.5
Maximum	60.00000	1.000000	7.000000	6.000000	9204.000	95.00000	3.31E+08
Minimum	8.000000	0.000000	2.000000	1.000000	-2221.000	0.002464	27196.24
Std. Dev.	10.87684	0.446679	0.460537	0.830813	1140.475	7.550835	15321885
Skewness	-0.372804	1.010188	1.263753	-0.017611	2.172081	12.01885	17.42175
Kurtosis	2.416109	2.020480	17.65989	2.993069	10.77499	145.8588	361.7664
Coefficient of variation	0.298411	1.627945	0.091027	0.271807	1.097284	6.321505	5.726638

According to Table 1 firm's size has the most coefficient of variation (5.72) which shows that selected firms as a sample are different in size. In addition, board size has the least coefficient of variation (0.91) shows that selected firms as a sample have rather similar board size. Mean of age is 36.44 that means nearly 36.5 years have passed form selected firms establishment on average. Minimum of age is 8 showing that the least life of firms is 8 years and maximum of age is 60 which shows that the oldest firm in our sample has of life of 60 years. Mean of audit is 0.27

which indicates less than half of selected firms are audited by audit organization. Minimum and maximum of board size are 5 and 7, respectively, indicating that in Iran board of directors must be at least 5 and at most 7. Minimum and maximum of outsider board are 5 and 7, respectively, indicating that outsider board of directors is at least 5 and at most 7 which are great numbers.

Correlation between variables

Correlation between research variables is shown in Table 2.

Table 2. Correlation Matrix

	AGE	AUDIT	BRDSZE	BRDIND	DSI	INS	SIZE
AGE	1.000000						
AUDIT	-0.039056	1.000000					
BRDSZE	-0.050746	-0.038049	1.000000				
BRODIND	-0.041287	-0.011104	-0.016433	1.000000			
DSI	-0.054644	0.030370	0.005117	0.036273	1.000000		
INS	0.017175	-0.044326	-0.009445	0.115675	-0.063219	1.000000	
SIZE	0.111399	0.178645	-0.067969	0.109838	-0.038341	-0.009222	1.000000

According to Table 2, the most correlation is between audit quality and firms size and the least is between institution ownership and firm's size. This results show that bigger firms are more likely to employ audit organization as their auditor which indicates that bigger firms have more tendency to have qualified auditors. The results about the least correlation between institution ownership and firm's size indicate that the change in firm's size does not lead to change in ownership structure. The low correlations between variables show that there is not collinearly problem between dependent variables.

Table 3. Results of hypotheses test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1811.933	620.9768	2.917875	0.0037
INS	-4.214541	6.207558	-0.678937	0.4974
BRDIND	-23.19137	61.09972	-0.379566	0.7044
BRDSZE	-83.93598	102.8950	-0.815744	0.4150
AUDIT	151.8014	141.0064	1.076557	0.2821
AGE	-8.019759	6.050682	-1.325431	0.1856
SIZE	-1.69E-06	2.77E-06	-0.611819	0.5409
R-squared	0.298036	Mean dependent var		1054.849
Adjusted R-squared	0.289565	Durbin-Watson stat		1.986478
F-statistic	35.17911	Prob(F-statistic)		0.000000

The results which are indicated in Table 3 show that there is not a significant relationship between financial discourser quality and corporate governance attributes (including board size, board independence and institutional ownership). In addition, there is not a significant relationship between financial discourser quality and control variables (including firm's size, firm's age, and audit size). F-statistic shows that the model is significant in whole and adjusted R-squared indicates that 0.28 present of financial discourser quality is explained by board size, board independence, institutional ownership, firm's size, firm's age, and audit size, showing that the impact of this relationship may be bilateral. Durbin-Watson statistic is 1.9 which is near 2 and shows that there is no correlation between models residues proving the models reliability.

DISCUSSION AND CONCLUSION

The aim of this study was to investigate the relationship between financial discourser quality and corporate governance attributes in of Tehran Stock Exchange (TSE). To do so, 590 firms are selected as a sample to be studies during the period between 2004-2011. Board size, board independence, audit size, and institutional ownership are considered as corporate governance attributes and firm's size and firm's age as control variables. The results of the study show that there is not a significant relationship between corporate governance attributes including board size, board independence and institutional ownership with financial discourser quality and in TSE. Further results reveal that firms size and firm's age does not affect financial discourser quality. In addition, the results reveal that audit quality does not affect in disclosure quality. These results suggest that both TSE firm's auditors cannot require mangers to improve their discloser policy and also corporate governance attributes are not effective in improving discloser policy. However, considering the results of the study it is suggested to TSE firms that consider improving financial discloser quality as a tool for reducing agency cost.

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