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ORIGINAL ARTICLE

RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND PROFIT QUALITY IN BANKS LISTED IN TEHRAN'SSTOCK EXCHANGE

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ABSTRACT: As it stands, corporate governance has been emerged as an efficient approach to improve quality of financial reporting. Experimental research results showed that desirable governance corporate leads to increased quality of profit. The aim of present research is to evaluate effect of corporate governance on profit quality in banks listed in Tehran Stock Exchange (TSE) from 2008 to 2011. The major corporate governance mechanisms discussed here included percent of institutional shareholders ownership, present of non-accountable managers, the absence of the CEO as chairman, presence of independent accountant as well as number chairman sessions. Hypothesis testing was carried out using panel analysis and data from 10 aforementioned banks through integrating cross-sectional and time series data. Results indicated that there were no significant correlation between institutional stockholders to profit quality, non-accountable managers in chairman to profit stability, institutional stockholders to accruals quality and finally non-accountable managers to accruals quality. At the same time, significant relationship was reported to be between absence of manager as chairman and profit stability, internal accountants and profit stability, number of chairman sessions and profit stability, absence of manager as chairman and accruals quality, number of chairman sessions and accruals quality and internal accountants and accruals quality among others.

KEYWORDS: corporate governance, profit quality, institutional stockholders, accruals quality, profit stability

INTRODUCTION

Stocks companies have been emerged as one of the biggest economical resolutions and the most determinant factor in industrial breakthrough since 18th century. One of the main outcomes of stocks corporations was separation of ownership from management. Having been management and ownership segregated; subsequently some other issues emerged entailing for some owners and other unit's financial statements user's information as well. Among aforementioned information, data on profit was considered since users of financial statements use it in different ways. To achieve high profit quality, some mechanisms are required so that some countries have taken efforts to provide such mechanisms. These included appropriate governance corporate system in companies scale and economical institutions improved by some countries (Hasasyeganeh, 2005a).

Recently, enormous advances have been achieved on corporate governance in global scale. Literatures indicate that there are wide varieties of methods to define corporate governance. Compared to different theoretical attitudes, such methods ranged from limited definitions on companies and their stockholders to comprehensive ones including company's accountability to all stakeholders. Nonetheless, generally, corporate governance is defined as associations among different groups to determine company's performance and objective. According to above definition, it can be note that one of the main tasks undertaken by corporate governance is to assuring stockholders, investors and other users of financial statements on companies finance reporting quality and corporate governance mechanisms and structures. Hence, the present research was conducted to shed more light on corporate governance and ways to achieve much more profit quality.

THEORETICAL FRAMEWORK

Corporate governance is limited to association between company and stockholders in local scale. It is a traditional pattern expressed in agency theory framework. On the other hand, corporate governance can be seen as a set of relationships not only exist between companies and owners (stockholders), but also between a

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company and too many stakeholders including: staffs, customers, sellers, stock exchange members and so on. Such attitude can be seen in stakeholder's agency framework.

Some definitions are as follows:

A system by which companies works correctly (Hasasyeganeh, 2005b) or corporate governance is process of stewardship and control to warrant that company manager acts forward to stockholders profits. (Hasasyeganeh, 2005c) relationship between stockholders and their companies and an approach by which managers are encouraged to do best (for example through polling in public institutions and regular meeting to companies superintends), they provide structures, processes and systems for successful institution performance. According to documents, tools by which, every institution controls company's direction or corporate governance is served as relationships among different groups to determine company's performance. The main stakeholder groups included stockholders, manager and chairman, staffs, customers and associations. Monkezonel pointed out that corporate governance is set of rules, institutions and method determining how companies are managed and who take profits on them. According to Makinesonne, corporate governance is not related to company's operations management but also it deals with governing economical institutions, stewards' executional operations as well as their accountability to all stakeholders (Hasasyeganeh and Yazdanian, 2011). Given to above definitions, it can be concluded that corporate governance provides a framework by which companies objectives and tools to chive them as well as ways of stewardship on managers performance can be clarified.

2.1. Reasons for establishing corporate governance in banks and financial institutions

Banks provide a unique opportunity to develop economical financial system as well as economic development stimuli and financial source for companies. Most of developing economies, have been specialized their banking system, in turn empowering bank managers to large extent (Hasasyeganeh, 2008).

2.2. The main corporate governance criteria considered in the present research are as follow

Institutional stockholders, non-accountable managers in chairman, absence of company's manager as chairman, internal accountant and number of chairman meetings.

