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STUDYING THE RELATIONSHIP BETWEEN ISSUING ACCEPTABLE AUDITING REPORT WITH A CORPORATE GOVERNANCE SYSTEM AND BOARD OF DIRECTORS' CHARACTERISTICS IN ELECTRICITY DISTRIBUTION COMPANIES IN IRAN

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ABSTRACT

In this research the relationship between issuing acceptable reports of auditing with a corporate governance system and the characteristics of board of directors in electricity distribution companies in Iran (depending on the base company of Tavanir) was investigated. To do so, active companies in electricity distribution industry were studied for the period between 2008 and 2012. Independent variables of this research included: 1- educational degrees of board of directors' members, 2- educational majors of board members, 3- accounting conservatism, 4- employers' rank, and 5- size of board of directors. The dependent variable for this research was acceptable auditing report. Our statistical sample included 34 companies from among those electricity distributing companies and the data gathered to study the research hypotheses were analyzed by Eviews software and in the form of logistic regression. Results of investigations showed that 3 elements mentioned (educational majors of board members, employers' rank, and size of board of directors) have had a meaningful relationship with acceptable auditing reports. But the constituents of: educational degrees of board of directors' members, and accounting conservatism did not have any meaningful relationship with acceptable auditing reports.

KEYWORDS

corporate governance system, board of directors' characteristics, acceptable auditing reports.

INTRODUCTION

Without any doubts auditing is an assuring process about reliability and relatedness of information in financial statements. The existence of controversy between the benefits of stockholders and managers renders a specific importance to an audit to remove this controversy. Auditing, as an efficient mechanism, assures the stockholders that whether managers have acted to the benefit of stockholders' or not. Thus, the use of auditing is to assure stockholders and other beneficiaries who have contracts with the company (Walker, 2003). Since reports of auditors are considered as useful information in the process of making decisions by financial statements' users, the goal of this research is first to recognize and investigate effective factors in issuing acceptable auditing reports in electricity distributing firms during a 5 years time period and then to devise and suggest a pattern to identify it. The importance of this research is due to the fact that it tries to show experimentally to formal auditors' assembly, financial analysts, investors, and other users of accounting information that managers in business units permanently try to show their performance to be positive through the receipt of acceptable auditing reports. Electricity industry is a dynamic and effective one due to its fundamental role and its relations with all factors affecting economic growth. Due to the broad spread of electricity energy we can consider it as one of the main factors setting the backgrounds for economic development in the country. Electricity industry is divided into three main parts of: production, distribution, and transfer and each of them is important in its own place. Regarding accounting approaches electricity companies need audited financial statements to collect their claims in time because they have a key role in optimal energy use and are among some limited resources and the audited financial statements of these companies are left to users (especially contractors) who get the responsibility of administrative equipments of electricity in planning and to absorb their trust. Also this issue is fundamentally important due to the future plans to cede stocks of electricity distributing companies. Also different strategies have been posed in financial literature to reduce agency problem and one of the most important issues in this regard is firm's corporate governance system. Firm's corporate governance system is the process of supervising and controlling firm's management to get confidence about the convergence of their performances with stockholders' benefits and the most important elements related to it are: stockholders and their ownership type, members of board of directors and its composition, and ...

RESEARCH LITERATURE

RESEARCH CARRIED OUT IN IRAN

Vahidi & et al (2009) found out in their studies about withdrawals of internal and independent auditors and the efficiency of alarm signs in discovering fraudulent financial reporting that there is not a main difference between withdrawal of internal and independent auditors. Also they showed that experience amount and job rank are effective in withdrawals of internal auditors regarding the efficiency of alarms. However, these two variables were not effective regarding independent auditors.

Abbaszadeh & Manzarzadeh (2011) showed that there is a negative and meaningful relationship between increasing the members of board of directors and acceptable auditing reports and there is a positive and meaningful relationship between increasing ownership ratio and acceptable auditing reports. Lack of changes in members of board of directors in current year compared to the previous year affects acceptable auditing reports negatively and meaningfully. There is a positive and meaningful relationship between increasing the ratio of market value to book value of owners' equity and acceptable auditing reports. There is a negative and meaningful relationship between changing audits in current year compared to the previous year and acceptable auditing reports. Also there is a positive and meaningful relationship between increasing assets' return rate and acceptable auditing reports.

