

## The Relationships between Tenure Duration of Chairman of the Board and Quality of the Financial Reporting (Case study of listed companies in Tehran Stock Exchange)

Karimi Mansooreh<sup>1</sup> and Mansour Garkaz<sup>\*2</sup>

<sup>1</sup>Department of Management, Aliabad katoul Branch ,Islamic Azad University ,Aliabad katoul, Iran.

<sup>2</sup> Department of Accounting, Aliabad katoul Branch ,Islamic Azad University ,Aliabad katoul, Iran.  
Corresponding Author

### Abstract

The purpose of this study is to investigate the relationships between the tenure of the chairman of the board and the quality of the financial reporting of listed companies in Tehran Stock Exchange. This is an applied research in terms of the purpose and a semi experimental research (Ex-Post Facto) in terms of the method of data collecting. Given the purpose of the survey and its limitations, 97 companies were selected for the period of 2007 to 2012. Before testing the hypotheses, the overall characteristics of research variables have been described. The results of the combined data selecting test indicated that the first hypothesis- the manager with longer tenure duration has more accurate predicted profits - was accepted. The second hypothesis- the manager with longer tenure duration has more acceptable assessments for his financial statements - was rejected at 5% error level.

**Key words:** quality of financial reporting, the tenure duration of the chairman of the board, profit forecast error, acceptable assessments

### 1. Introduction

Financial statements are the end product of financial accounting and financial reporting. The main objective of financial reporting is to express the financial position and performance of a business unit for the outside users of the organization to assist them in making financial decisions. The stakeholders who are the most important group of users of financial information search for their interests in profit information. Accounting profit is a sign which changes the investors' beliefs and behavior. Earnings quality and, subsequently, the financial reporting can affect investor confidence in financial markets.

On the other hand, one of the requirements of the Stock Exchange is to predict the profit by managers. There are several models to forecast the profit. These models are not accurate. Predictions made by professionals, including analysts, are more accurate than predictions made by such models (Brown, 1968). But, the accuracy of such individuals' predictions is influenced by several factors. For example, Bolliger (2001) research

shows that there is a direct relationship between the analysts forecast accuracy and their experience as well as the number of organizations where they work in. The prediction accuracy of different countries can be affected by factors such as tax system or accounting principles. The predicted profit by manager is an important criterion in companies' evaluation and affecting the share prices (Koch, 2001). It should be expected that the managers of the stock exchange companies do their best in their predictions and make it as accurate as possible.

According to Hermalin and Weisbach (1998), there is a negative relationship between the tenure duration of the chairman of the board and the quality of the financial reporting. The tenure duration of the chairman of the board may determine his effectiveness. In terms of the tenure duration of the chairman of the board, Jensen (1993), Hermalin and Weisbach (1998) argue that the chairman of the board is in a position where he controls the composition of the board and, therefore, he reduces the board supervision. Since

the enhancement of the tenure duration of the chairman of the board may lead to a stable position and a greater power, therefore, he is less likely to pursue the interests of shareholders. If the tenure duration of the chairman of the board reduces the monitoring of management, the information content of profit can be reduced. The yardstick of financial reporting quality is the profits prediction accuracy. In this study, the main objective is to investigate the relationships between the tenure of the chairman of the board and the quality of the financial reporting and the secondary objectives are to investigate the relationships between the tenure of the chairman of the board and the earnings forecast accuracy and to investigate the relationships between the tenure of the chairman of the board and the kind of assessment on the statements.

## 2. Literature review

Lonkani and his colleagues (2005) have investigated the relation between the earnings forecast accuracy and the abnormal returns of newly arrived companies in Bangkok. The results showed that the managers were optimistic in profit estimating and more accurate in time series models. On the other hand, there is a negative relationship between profits estimating accuracy and the abnormal long-term returns of new stock. But, this relationship is not significant.