2.2.1. Institutional stockholders

They involve insurance companies, banks, retiring deposit, common saving deposit of investing and investor companies (Dey, 2005). In wide ownership structured countries like England and US, institutional stockholders have great deal of contributions in controlling company's activities. Those institutional stockholders, who are skilled investors with much asset and wealth, tend to obtain and use valuable and on time data to predict future companies profitability and explore profit management compared to others. So they are able to prevent some managers activates and policies to use opportunistic profit management. Stockholders play a controlling role to force managers to behave so that company not subjected to damages in long term (Bushman and Smith, 2001).

2.2.2. Non-accountable managers

Agency theorists advocate increased independency of chairman from managers and insist that chairman should be dedicated for non-accountable managers and opportunity behaviours of managers must be controlled by non-executional managers. Non-accountable manger is part-time member of chairman with no executional responsibilities in companies and has following qualifications: 1-does not stockholder for company or its tributaries, 2- he or she should not involve in managing company3- he or she must not companies console or employee 4- having financial direct or indirect profit on company and its tributaries and 5- no relativity to managers and stockholders. The previous research indicated that presence of non-accountable members in chairman stops profit management activities to large extent (Aghaee and Chlaki, 2009).

2.2.3. Absence of director as chairman

Karami *et al.*, (2006) reported that a balance should be between chairman members to prevent some non-conditional control of decision making process. As well, responsibilities and tasks must be specified in high level of company to assure power balance and empowerment of chairman members. Absence of company manager plays substantial role in efficiency of chairman performance (Baek *et al.*, 2004).

2.3. Internal Accounting

Various researches implied that internal accountants involve in both strategically and traditional aspects of corporate governance, however, both aforementioned roles, result in improving financial reporting quality. Governance corporate emphasizes on internal accounting system, accounting committee and independent accounting execution and at the same time it has been found that relationship between managers and independents accountants forms via accounting committee and non-accountable managers (Mashayekhi *et al.*, 2005).

2.4. Profit quality

Although accounting staffs should take some impartial and conservative approaches, in practice, completive motivations affect selecting procedures management and accounting estimations. That's why; somecompanies manipulate accounting data to meet management demands. It means that while presenting financial results, companies apply profit management techniques (under- or overestimation). Hence, to identify some companies which do not report their real profit is became a main challenge (Karami *et al.*, 2006). Moradzadehfard *et al.*, (2009) reports that profit management occurs when managers apply their subjective judgments in financial reporting and manipulate trading structure to change financial reporting.

2.5. Profit quality measures

Since there is no comprehensive definition on profit quality, so there is no the same measure too. Therefore, researchers have used various measures to assess this variable:

Profit stability and prediction potential, accredited items quality, profit smoothness, profit timing and conservativeness. As it was stated previously, the present research deals with profit stability and accruals quality. Following, these variables are described separately:

2.5.1. Profit stability

More stable profits might be outputs for impartial application of accounting standards in some economical mediums, whereas, in respect to some limitations, manager involvement in financial reporting can shows profits inherent instability as stable profits (Nikomaram and Fathi, 2011).

2.5.2. Accruals quality

Accruals items can be separated into optional and non- optional components:

Accruals optional components are those which can control by management.

Accruals non-optional components are those not affected by management.

So, since some accruals are not exposed to manipulation and are constant, change in accruals represent management manipulation rate, providing inverse measure on profit quality (Foroughi and Nushin, 2009).

LITERATURE REVIEW

Richardson *et al.*, (2001) concluded that accruals data on profit quality is not concentrated on a given part of them (e.g. current accruals). Xie 2001 showed that abnormal accruals are less stable than normal ones, in turn are less stable compared to operational cash flow. Francis *et al.*, (2005) provides some evidences, suggesting positive relationship between pricing, profitability patterns and profit quality. He evaluated relation between stocks barrowing sale and profit quality and concluded that those people sale stocks in barrowing manner, would not take considerable advantages in accruals information on future profit.

Chan *et al.*, (2001) dealt with profit quality information content association to stocks future profitability and concluded that accruals negatively related to future stocks profitability. Ball &Shiva Kumar concluded that non-stock companies have less profit quality compared to others due to less demands for financial reporting. Siegel, (1982) studied profit quality and profit response coefficient while stable increasing of profit. Results showed that those companies with higher profit and sale, had higher profit quality and response coefficient than those with higher profit as well as reduced costs. Penman and Zhang, (2002) investigated factors affecting less profit quality in 1990s. Two measures of optional accruals and profit response coefficient were used to assess profit quality. Results clearly showed that optional accruals and profit response coefficient imply to less profit quality during study period. Logie tested profit quality considering conceptual framework of financial accounting standards in to account and concluded that companies profit quality is improved when theirinstitutional ownership is increased. In that case, items and components of companies profit will be more reliable. Following hypothesis were assumed in the present study:

3.1. Main hypothesis

There is significant relation between corporate governance and profit quality in banks accepted in Tehran stock exchange

3.2. Secondary hypothesis A

A.1. there is significant relationship between institutional stockholders and profit stability

A.2. there is significant relationship between non0resposible managers in chairman and profit stability

A.3. there is significant relationship between chairman and profit quality
A.4. there is significant relationship between internal accountant and profit quality
A.5. there is significant relationship between chairman session and profit quality

3.3. Secondary hypothesis B
B.1. there is significant relationship between institutional stockholders and accruals quality
B.2. there is significant relationship between non- responsible mangers in chairman and accruals quality
B.3. there is sign cant relation between chairman and accruals quality
B.4. there is significant relationship between internal accounting and accruals quality
B.5. there is significant relationship between chairman meeting and accrual quality.

METHODOLOGY

The present research is applied research in terms of objective and is descriptive-analytic one in terms of data collection since statistical analysis conducted while describing variables of interest using tables and statically indices.

4.1. Research scale
4.1.1. Subjective scale
To evaluate relationship between some corporate governance mechanisms (institutional stockholders, non-accountable manager in chairman, absence of chairman, internal accountant and number of chairman session) to two determinate factors of profit quality (profit quality and accruals quality) in banks accepted in Tehran's stock exchange.

4.1.2. Spatial scale
Statically population in the present thesis is all banks accepted in Tehran's stock exchange.

4.1.3. Temporal scale
Statistics are related to aforementioned banks during years 2008 to 2011.

4.2. Data collection method
Data involves financial statements items extracted from financial statements texts and explanatory notes.
Data in operational profit and cash flow were obtained from Tadbirpardaz comprehensive and Rahavard database as well as stock website and evaluating companies finical reports including balance sheet, profit and loss statement and cash flow statement.
Data involving number of non-responsible managers and manager's separation from chairman were collected from company's decisions and others database from stock exchange institution.

4.3. Sampling method
Available data are the main prerequisite to select statically community, as we know, at present; all data and information on companies accepted in Tehran's stock exchange are available. So statistical community in the present research is banks accepted in Tehran's stock exchange. The elected banks had following conditions:

1- Before 2007 were accepted in stock to homogenize statistical communities.
2- They ended into March to improve comparability of their financial period
3- They had not losses during study periods
4- Without no fiscal year change
5- Their data were available

Table1: banks selected for study

Sign	Bank name
V-post	Iranian Post bank
V-bsader	Iranian Saderat bank
V-pars	Persian bank
V-sina	Sina bank
V-novin	Eghtesadnovin Bank
V-kar	Karafarin Bank
V.ansar	Ansar bank
V-tejarat	Tejarat bank
V-bmelat	Melat bank
V-parar	Pasargad bank

4.4. Measuring research variables
4.4.1. Profit quality measures
Given to difficulty of profit quality definition, researchers have been used various criteria to measure this variable. It has been applied in two following manner:

4.4.1.1. Accruals quality
Accruals quality was measured according to Mc Nicolas pattern.

$$\Delta wc_t = b_0 + b_1 CFO_{t-1} + b_3 CFO_{t+1} + b_4 \Delta sales_t + b_5 PPE_t + \alpha_t$$

Where, Δwc_t represents asset change in year t compared to previous year, CFO_t is operational cahs flow for year t, $\Delta sales_t$ is change in sale for year t compard to previous year and PPE_t is equipment for year t.

4.4.1.2. Profit stability
Profit stability is quantified based on coefficients obtained by fitting current year profit regression on previous year profit. So there is an operational definition for it. Following model has been used to calculate profit stability.

$$\frac{EARN_{i,t}}{TA_{i,t-1}} = \lambda_0 + \lambda_1 \frac{EARN_{i,t-1}}{TA_{i,t-1}} + \varepsilon_{i,t}$$

Where EARN represents net profit of accredited items divided by total assets in early period of TA. $\varepsilon_{i,t}$ is estimation error by fitting regression model. Values close or up to one denote to higher profit stability, while those close to zero indicates profit instability. Stable profits are superior to instable ones thanks to their much predictability. Independent variable in the present research is corporate governance measured according to institutional stockholders, non-responsible managers, and absence of chairman, internal accounting and number of chairman meetings. Following procedure has been adopted on corporate governance variables:

In case of more non-responsible members to total members ratio, the calculated ratio for all banks is zero, otherwise it taken to be 1. In case of no internal accountant, value zero and otherwise 1 are taken. In case of less percent of institutional stockholders ownership than total mean, zero and otherwise 1 are considered. In case of the same ratio of chairman and manger, value zero and otherwise 1 are considered.