Bahman Banimahd (2012) showed in his research that the probability of issuing an acceptable auditing report varies affected by: ownership change, auditing privatization, opinion expression phenomenon, changing audit from one private auditing entity into another private auditing entity, and firm size, respectively. From among the variables mentioned above, all variables except firm size audited by an auditor have a direct relationship with the probability of issuing an independent acceptable auditing report.

FOREIGN RESEARCHES

Pivot & Missioner (2007) studied the relationship between corporate governance, auditing quality, and financing cost through debt in France. They claimed that financing system in France enforces the use of debt approach and banks and other financial institutions have little direct effects on corporate governance system and thus they tend to have a better supervision system and financial reporting quality. They used aggregate data of French companies between 1999 and 2001 and concluded that corporate governance quality has an important regressive effect on debt cost but auditing quality does not have this regressive relationship. Chen & et al (2010) found out in a study in China that by merging a Chinese auditing company with one of big auditing entities (Ernst Wiong's institution) 30 employers out of 46 employers of this Chinese auditing entity changed their auditor and selected smaller auditing entities as their auditors. They showed that the incentive of 30 companies in changing auditors was to receive acceptable auditing report against low quality of auditing. Based on the results gained competition in auditing can reduce auditing quality.

Fafatas (2010) studied audit's conservatism after bankruptcy of auditing entities in his research. He found out that after the rule Sarbenz-Axely was approved, the conservatism of auditors after bankruptcy of some auditing entities has increased. His research findings approved that using conservative accounting approaches has increased among the employers of these entities and in other words, auditors have enforced the use of these approaches for their employers.

RESEARCH GOALS

The main goal of this research is to study the relationship between issuing acceptable auditing report and characteristics of board of directors in electricity distribution companies in Iran (depending on base professional company of Tavanir) through hypotheses utilized in the research. Also the ideal goal of this research is to step forwards to reduce information asymmetry and try to present transparent, related, and reliable information for the users on the part of suppliers to let investors and creditors to be able to analyze financial reports of companies in a more conscious way in order to make decisions. In this way they can analyze financial statements that have had acceptable auditing reports with a broader outlook (regarding the consideration of independent research variables here) and make more appropriate decisions.

RESEARCHES METHODOLOGY

The present research is post incidental regarding time which deals with financial data of the company in the past and studies hypotheses. Also it is applied regarding the nature of its goal and the results gained could be used directly in decision makings by the users. Research data are of aggregate data and in order to discover the relationship between two variables we have used a correlation method by using logistic regression model. Information in this research include data gained from financial reports and data and information about electricity distributing companies which have been estimated based on research models to devise a base for testing hypotheses. Raw data needed about companies in order to study research hypotheses were collected directly and face to face through studying financial statements of electricity distributing companies and after comparing and removing lack of frequent harmonies and transferring into Excel broadsheet were transmitted into Eviews7 software for final analysis.

The statistical population for this research includes all electricity distributing companies during the time period between 2008 and 2012. Of course, the following limitations were observed in order to collect data through the statistical society to form our research sample:

- 1- Financial information needed and audited financial statements of firms should be complete and accessible.
- 2- Auditing report of companies should be acceptable or conditioned. We should have chosen two report types from among four ones as: acceptable, conditioned, lack of opinion expression, and rejection. This was due to the selection of binary logistic regression model to analyze data.

Regarding the limitations above, our research sample entailed 34 electricity distributing companies (depending on base professional company of Tavanir).

RESEARCHES HYPOTHESIS

H1: There is a meaningful relationship between educational levels of board of directors and acceptable auditing reports.

H2: There is a meaningful relationship between study majors of board of directors and acceptable auditing reports.

H3: There is a meaningful relationship between accounting conservatism and acceptable auditing reports.

H4: There is a meaningful relationship between employer's rank and acceptable auditing reports.

H5: There is a meaningful relationship between size of board of directors and acceptable auditing reports.