Kamran and his colleagues (2007) have investigated the factors affecting earnings forecast error in companies supplying the shares in Dhaka Stock Exchange. The result suggests that there is a diverse relationship between the economic prosperity conditions and the earnings forecast error. It also indicates that there is a positive relationship between the company's lifetime and the earnings forecast error. Other evaluated variables were not significant.

Lee and his colleagues (2012) have conducted a research entitled "earnings forecast accuracy and the chairman of the board turning". The results indicated that there is a positive relationship between the probability of the chairman of the board turning and the absolute value of earnings forecast error. The board members use the

absolute value of earnings forecast error as the capability of the chairman of the board.

Hong and his colleagues (2012) have conducted a research entitled "the age of chairman of the board and the quality of the financial reporting". The results indicated that there is a significant positive relationship between the age of the chairman of the board and the quality of the financial reporting. Khodayi Valeh Zagherd and yahyayi (2010) conducted a research entitled "The relationships between the quality of the financial reporting and the investment efficiency in Tehran Stock Exchange". The results indicated that there is a significant negative relationship between the quality of the financial reporting and a low investment. There is an insignificant negative relationship between the quality of the financial reporting and a high investment.

Kordestani and Ashtab (2010) conducted a research entitled "The relationships between the earnings forecast error and the abnormal returns of newly arrived companies in Tehran Stock Exchange. The results of research, using the multivariate linear regression analysis, showed that there is a significant positive relationship between the earnings forecast error the abnormal returns of newly arrived companies.

Mousavi his colleagues (2011) have investigated the relation between the earnings forecast error by manager and the governance structure of one of the company listed in Tehran Stock Exchange. The results showed that that there is a positive relationship between the percent owned by board members, the number of board members and the number of outside board members and the accuracy of management earnings forecasts. There is a negative relationship between the interest risk of the board and the accuracy of management earnings forecasts.

Izadi Nia and Alinaghiyan (2011) have investigated the relation between the earnings forecast error and business and financial risk in companies listed on Tehran Stock Exchange. The test results showed that there is a significant relationship between business and financial risk and earnings forecast error. Companies that have

high business risk or financial risk are likely to have difficulty in estimating their profit forecasts.

Diyanati Deilami and his colleagues (2013) have investigated the effect of management tenure duration on the firm value, agency costs and information risk. The test results showed that there is a significant negative relationship between the management tenure duration and the firm value and information risk. There is no significant relationship between the management tenure duration and the agency costs.

To achieve the desired objectives of the study, the hypotheses test was carried out.

#### **Hypotheses:**

**First hypothesis:** the companies with longer management tenure duration have more accurate earnings forecast.

**Second hypothesis:** the companies with longer management tenure duration have acceptable assessment for their financial statements.

### **3. Materials**

This is an applied research in terms of the purpose and a semi experimental research (Ex-Post Facto) in terms of the method of data collecting. This is a correlational research in terms of analyzing the relationship between the dependent and independent variables. In this study, to collect the required data, the library method was used. In the library section, the theoretical principles of study are collected out of books and magazines. The selected companies' relevant data were extracted from financial statements, explanatory notes, Dena Sahm and Tadbir Pardaz software and financial information CDs. For data analysis and hypothesis testing, combined data regression method Eviews7 software and were used.

This research has been conducted during a 6-year period, from 1386 to 1391. After a series of restrictions, the study population consists of all companies listed in Tehran Stock Exchange. In this study, for the sampling, the random sampling method has been used.

#### **Research models**

To test the first hypothesis, the following model was used:

$$\text{SURPRISE} = \beta_0 + \beta_1 \text{AGE} + \beta_2 \text{AGERET} + \beta_3 \text{AGE} * \text{AGERET} + \beta_4 \text{TENURE} + \beta_5 \text{LnMVE} + \beta_6 \text{MB} + \beta_7 \text{ROA} + \beta_8 \text{BIG4} + \beta_9 \text{BLOCK} + \beta_{10} \text{GROWTH} + \beta_{11} \text{FIN} + \beta_{12} \text{COAGE} + \beta_{13} \text{LOSS} + \beta_{14} \text{EPR} + \beta_{15} \text{ACIND} + \beta_{16} \text{ACSI} + \epsilon$$

**SURPRISE** is a dependent variable and equal to the earnings forecast error. It is obtained by the difference between the earnings forecast and actual earnings.