4.5. Data analysis

Table (2) shows summary on variables descriptive statistics. In following table, mean and medium are central indices.

Table 2: summary of data descriptive statistics

Number of chairman's sessions	Institutional stockholders	Non-responsible managers	Absence of director as chairman	Internal accountants	Accrual's quality	Profit quality	
10	10	10	10	10	10	10	number
10.72	0.39	0.501	0.62	0.64	0.043	0.47	mean
10.28	0.33	0.540	0.53	0.37	0.046	0.42	median
8	0	0	0	0	0.020	0.17	min
15	1	1	1	1	0.060	0.47	max
0.053	0.019	0.013	0.047	0.032	0.013	0.027	Sd

4.6. Normalization of dependent variable distribution

H0: data for dependent variable follow normal distribution

H1: data for dependent variable do not follow normal distribution

Table 3: results of kolomogrove- Simonov test

Number	10
Normal mean	17720
Standard deviation	80726
Difference	0.432
Positive	0.432
Negative	-0.279
kolomogrove- Simonov statistic	1.25
Significance level	0.308

Given to results (0.05<0.308) null hypothesis is not rejected and so data follow normal distribution.

Hypothesis A: the first model using regression analysis

Here, the first hypothesis is analysed by regression model. Model is following:

$y_t = \alpha_0 + \sum_{k=1}^{k} \alpha_k (X_k) + \varepsilon_t$

Y= profit stability

X1=institutional stockholders

X2=presence of non-responsible managers in chairman

X3= absence of director as chairman

X4=internal accountants

X5=number of chairman's meetings

Table4: Hypothesis A regression analysis

statistics DW	P-VALUE	statistics F	R^2	R^2	p-value	statistics t	coefficients	variable
					0.01	9.35	23.64	Constant
					0.01	1.854	0.0042	X1
1.87	0.01	4.44	0. 654	0.717	0.03	2.048	1.462	X2
					0.58	-1.941	12.39	X3
					0.01	2.417	2.697	X4
					0.001	1.89	2.14	X5

Significance level of F equals to 0.01 and less than 0.05, so it is significant. Coefficient of determination value is about 0.654 and it is expressed as 65.4% of dependent variables variations (profit quality). Dorbib-Watson statistics vary 1.5 to 2.5, indicting no autocorrelation between residues. According to obtained results, model is rewritten as following:

$y_t=0.0042x_1+1.46x_2+2.697x_4+2.14x_5+23.61$

Hypothesis B: the second model using regression analysis

Here, the second hypothesis regression analysis is presented. Model is as follow:

$y_t = \alpha_0 + \sum_{k=1}^{k} \alpha_k (X_k) + \varepsilon_t$

Y=accruals quality

X1=institutional stockholders

X2=presence of non-responsible managers in chairman
X3= absence of director as chairman
X4=internal accountants
X5=number of chairman's meetings

Table 5: Hypothesis B regression analysis

statistic DW	P-VALUE	statistic F	R2adjusted	R2	p-value	statistic	coefficient	variable
					0.01	8.11	21.34	Constant
					0.01	1.36	3.21	X1
2.03	0.01	4.18	0. 636	0.689	0.03	3.012	2.15	X2
					0.58	1.74	4.63	X3
					0.01	1.96	2.38	X4
					0.001	1.64	2.27	X5

Significance level of F equals to 0.26 and is not less than 0.05, so it is not significant. Coefficient of determination value is about 0.636 and it is expressed as 63.6% of dependent variables variations (profit quality). Dorbin-Watson statistics vary 1.5 to 2.5, indicting no autocorrelation between residues. According to obtained results, model is rewritten as following: .y_t=3.215x_1+1.46x_2+2.697x_4+23.61

RESEACH ANALYSIS AND INTERPRETATION

Two main hypothesis were evaluated in the present research of which 5 one secondary. Of course it is worthy to note that to the best of our knowledge, most of researches in Iran have been conducted in companies accepted in stocks, however, the present research was conducted in bank system.