INDEPENDENT VARIABLE

Independent variables in this research include: 1- knowledge of board of directors, 2- educational majors of board of directors, 3- accounting conservatism, 4- employer's rank, and 5- size of board of directors. The methods to calculate each of these variables are described below:

- 1- **Knowledge of board of directors:** if at least two of the members of board of directors have got MA or higher educational degrees number 1 will be attributed and if not 0 will be attributed.
- 2- **Educational majors of board of directors:** if at least two of the members of board of directors have got educational degrees in financial and accounting fields, number 1 will be attributed and if not 0 will be attributed.
- 3- **Accounting conservatism:** to measure conservatism index we have used operational accruals' ratio to total assets of start of the period multiplied by -1 (Giluli & et al's model).
- 4- **Employer's rank:** employer's rank was measured by numbers (1, 2, 3, 4) and this ranking was carried out by Tavanir professional base company. In this ranking method 4 was the lowest rank while 1 was the highest.
- 5- **Size of board of directors:** number of members of board of directors at the end of fiscal year represents the size.

DEPENDENT RESEARCH VARIABLE

The dependent research variable here is acceptable auditing report. This variable is a virtual variable which was shown with 1 or 0. 1 represented acceptable auditing report while 0 was considered to show conditioned auditing report.

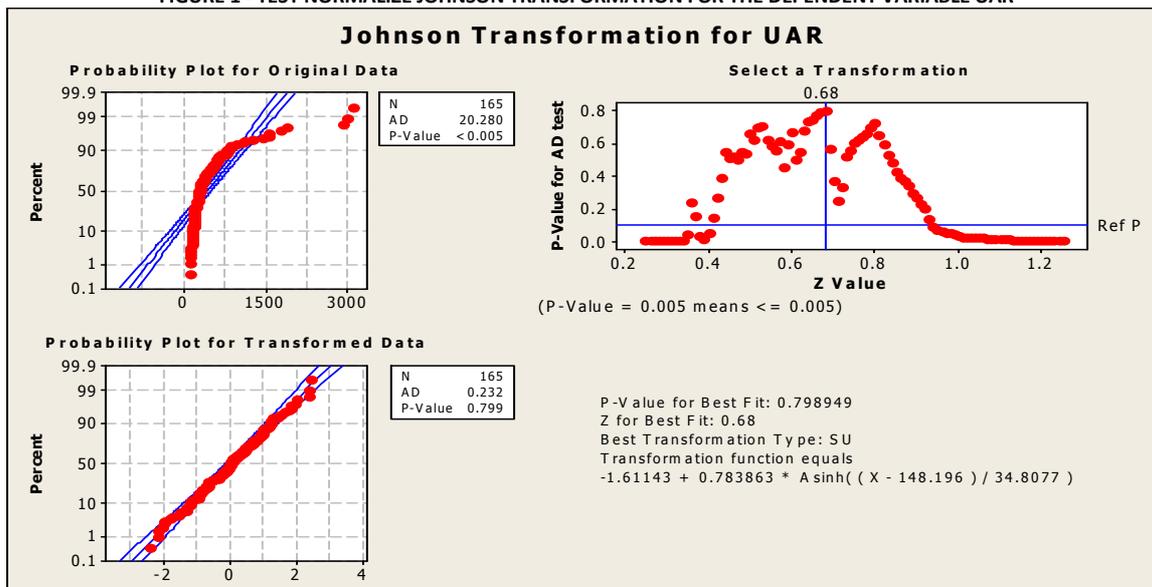
RESEARCH FINDINGS

In this part and in order to enter information analysis stage, the descriptive statistics of data including central indexes, dispersion indexes, and deviation from symmetry and also Jarque-Bera test which approve normal distribution of leftovers were calculated and results were represented in table 1.

TESTING DEPENDENT VARIABLE' NORMALITY

Since normality of data distribution was one of the presuppositions in regression model, first normality of the distribution of research variables was investigated and Jarque-Bera's test was utilized to do so. In order to test normality of dependent variable we also used a test. If the probability of statistics was less than %5 (prob. < 0.05), H_0 claiming that error sentence and dependent variable is normal will be rejected. Based on calculations estimated by Eviews7 software represented in table 1, all probabilities are equal to 0. Thus, null hypothesis is rejected and it was found that the distribution of data in variables were not normal. To normalize the dependent variable we use Johnson's transformation in Minitab software and the transformation function of dependent variables has been presented in figure (1). As it can be seen in figure (1), the probability of statistics of initial data was less than 0.005 (prob. < 0.05) and this showed that dependent variable was not normal. By normalizing data using Minitab software the probability of statistics increased to 0.864 for UAR variable. Thus, in this case H_0 regarding the normality of error sentence and dependent variable is approved.

