

The Effect of Corporate Governance Mechanisms on Internal Financial Reports of Listed Companies Accepted in Tehran Stock Exchange

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Abstract: The main purpose of this study was to investigate the relationship between corporate governance and internal financial reports. In order to achieve the research goals seven hypotheses (three main hypotheses and four subsidiary hypotheses) have been developed. After that, in order to test these hypotheses, sampling was carried out from listed companies accepted in Tehran stock exchange during years of 2008 to 2014, using systematic elimination method. Hypotheses testing method was multivariate regression through combined data. The research results showed that there was a direct and significant relationship between the internal reports level on the one hand and the percent of stock ownership, institutional ownership and the percent of non-bound members of companies' board. Results also showed that there was a reverse and significant relationship between the internal reports level and financial leverage and liquidity. Furthermore, the results suggested that there was a significant and direct relationship between the internal reports level, as dependent variable, and company size and profitability, as independent variables.

Keywords: Internal Reports Level (Disclosure), Corporate Governance, Institutional Ownership, Tehran Stock Exchange.

Introduction

In recent years, corporate governance has attracted a lot of attention. The reason for this is the attention to the economic health of the community and business units in particular, especially, for the reason that the excessive increase of frauds in companies and the scandals caused by their discovery in recent decades has necessitated the need to use these mechanisms of the governance structure more than ever. United States, Canada, England, and other European countries and East Asia countries are evidences of this claim that economic pressures to companies cause numerous problems for the whole community, including the inability of many leading companies in various industries to continue with the former power and also pushing them towards bankruptcy and collapse (Dalton and Dalton, 2005). Moreover, corporate governance structure, as one of the most important controlling and monitoring structure, could be an important factor in performing justice. The development and implementation of corporate governance structure are as political and economic requirements for the countries which have plans to perform privatization programs, especially through the spread of stock, although the ownership level of the larger corporations has not been spread in the total community of Iran (Kashani, 2009). In recent years many studies have been done in the field of investigating the relationship between the quality of financial reporting, or disclosure

levels, in annual reports and features of companies. Investigating the companies' annual reports shows that the quality of disclosed information in such reports is different and the difference in companies' disclosure is more likely due to their management thinking and intellectual philosophy, as well as their discretion about information disclosure of investment purposes (Zhang, 2006). Corporate governance was introduced as a topic which emphasized on companies' strategy and shareholders' earnings and its role is decreasing the conflict between the interests of shareholders and managers. This conflict of interests is often associated with agency issues, which is due to two main reasons: first, the difference in goals and preferences of the participants in the company and second, participants' lack of information about performance, knowledge and preferences of each other.

Although the companies' management and ownership strategies have been undergone radical changes in recent years, which have had many positive and negative effects with themselves, but it seems that corporate governance have a lot of interests, which by using its key capabilities can move along achieving the organization's goals. On the other hand, companies that work at macro-level and within the standard and specified framework and their stock are traded on Tehran stock exchange are bound to present collected, written and analyzable reports, which are used for the usage of internal and external shareholders. Accordingly, these reports, the main purpose of this research was to investigate the relationship between some corporate governance mechanisms and internal reports level.

Materials and Methods

According to the purpose of this study which was investigating the relationship between corporate governance mechanisms and internal reports level in Tehran stock exchange, the type of the research is practical in the case of the goal and descriptive-correlational in the case of data gathering method, which the regression method has been used in order to a closer investigation of variables. The population refers to the whole group of people, events and phenomena which are of the researcher's interest who wants to investigate those (Danaei-fard et al, 2007). In other words, the population is a set of real or hypothetical members to whom the research results can be transferred. The definition of the population should be clear enough so that no question would be raised about the generalizability or the application of the results to any member of the population. The accuracy of research findings is to some extent influenced by the congruence of the population which we want to select the sample from (Delvar, 1997).

Population and Statistical sample

In the present research the listed companies accepted in Tehran stock exchange during the years 2008 to 2014 have been considered as the research population since they were required to provide audit financial reports and information, so the possibility to achieve their reliable information is more about them. In order to determine the population size through systematic elimination method:

1. Their financial year should be ended to March 29 each year.
2. The companies should have not changed their financial year during the research period.
3. All of the data required for the research should be available for those companies during the mentioned time domain.
4. The book value of the equity of their shareholders should not be negative in any year.
5. These companies should have been accepted before 2008 in Tehran exchange and their stock should have been traded from the beginning of 2008.
6. The transactions of these companies should have not been interrupted during the years of 2008 to 2014. In other words the stock of these companies should be active during the above-mentioned years and the length of the pause should not be more than three months.
7. Investment, insurance and financial intermediation companies are not investigated in this research.

According to the above-mentioned set of conditions 144 companies have the features of the sample companies in this research, which their related information is in Appendix two.

Results

After determining the appropriate method for estimating the parameters, we express the results of estimating the pattern for companies. Since based on Hausman test for estimating the model, the fixed effects method should be used, the results of EvIEWS program are shown in the table below.

Table 1. Results of estimating the regression pattern.