**AGE** is equal to tenure duration of the chairman of the board.

**AGERET** is a nominal variable. If the tenure duration of the chairman of the board is more than mean, the **AGERET** is 1 and, otherwise, it is equal to zero.

**TENURE** is a nominal variable. If there is a turning in the chairman of the board, the **TENURE** is 1 and, otherwise, it is equal to zero.

**LnMVE** is the natural logarithm of the price per share at year end.

**MB** is the ratio of market value to book value of equity.

**ROA** is the return rate of assets which is obtained by dividing the net profit by total assets.

**BIG4** is a nominal variable. If the independent auditor is the audit organization, **BIG4** is 1 and, otherwise, it is equal to zero.

**BLOCK** is the share percent of major shareholders, more than 5%.

**GROWTH** is the rate of sales growth which is obtained by the difference between this year and last year's sales divided by last year's sales.

**FIN** is the total funds resulting from the issuance of stock and long-term loans.

**COAGE** is the firm age.

**LOSS** is a nominal variable. If the company reports losses, it is 1 and, otherwise, it is equal to zero.

**EPR** is the ratio of earnings to cost which is equal to earnings divided by the market price at end of year.

**ACIND** is a nominal variable. If the company has an outside manager, it is 1 and, otherwise, it is equal to zero.

**ACSIZE** is the ratio of outside managers on the board.

To test the second hypothesis, the following model is used:

$$\text{RESTATE} = \beta_0 + \beta_1 \text{AGE} + \beta_2 \text{AGERET} + \beta_3 \text{AGE} * \text{AGERET} + \beta_4 \text{TENURE} + \beta_5 \text{LnMVE} + \beta_6 \text{MB} + \beta_7 \text{ROA} + \beta_8 \text{BIG4} + \beta_9 \text{INSPCT} + \beta_{10} \text{GROWTH} + \beta_{11} \text{FIN} + \beta_{12} \text{COAGE} + \beta_{13} \text{EPR} + \beta_{14} \text{MW} + \beta_{15} \text{BLOCK} + \beta_{16} \text{ACIND} + \beta_{17} \text{ACSIZE} + \beta_{18} \text{BDSIZE} + \epsilon$$

**RESTATE** is a nominal variable. If the assessment is acceptable, it is 1 and, otherwise, it is equal to zero.

**INSPCT** is the total percentage of shares in the hands of managers.

**BDSIZE** is the number of board members.

#### 4. Results

##### Infrastructural test

Before testing the hypotheses, the reliability of the variables was tested by Im & Pesaran and Shin test. The results showed that the variables have the needed reliability. To check the consistency of the variance models, ARCH test was employed. The results showed that the research models have the same variance. The test results of the combined data showed that the joint effects test was used in the first model and the fixed effects test was used in the second model.

#### Test models

##### The first model testing

**First hypothesis:** the companies with longer management tenure duration have more accurate earnings forecast.

**HO:** the companies with longer management tenure duration do not have more accurate earnings forecast.

**H1:** the companies with longer management tenure duration have more accurate earnings forecast.

The results show that F statistics and significance level indicates the significance of the model to test the hypotheses. Durbin-Watson test results indicate the absence of autocorrelation between the disruption sentences. In order to confirm or refute the hypothesis, the coefficient of the variable of AGE \* AGERET is used. If the above variable coefficient is positive and it is significant at the 5% error level, the above hypothesis will be confirmed and, otherwise, it will be rejected. The following table shows that the HO is rejected and H1 is confirmed. Among the research control variables, there is a significant relationship between the ratio of market value to book value of equity and the size of the board and earnings forecasts error (difference between the earnings forecast and actual earnings).