Table 6: results and similar researches on hypothesis

Similar research	Result	Hypothesis	Row
Esmaeilzadeh, (2014) and Chang, (2008) confirmed this hypothesis	rejected	there is significant relationship between institutional stockholders and profit stability	Secondary hypothesis 1-1
Esmaeilzadeh, (2014) confirmed this hypothesis and baek et al., (2004) rejected it.	rejected	there is significant relationship between non0resposible managers in chairman and profit stability	Secondary hypothesis 2-1
Esmaeilzadeh, (2014), confirmed this hypothesis, but Mashayekhi *et al.*, (2005) and Mayoral and Sánchez-Segura, (2008) rejected it.	accepted	there is significant relationship between chairman and profit quality	Secondary hypothesis 3-1
Hasasyeganeh and Yazdanian, (2011) rejected the hypothesis.	accepted	- there is significant relationship between internal accountant and profit quality	Secondary hypothesis 4-1
Mashayekhi *et al.*, (2005) accepted it and Garcia et al., (2009) rejected it.	accepted	there is significant relationship between chairman session and profit quality Secondary hypothesis	Secondary hypothesis 5-1
Esmaeilzadeh, (2014) and Jiang *et al.*, (2008) accepted it.	rejected	there is significant relationship between institutional stockholders and accruals quality	Secondary hypothesis 6-1
Esmaeilzadeh, (2014) and Mashayekhi *et al.*, (2005) accepted hypothesis	rejected	there is significant relationship between non-responsible mangers in chairman and accruals quality	Secondary hypothesis 7-1
Mehrani and Safarzadeh, (2011) and Jiang *et al.*, (2008) rejected it.	accepted	- there is significant relation between chairman and accruals quality	Secondary hypothesis 8-1
Mehrani and Safarzadeh, (2011) and Jiang *et al.*, (2008) rejected it, but Mashayekhi *et al.*, (2005) accepted it.	accepted	- there is significant relationship between internal accounting and accruals quality	Secondary hypothesis 9-1
Mashayekhi *et al.*, (2005) accepted it.	accepted	- There is significant relationship between chairman meeting and accruals quality.	Secondary hypothesis 10-1

SUGGESTIONS

Given to hypothesis 1-2 and 1-1, it seems that non-responsible managers and institutional stockholders as two corporate governance mechanisms have no substantial role in profit quality. Policy makers must be care that just non-responsible members are not sufficient. Stewardship and governance tools should reduce some conflictions between stockholders and managers.

1- given to hypothesis 1-1, institutional stockholders must involve more actively helping integrating mangers and stockholders. Users of financial statements must care that presence of sufficient number of non-responsible managers in chairman or institutions ownership percent does not provide sufficient data on profit quality.
2- Necessity for disclosing more data and information via note and other tools to

assuring financial statements users to achieve reliable information

3- In respect to hypothesis 1-4 and 1-8, to evaluate role of accounting and stewardships mechanism and giving more detail data on profit quality and assess role of agency theory and contracts theory while publish9ng financial reporting.

4- To encourage financial analyzer, financial stockholders to shed more light in financial data quality and transparency.

5- According to role of no responsible members in governance corporate, it is recommended that stockholders and chairman members be acquainted to these members stewardship function to play more efficient role in corporate governance and doing their task on forming associate committee (accounting, appointments) and to report some profit stability and quality and etc.

6- According to hypothesis 1-1 and 1-6, major contribution of banks stock is dedicated or private and seme-private institutions and on the other hand, markets are validated in less scale. So it is recommended to specialization polices and concede private stock to improve profit quality.

7- To use results of the present research in approving corporate governance in Tehran's stock exchange

8- According to hypothesis 1-2 and 1-7, it was stated that generally, companies not only are accountable to stockholders and others shareholders, but also to society. So to assure reliable accountability of economic institutions against public and private sections, sufficient stewardship must be taken. This entails for appropriate mechanisms. Among them, to design and execute suitable corporate governance in financial companies and institutions. So it is recommend that policy makers taken this into account while approving new rules.

FUTURE STUDY PERSPECTIVE

- To identify variables affecting companies' profits and different aspects of corporate governance in others financial institutions
- To use much more data or methodology in future studies
- To evaluate relationship between profit quality and different components of accounting including non-accounting services fee
- To evaluate relationship between corporate governance system and profit management as well as profit smoothness
- To evaluate others corporate governance aspects like accounting committee, legal stewardship, internal controls
- To assess effect of other factors related to institutional stockholders such as type of institutional stockholders, ownership longevity

RESEARCH LIMITATIONS

As a whole, a scientific research entails for reasonable and regular suspicion so that researcher must see results in critical manner. In other world, the world we taken to study is not basally flawed or flawless. The main limitations for the present research were as follow:

1- Effect of external factors and variables is unavoidable and research results may affected by them like political conditions, stock market condition, managers experience and education level.

2- Lake of access to bank databases due to data deficiency

3- Time period considered for the present research is one of the factor can limits generalizations.

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