FIGURE 1 - TEST NORMALIZE JOHNSON TRANSFORMATION FOR THE DEPENDENT VARIABLE UAR



Then we will try to describe tests carried out by Eviews software version 7.01.

CHOW TEST OR TEST OF STRUCTURAL CHANGES RELATED TO HYPOTHESES

In order to test research hypotheses first time fixed effects model was estimated and then to study about the meaningfulness difference we used structural changes test. This test is hypothesized in the following way to investigate about the existence of fixed effects:

- H₀: lack of existence of fixed effects ---- pooled model
- H₁: existence of fixed effects ---- fixed effects model

TABLE (1): RESULTS OF CHOW TEST RELATED TO RESEARCH HYPOTHESES

RESULTS OF CHOW				
Assumptions	Cross-sections	Statistics	Degrees of freedom	P-VALUE
first hypothesis	F-statistic	0.710254	(32,131)	0.8693
	Kai-do	26.398089	32	0.7457
second hypothesis	F-statistic	0.719784	(32,131)	0.8596
	Kai-do	26.725064	32	0.7307
third hypothesis	F-statistic	0.738162	(32,131)	0.8400
	Kai-do	27.353848	32	0.7009
fourth hypothesis	F-statistic	0.723131	(32,131)	0.8562
	Kai-do	26.839771	32	0.7253
fifth hypothesis	F-statistic	0.717293	(32,131)	0.8622
	Kai-do	26.639669	32	0.7346

As it can be seen, regarding the meaningfulness level gained in the hypothesis, latitudes from base are rejected. In this stage pooled model is selected as the preferred model for these hypotheses. The statistical method used in this research was binary logistic regression and we also used Logit method.

First hypothesis: There is a meaningful relationship between educational degrees of board of directors and acceptable auditing report.

UAR = β₀ + β₁BE

TABLE (2): RESULTS OF ESTIMATION GAINED FROM TESTING THE HYPOTHESIS USING LOGIT METHOD

Variables	Coefficient	Criterion deviation	t statistics	Meaningfulness
Fixed number	-0.287682	0.230283	-1.249254	0.2116
Educational degrees of board of directors	0.424258	0.314161	1.350446	0.1769
McFadden identification coefficient	0.008026	Average of dependent variable		0.484848
Criterion deviation of dependent variable	0.501292	Standard error of regression		0.500030
Akaikeh index	1.398499	The amount of residuals		40.75487
Shwarts index	1.436147	Likelihood of interruption		-113.3762
Hannan-Queen index	1.413782	Deviation		226.7523
Limited deviation	228.5870	Limited likelihood of interruption		-114.2935
LR statistics	1.834688	Average likelihood of interruption		-0.687128
LR statistics probability	0.175575			

Coefficients of regression model in figure 4-4 shows that in Logit method there is a positive relationship between educational degrees of board of directors and acceptable auditing report. This is not meaningful statistically and regarding McFadden identification coefficient (0.008), this relationship is weak. Also likelihood of interruption statistics shows that model is not meaningful on the whole. The positive relationship between these two variables showed that the educational degrees of board of directors affects acceptable auditing report but the weakness of this relationship showed that there are numerous factors other than educational degrees of board of directors which affect acceptable auditing report. It should be noted that McFadden identification coefficient is similar to ordinary regression identification coefficient.

Second hypothesis: There is a meaningful relationship between study majors of board of directors (accounting, financial management) and acceptable auditing report.

UAR = β₀ + β₁BF

TABLE (3): RESULTS OF ESTIMATION GAINED FROM TESTING THE HYPOTHESIS USING LOGIT METHOD

Variables	Coefficient	Criterion deviation	t statistics	Meanfulness
Fixed number	-0.552069	0.287984	-1.917013	0.0552
Educational majors of board of directors	0.711699	0.344324	2.066947	0.0387
McFadden identification coefficient	0.019171	Average of dependent variable		0.484848
Criterion deviation of dependent variable	0.501292	Standard error of regression		0.496172
Akaikeh index	1.383060	The amount of residuals		40.12849
Shwarts index	1.420708	Likelihood of interruption		-112.1024
Hannan-Queen index	1.398342	Deviation		224.2049
Limited deviation	228.5870	Limited likelihood of interruption		-114.2935
LR statistics	4.382176	Average likelihood of interruption		-0.679409
LR statistics probability	0.036317			