**Table (1). The first model testing results**

Prob.	t-Statistic	Coefficient	Variable
0.65	0.44	0.08	C
0.000*	-3.22	-0.01	AGE
0.11	-1.57	-0.08	AGERET
0.000*	3.66	0.02	AGE*AGERET
0.72	0.35	0.07	TENURE
0.51	0.66	0.02	LN MVE
0.000*	4.41	0.001	MB
0.88	0.15	0.01	ROA
0.51	-0.66	-0.02	BIG
0.71	-0.38	-0.05	BLOCK
0.68	-0.41	-0.005	GROWTH
0.31	1.02	0.09	FIN
0.52	-0.63	-0.002	COAGE

0.81	-0.24	-0.006	LOSS
0.000*	4.41	0.02	EPR
0.21	-1.26	-0.11	ACIND
0.04*.	2.02	0.22	ACSIZE
0.21			Adjusted R-squared
2.49			F-statistic
0.000			Prob(F-statistic)
2.44			D.W

**The second model testing**

**Second hypothesis:** the companies with longer management tenure duration have acceptable assessment for their financial statements.

HO: the companies with longer management tenure duration do not have acceptable assessment for their financial statements.

H1: the companies with longer management tenure duration have acceptable assessment for their financial statements.

The results show that F statistics and significance level indicates the significance of the model to test the hypotheses. Durbin-Watson test results indicate the absence of autocorrelation between the disruption sentences. In order to confirm or refute

the hypothesis, the coefficient of the variable of AGE \* AGERET is used. If the above variable coefficient is positive and it is significant at the 5% error level, the above hypothesis will be confirmed and, otherwise, it will be rejected. The following table shows that the HO is confirmed and H1 is rejected. Given the obtained result, the second research hypothesis was rejected at the 5% error level. Among the research control variables, there is a significant relationship between the Market value of equity, the management ownership and funds caused by issuance of shares and loans and the audit assessment.

**Table (2). The second model testing results**

Prob.	t-Statistic	Coefficient	Variable
0.08	1.72	0.30	C
0.99	0.01	0.002	AGE
0.11	1.59	0.16	AGERET
0.23	-1.18	-0.03	AGE*AGERET
0.32	-0.97	-0.04	TENURE
0.54	0.61	0.03	LN MVE
0.85	-0.14	-0.001	MB
0.44	0.74	0.11	ROA
0.45	-0.75	-0.04	BIG
0.04*.	2.11	0.26	INSPACT
0.69	-0.45	-0.004	GROWTH
0.000*.	3.56	0.06	FIN
0.21	-1.27	-0.01	COAGE
0.000*.	3.08	0.12	EPR
0.000*	3.28	0.04	MW
0.57	0.56	0.07	BLOCK
0.38	0.89	-0.08	ACIND
0.21	1.21	0.12	ACSIZE

0.000*.	3.02	0.11	ACSIZE
0.11			Adjusted R-squared
13.04			F-statistic
0.000			Prob(F-statistic)
1.73			D.W

**5. Discussion and Conclusions**

The purpose of this study is to investigate the relationships between the tenure of the chairman of the board and the quality of the financial reporting of listed companies in Tehran Stock Exchange. Given the purpose of the survey and its limitations, 97 companies were selected for the period of 1386 to 1391. Before testing the hypotheses, the overall characteristics of research variables have been described. The results of the combined data selecting test indicated that the manager with longer tenure duration has more accurate predicted profits. The obtained results were corresponded to the results of Hong et al (2012). The companies with longer management tenure duration do not have acceptable assessment for their financial statements. This result contradicts the results of Hong et al (2012).

**6. Applied suggestions**

According to the research results, the companies with longer management tenure duration have more accurate earnings forecast. Using the accounting profit, users of financial statements can evaluate the ability of an entity to generate cash, time and certainty of its generation. Using the profit, they can predict the amount, time and certainty of cash generation compared to cash flows. Accounting profit is one of the items of financial statements which plays an important role users of the financial statements. It helps them to make reasonable and appropriate decisions. Therefore, given the importance of profits and their prediction, it is recommended to investors and those interested in profits to focus on companies with longer management tenure duration.

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