

The impact of Expertise and experience of Board of Directories on Weakness of Internal Control of Companies Accepted in Tehran Stock Exchange

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ABSTRACT

Internal control is a process was designed by participation of BD.,(Board of Directories) management and other staff of commercial units in order to obtain confidence in regard to achieve operational, reporting and observations aims. According to it, combination of effectiveness of BD., can be effective to improve and supervise internal control. In this research, we discuss the impact of specialty and experience of BD., (Board of Directories) on weakness of internal control for companies accepted in Tehran stock exchange. Thus, data pertain to 97 non-financial companies accepted in Tehran stock exchange were analyzed during 7 years between 2014 to 2020. The results showed that experience and studying degree of BD., studying and experience of BD., (Board of Directories) have negative relationship. Also, type of ownership is effective on relation between personal specification and weakness of internal control.

Keywords: Specialty of BD., Experience of BD., Weakness of Internal Control

Introduction

Internal controls can be considered as one of the management tools to achieve the goals of the organization, means increasing the wealth of shareholders. Also, internal controls have always been the basis of auditors' audits as well as the assessment of the reliability of financial statements. The evaluation of internal controls by researchers has received a lot of attention in recent years, so that after the passage of the Sarbins-Axel Act, this attention has increased, so the impact of internal controls on the correct implementation of policies and management methods and thus improve company performance and reduce investor risk. It does not indicate the importance of examining the effective factors as much as possible reducing the investment risk of capital owners is not hidden from anyone and indicates the importance of investigating the factors affecting the weaknesses of internal control. The present study also examines the effect of the nature of major shareholders on the relationship between the expertise and experience of board members with the weakness of internal control of companies listed on the Tehran Stock Exchange. In this regard, in this chapter, general information about the research topic and the stages of research is provided for general acquaintance.

Research Problem

When ownership is separated from management in an organization, there is a "representation problem" (Jensen & Mackling, 1976), in the sense that the goals and wishes of owners and managers are in conflict and shareholders cannot adequately oversee management. In this regard, the role of the board of directors is to protect the interests of shareholders on behalf of shareholders. As a result, the board plays a key role in reducing representation problems (Dalton et al., 2007); thus, examining the impact of board characteristics in the areas of corporate governance and auditing is a critical issue (Ko and Lu, 2018).

Economic units must have an effective internal control system to achieve short-term and long-term goals and to achieve missions and visions, maintain financial strength and profitability, deal with unexpected events and be accountable to users (capital owners, government, etc.). Internal control is not a specific event or situation, but a set of sequential and pervasive actions that permeate all of the organization's activities. These actions occur within the scope of an organization's operations and continuously. They exist in an all-encompassing and inseparable way in the path that manages and promotes the management of the organization (Shari, 2007). Effective internal controls ensure that the business unit can achieve its goals. To achieve this goal, it must be ensured that internal control reports are reliable. This includes efficient access to laws, regulations, policies and obligations of the company (Hasas Yeganeh and Taghi Nejat Malekshah, 2006). Following the financial scandals, the passage of the Sarbines-Axel Act drew management's increasing attention to internal controls. The importance of Sarbins-Axley law justifies the effectiveness of internal control weaknesses (Hajiha and Hosseinnejad, 2015). In our country, the Stock Exchange and Securities Organization has recently published a draft of internal control instructions for publishers listed on the Tehran Stock Exchange in accordance with Article 35 of the Tehran Stock Exchange Admission Instruction. According to this article, management is responsible for evaluating the effectiveness of internal control Prepare a report on the results of the internal control evaluation (Instructions of the Tehran Stock Exchange, 2012).

Much research has examined the determinants and effects and consequences of poor internal control. Preliminary research (Scafi, Collins, & Kinney, 2007) has shown a relationship between these weaknesses and firm characteristics such as firm complexity, organizational change, firm size, firm profitability, and resource investment on internal controls (Hajiha and Hosseinnejad, 2015). Based on what has been said, the key to effectively forming a board is to ensure that people in the board hold positions that are sufficiently skilled, experienced, and knowledgeable to analyze organizational issues and find ways to respond to them. Therefore, the present study, considering a sample of Iranian listed companies, examines the effect of the nature of major shareholders on the relationship between the company's internal control weaknesses and the expertise and experience of board members.

Research Objectives:

- 1,1 discuss relationship between graduation level of BD., and weakness of internal control
- 1,2 discuss relationship between accounting experience of BD., and weakness of internal control
- 1,3 discuss relationship between accounting degree of BD., and weakness of internal control
2. Discuss relationship between personal specifications of head of BD., and weakness of internal control

Research Hypothesis

- 1,1 there is significant relationship between members of BD., and weakness of internal control
- 1,2 there is significant relationship between members of BD., and weakness of internal control
- 1,3 there is significant relationship between accounting degree of BD., and weakness of internal control
2. There is significant relationship between personal specifications of head of BD., and weakness of internal control

Population and sample statistical

The statistical population consist of all companies accepted in Tehran stock exchange during 2014 to 2020 and sample of volume was determined by systematic deletion.