Coefficients of regression model in figure 4-5 shows that in Logit method there is a positive relationship between study majors of board of directors (accounting, financial management) and acceptable auditing report. This is not meaningful statistically and regarding McFadden identification coefficient (0.01), this relationship is weak. Also likelihood of interruption statistics shows that model is meaningful as a whole. The positive relationship between these two variables showed that study majors of board of directors (accounting, financial management) have a direct relationship with acceptable auditing report. This means that by increasing study majors of board of directors (accounting, financial management), acceptable auditing report will also increase and vice versa.

Third hypothesis: There is a meaningful relationship between accounting conservatism and acceptable auditing report.

$$UAR = \beta_0 + \beta_1AC$$

TABLE (4): RESULTS OF ESTIMATION GAINED FROM TESTING THE HYPOTHESIS USING LOGIT METHOD

Variables	Coefficient	Criterion deviation	t statistics	Meanfulness
Fixed number	-0.0648822	0.157447	-0.411704	0.6806
Accounting conservatism	-0.010756	0.058776	-0.182993	0.8548
McFadden identification coefficient	0.000148	Average of dependent variable		0.484848
Criterion deviation of dependent variable	0.501292	Standard error of regression		0.502777
Akaikeh index	1.409414	The amount of residuals		41.20398
Shwarts index	1.447062	Likelihood of interruption		-114.2766
Hannan-Queen index	1.424696	Deviation		228.5533
Limited deviation	228.5870	Limited likelihood of interruption		-114.2935
LR statistics	0.033751	Average likelihood of interruption		-0.692586
LR statistics probability	0.854237			

Coefficients of regression model in figure 4-8, shows that in Logit method there is a negative relationship between accounting conservatism and acceptable auditing report. This is not meaningful statistically and regarding McFadden identification coefficient (0.0001), this relationship is very weak. Also likelihood of interruption statistics shows that model is not meaningful on the whole. The negative relationship between these two variables showed that accounting conservatism affects acceptable auditing report but the weakness of this relationship showed that there are numerous factors other than accounting conservatism which affect acceptable auditing report.

Fourth hypothesis: There is a meaningful relationship between employer's rank and acceptable auditing report.

$$UAR = \beta_0 + \beta_1RE$$

TABLE (5): RESULTS OF ESTIMATION GAINED FROM TESTING THE HYPOTHESIS USING LOGIT METHOD

Variables	Coefficient	Criterion deviation	t statistics	Meanfulness
Fixed number	0.559616	0.361873	1.546441	0.1220
Employer's rank	-0.772538	0.401995	-1.921759	0.0446
McFadden identification coefficient	0.016720	Average of dependent variable		0.484848
Criterion deviation of dependent variable	0.501292	Standard error of regression		0.500030
Akaikeh index	1.386455	The amount of residuals		40.75487
Shwarts index	1.424102	Likelihood of interruption		-113.3762
Hannan-Queen index	1.401737	Deviation		226.7523
Limited deviation	228.5870	Limited likelihood of interruption		-114.2935
LR statistics	3.822023	Average likelihood of interruption		-0.687128
LR statistics probability	0.050583			

Coefficients of regression model in figure 4-12, shows that in Logit method there is a negative relationship between employer's rank and acceptable auditing report. This is not meaningful statistically and regarding McFadden identification coefficient (0.01). Also likelihood of interruption statistics shows that model is meaningful on the whole. The negative relationship between these two variables showed that employer's rank has a reverse relationship with acceptable auditing report. This means that by increasing employer's rank, acceptable auditing report reduces and vice versa.