Research model	$IDI_{it} = \beta_0 + \beta_1 OC_{it} + \beta_2 BS_{it} + \beta_3 CEO_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 LIQ_{it} + \beta_7 PROFIT_{it} + \varepsilon_{it}$		
Research Variables	Coefficients	T Statistic	Sig.
Fixed coefficient	61.624	8.522	00.00
Institutional ownership	5.639	3.790	00.00
the percent of managers' stock ownership	17.945	5.404	00.00
The percent of non-bound members	8.339	3.387	00.00
Size	0.180	0.168	00.866
Financial leverage	-17.498	-6.549	00.00
Liquidity	-4.576	-6.134	00.00
Profitability	7.013	1.317	00.188
F statistic		4.698	
Probability of F statistics		00.0	
Durbin-Watson statistic		1.955	
Determination coefficient		0.497	
Adjusted determination coefficient		0.391	

For linear investigation and the significance of the regression model, the F test has been used. The null hypothesis of F test showed the significance and linearity of the regression model. According to the results of F test, in the table it can be seen for the second hypothesis model that the amount of probability level equals zero and less than the importance level required for the study of α . As a result, the null hypothesis of F test is rejected at %95 confidence level. So, the model has been significant and there is a linear relationship between the dependent and the independent variable. According to the results in the table it can be seen that the amount of determination coefficient equals %49, which means that independent variables explain the %49 of the changes in the dependent variable. The high amount of the determination coefficient shows the high explanatory power of the model in explaining the changes of the dependent variable by the independent variable. While using the regression, noting several points is necessary. First, the results of the regression model are reliable when the fitted regression model is significant. The results from F statistics show the significance of the model. The next important subject is the independence of error components in the fitted model. For investigating this case the Durbin-Watson statistic has been used and since this amount is between 1.5 and 2.5, it can be concluded that error components in model do not have significant correlation and have an independent behavior from each other. The amount of Durbin-Watson statistic equals 1.95 and it is at an acceptable level (between 1.5 & 2.5).

The first hypothesis test

There was a significant relationship between the internal reports level and the percent of the managers' stock ownership in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the coefficient of the variable of the percent of the managers' stock ownership of the companies was positive (5.639) and it was significant according to the significance level of T-test (0.00), so, the first hypothesis was confirmed at the significance level of %95, which means that the variable of the percent of the managers' stock ownership of the companies in listed companies accepted in Tehran stock exchange had a direct and significant relationship with the variable of the internal reports level. The results of the present research were consistent with the results of Vaez et al (2010).

The second hypothesis test

There was a significant relationship between the internal reports level and the companies' institutional ownership in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the coefficient of the variable of the companies' institutional ownership was positive (17.945) and it was significant according to the significance level of T-test (0.0), so, the second hypothesis was confirmed at the significance level of %95, which means that the variable of the companies' institutional ownership in listed companies accepted in

Tehran stock exchange had a direct and significant relationship with the variable of the internal reports level. The results of the present research were consistent with the results Ebrahimi-Kordlar and Aarabi (2005).

The third hypothesis test

There was a significant relationship between the internal reports level and the percent of the non-bound members of the companies' board in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the variable of the percent of the non-bound members of the companies' board was positive (8.339) and it was significant according to the significance level of T-test (0.0), so, the third hypothesis was confirmed at the significance level of %95, which means that the variable of the percent of the non-bound members in listed companies accepted in Tehran stock exchange had a direct and significant relationship with the variable of the internal reports level. The results of the present research were not consistent with the results of Kashani, Rahmani and Parchini-Parchin (2009).

The fourth hypothesis test

There was a significant relationship between the internal reports level and the financial leverage in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the coefficient of the variable of the companies' financial leverage was negative (-17.498) and it was significant according to the significance level of T-test (0.0), so, the fourth hypothesis was confirmed at the significance level of %95, which means that the variable of the financial leverage of listed companies accepted in Tehran stock exchange had a significant and reverse relationship with the variable of the internal reports level. The results of the present research were consistent with the results of Dal-Ri and Santos (2011).

The fifth hypothesis test

There was a significant relationship between the internal reports level and the company size in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the significance level of T-test was more than 0.05 for the variable of the company size, the significance of this variable was rejected, which means that the variable of the size of the listed companies accepted in Tehran stock exchange did not have a significant relationship with the variable of the internal reports level. The results of the research were consistent with the results of Dal-Ri Murcia and Santos (2011).

The sixth hypothesis test

There was a significant relationship between the internal reports level and liquidity in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the coefficient of the variable of the companies' liquidity was negative (-4.576) and it was significant according to the significance level of T-test (0.0), so, the sixth hypothesis was confirmed at the significance level of %95, which means that the variable of liquidity of the listed companies accepted in Tehran stock exchange had a significant and reverse relationship with the variable of the internal reports level. The results of the present research were consistent with the results of Dal-Ri Murcia and Santos (2011).

The seventh hypothesis test

There was a significant relationship between the internal reports level and profitability in listed companies accepted in Tehran stock exchange. According to the results of the table 1, since the significance level of T-test was more than 0.05 for the profitability variable, the significance of this variable was rejected, which means that the profitability variable of the listed companies accepted in Tehran stock exchange did not have a significant relationship with the variable of the internal reports level. The results of the research were not consistent with the results of V. Jiang, A. Habib A and H.Baiding H (2009).

Conclusion

The results of the hypotheses test show that there is a significant relationship between the internal reports level and the percent of the managers' stock ownership. Also, the second hypothesis of the research is confirmed, which means that there is a significant relationship between the internal reports level and the companies' institutional ownership. In the following, the third hypothesis is also confirmed and as a result, there is a significant relationship between the internal reports level and the percent of the non-bound members of the board. Also, the fourth hypothesis of the research is confirmed and as a result, there is a significant relationship between the internal reports

level and financial leverage. The fifth hypothesis of the research is not confirmed and as a result, there is not a significant relationship between the internal reports level and the company size. Also, the sixth hypothesis of the research is confirmed, which means that there is a significant relationship between the internal reports level and liquidity. Finally, the seventh hypothesis of the research is not confirmed and as a result, there is not a significant relationship between the internal reports level and profitability.

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