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UCT Journal of Management and Accounting Studies

UCT . J.Educa.Manag .Account. Stud., (UJMAS)

Volume 3,Issue3

37-43 (2015)

ISSN 2382-9748

Competition in Industries, Corporate Governance; and Financial Reporting Quality

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ABSTRACT

The present study aimed to investigate the impact of product market competition, corporate governance accounting restatements of the firms listed on TSE. This study applies accounting restatement criterion for identification of low quality of reported accounting information in past financial statements of the firms listed on TSE. For this purpose, according to literature and institutional environment we select a set of most important corporate governance mechanisms include ownership concentration, board of directors independence and audit firm size associated with some control variable include corporation size and liquidity ratio that can be related to FRQ, and then considered to relation with earnings restatements. This study applies the financial statements information of firms listed on TSE during 2007 to 2013. The results of logistic regression analysis based on 846 year-firm observations indicate that according to past research corporate governance have a positive effect and competition has a negative effect on financial reporting quality (FRQ), however their interaction effect indicate that accounting information quality is increased. Therefore evidence of this paper support this opinion that competition and corporate governance mechanisms are complementary.

Original Article:

Received 22 June. 2015
Accepted 15 Aug. 2015
Published 30 Sep. 2015

Keywords:
corporate governance, accounting restatements, product market competition.

1. Introduction

The present study aimed to evaluate the relationship between product market competition (PMC) and corporate governance with accounting restatements. The purpose of financial statements is presenting summarized and classified information about financial status, financial performance and financial flexibility of business unit as useful for wide range of financial statement users to take economic decisions (The committee of financial standards, 2009). Net earnings are one of the most important items of financial statements considered as the criterion of performance evaluation criterion and profitability of business unit. As the calculation of profit is affected by authority of managers to use consistency and fulfillment and estimation and prediction, the reported earnings can be manipulated by management to achieve specific goals (Khajavi and Ghadirianarani, 2014).

Nowadays, firms and companies work in an ever-expanding and highly competitive environment. In order to survive, they have to take on numerous competitors in national or international scale. Only companies which are more successful in achievement of the designated organizational objectives would survive in such a condition; and of course in order to achieve those objectives, they should devise an appropriate management system. These systems are generally focused on methods by which corporations are managed and controlled [Teymouri Jami et al. 2014]. Due to their specific characteristics and organizational environment, companies implement certain systems of governance in order to reduce agency costs. Therefor it can be said that corporate governance mechanisms can minimize opportunistic behaviors, and improve the quality of the information in financial reports and disclosures through reducing agency costs.

Models presented in various studies suggest that firms in the more exclusive industries where there is a higher dependence on investors' strategies, prefer to have less information disclosure policies, because disclosure of the information by those companies may in the future be exploited by their competitors. In this regard, Verrecchia (1999) points out that preventing voluntary disclosure in competitive markets is a natural characteristic of competition in product market. On the other hand, there are growing studies which show mechanisms of corporate governance are solutions for improvement of financial reporting quality (e.g. Iqbal & Strong, 2010). Meanwhile a few studies have been conducted on the interaction effect between corporate governance and market competition on the quality of financial reporting. The present study seeks to use information in financial statements of companies listed in Tehran stock exchange market to examine the role of interaction between product market competition and corporate governance in enhancement of financial reporting with the use of earnings restatement criteria. Using information collected from a sample of 846 observations (firm-year being the unit of observation) between 2007 and 2013; this study concludes that as suggested by previous researches, corporate governance has a positive effect on financial reporting quality, while the effect of competition is