Fifth hypothesis: There is a meaningful relationship between size of board of directors and acceptable auditing report.

$$UAR = \beta_0 + \beta_1BS$$

TABLE (6): RESULTS OF ESTIMATION GAINED FROM TESTING THE HYPOTHESIS USING LOGIT METHOD

Variables	Coefficient	Criterion deviation	t statistics	Meanfulness
Fixed number	-0.510826	0.210818	-2.423059	0.0154
Size of board of directors	1.076139	0.327371	3.287218	0.0010
McFadden identification coefficient	0.049052	Average of dependent variable		0.484848
Criterion deviation of dependent variable	0.501292	Standard error of regression		0.500030
Akaikeh index	1.341663	The amount of residuals		40.75487
Shwarts index	1.379311	Likelihood of interruption		-113.3762
Hannan-Queen index	1.356945	Deviation		226.7523
Limited deviation	228.5870	Limited likelihood of interruption		-114.2935
LR statistics	11.21267	Average likelihood of interruption		-0.687128
LR statistics probability	0.000812			

Coefficients of regression model in figure 4-13, shows that in Logit method there is a positive relationship between size of board of directors and acceptable auditing report. This is meaningful statistically regarding McFadden identification coefficient (0.01). Also likelihood of interruption statistics shows that model is meaningful on the whole. The positive relationship between these two variables showed that size of board of directors has a direct relationship with acceptable auditing report. This means that by increasing size of board of directors, acceptable auditing report will also increase and vice versa.

RESEARCH LIMITATIONS

Like most developing countries, one of the limitations in the present research was lack of a complete access to financial statements through different ways while the information should be completely accessible for the users. The most important limitation was due to corporate governance information collection where there is a need to have access to articles of association but there hasn't been an appropriate strategy to present corporate governance information in notes accompanying financial statements and companies did not present the information precisely or repetitively every year.

SUGGESTIONS RESULTED FROM THE PRESENT RESEARCH

- 1- Companies should use people having higher educational degrees in financial and accounting fields to supply a mechanism to reduce professional doubts of auditors towards information prepared to increase correctness and reliance of auditors towards such information and following that to have more expectations about acceptable auditing reports by auditors.
- 2- Considering the employers we can suggest two things to users of financial statements (managers in electricity distribution companies and other users of financial statements especially investors). Companies can try to create some changes in fundamental systems of the company to reach grade 1 from among 4 ranks (1 to 4) in order to get more confidence to get acceptable opinions on the part of auditors to give a higher level of assurance regarding the presentation of acceptable reports on the part of auditors by having a higher validity. But it is also suggested to investors to act on financial statements of such companies and make decisions by being more conscious and having more professional precision.
- 3- Also companies should increase the number of members of board of directors as much as they can and create a self-control mechanism because evidences showed a positive relationship between auditor's report and size of board of directors. This is contrary to some of current researches through which the smaller board of directors has been shown to be more appropriate.

SUGGESTIONS FOR FUTURE RESEARCHES

- 1- Doing the research in another range such as Tehran Stock Exchange
- 2- Using other corporate governance indexes such as indexes G and E
- 3- Since there hasn't been any similar Iranian research found, carrying out similar researches during different time ranges, in isolated industries or each of corporate governance indexes (E and G) can describe this relationship better.
- 4- Using other elements of corporate governance (ownership of institutional stockholders, external stockholders with higher than %5 ownership, the percentage of independence of board of directors, ...) and studying their relationship with acceptable auditing reports

RESEARCH RESULTS

- Results gained from first hypothesis showed that there is not a meaningful relationship between educational degrees of board of directors and acceptable auditing report. In this way the amount of dependence of the dependent and independent variables were (0.008026) and this showed that dependence amount and the strength of being affected are different for both of these variables.
- Results gained from second hypothesis showed that there is a meaningful relationship between study majors of board of directors (accounting financial management) and acceptable auditing report. The amount of dependence between dependent and independent variables was (0.019171) and it showed that the amount of dependence and the intensity of being affected was weak regarding these two variables compared with each other.
- Results gained from third hypothesis showed that there is not a meaningful relationship between accounting conservatism and acceptable auditing report. The amount of dependence between dependent and independent variables was (0.000148) and it showed that the amount of dependence and the intensity of being affected between these two variables compared with each other.
- Results gained from fourth hypothesis showed that there is a meaningful relationship between employer's rank and acceptable auditing report. The amount of dependence between dependent and independent variables was (0.016720) and it showed that the amount of dependence and the intensity of being affected was almost weak regarding these two variables compared with each other.
- Results gained from fifth hypothesis showed that there is a meaningful relationship between size of board of directors and acceptable auditing report. The amount of dependence between dependent and independent variables was (0.049052) and it showed that the amount of dependence and the intensity of being affected was good regarding these two variables compared with each other.

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