Research Conceptual Model



Research Background

Imani Brandaghi et al. (2021), in a study entitled "Study of the effect of gender diversity in the board of directors on the possibility of weakness in internal controls" data of 152 companies listed on the Tehran Stock Exchange during the period 2016-1400 using logit regression analysis put. Findings confirm the negative effect of the presence of at least one female representative in the composition of the board of directors on the possibility of weakness in the internal controls of companies. Accordingly, the presence of a female representative on the board is expected to create an environment in which the homogeneity of the board is lost and the process of control and oversight becomes more precise. Cordler et al. (2016), in a study entitled "Study of the effect of internal control weaknesses on the performance and value of the company" concluded that the weaknesses of internal controls have a negative effect on the performance and market value of the company. Also, the weaknesses of internal controls have a negative effect on the relationship between profit and value of the company. Saedi and Dastgir (2017), in a study entitled "The effect of weak internal controls and controlling shareholder gap on the investment efficiency of companies listed on the Tehran Stock Exchange" concluded that there is a significant relationship between controlling shareholder gap and investment efficiency; In other words, the greater the gap between controlling shareholders, the more inefficient Investment increases. Also, the results show that there is a significant relationship between the weakness of internal controls and investment efficiency; in the sense that if there is a weakness of internal controls or an increase in their number, investment inefficiency will increase. Bazrafshan (2018), in a study entitled "Study of the effect of the quality of the audit committee on the achievement of internal control objectives governing financial reporting" concluded that in companies with an audit committee, the quality of the audit committee leads to reducing information inequality. Mehrabani et al. (2017), in a study entitled "Study of the characteristics of the board on accounting conservatism in companies listed on the Tehran Stock Exchange", 115 companies were screened for the years 2014 to 2017 as a statistical sample to test research hypotheses. Findings indicate that there is a direct and significant relationship between the dual role of the CEO and the Chairman of the Board and the non-executive chairman and the percentage of non-executive members and the lack of a direct and significant relationship between board size and financial expertise of the board and tenure of the CEO with accounting conservatism. Khajavi et al. (2015), in a study entitled "Study of the effect of board characteristics on the restatement of financial statements of companies listed on the Tehran Stock Exchange" concluded that there is no significant relationship between board characteristics and the occurrence of restatement of financial statements. Also, there is no significant relationship between board size and intensity of re-presentation; however, there is a significant negative relationship between the percentage of non-executive board members and the separation of the role of CEO from the chairman of the board with the intensity of restatement of financial statements. In other words, the independence of the board reduces the intensity of restatement of financial statements. Kovolo(2020), in a study entitled "The relationship between the personal characteristics of board members and the weakness

of internal control" examined Chinese listed companies during the years 2015 to 2020. The results show that the personal characteristics of board members including training, experience, qualifications and integration are related to weak internal control. The results also show that the individual characteristics of board members are related to weak internal control. The overall results show that the quality of internal control is higher and the reduction of internal control weaknesses and the possibility of correcting weaknesses increase in companies that have stronger board members. In addition, ownership has an effect on the relationship between the characteristics of the board and internal control. Chen et al. (2019) examined the number of company years from 2010 to 2018 in a study entitled "Board Independence and Weakness of Internal Control: Evidence of 404 SOX Disclosure." The results showed a negative relationship between board independence and exposing internal control weaknesses. Also, this negative relationship is stronger for companies with single leadership (one being the CEO and the chairman of the board) than companies with dual leadership. Finally, they showed that the independence of the board is related to the timely correction of internal control weaknesses, and the implementation of Auditing Standards No. 5 in 2018 weakens the impact of board independence on exposing internal control weaknesses. Lisic et al. (2018) in a study entitled "The relationship between the effectiveness of the audit committee, the power of the CEO and the quality of internal control" concluded that when the power of the manager is low, the characteristics of the audit committee members include independence and financial expertise. It has weaknesses in the internal control system. In contrast, as the CEO's power increases, the negative relationship between audit committee characteristics and weaknesses in the internal control system becomes longer. Mitchell et al. (2017) surveyed 149 companies between 2013 and 2018 in a study entitled "Monitoring the Internal Control System in Different Legal Environments." The findings support an inverse relationship between internal control disclosure and board oversight. They also find a significant negative relationship between the board and the disclosure of internal control. Evidence also shows that oversight rules have a moderating effect on the relationship between the board and the disclosure of internal control.

Research Methodology

The research method is correlational in nature and content, which analyzes the correlation relationship using secondary data extracted from the financial statements of companies listed on the Tehran Stock Exchange. This research will be conducted in the framework of deductive-inductive reasoning. In the present study, we will first test the correlation between research variables and if there is a correlation between research variables, we will estimate regression models. This research is also a library and analytical-causal studies and is based on the analysis of panel data (data panel). The research is considered as applied in terms of purpose and in terms of descriptive method and correlation.

Test of Hypotheses

Test of First Hypothesis

- 1,1 there is significant relationship between members of BD., and weakness of internal control
- 1,2 there is significant relationship between members of BD., and weakness of internal control
- 1,3 there is significant relationship between accounting degree of BD., and weakness of internal control

Regression pattern is used to test of hypothesis:

$$ICW_{i,t} = \beta_0 + \beta_1 Education_{i,t} + \beta_2 Experience_{i,t} + \beta_3 Certification_{i,t} + \beta_4 nonduality_{i,t} + \beta_5 Independence_{i,t} + \beta_6 Meeting_{i,t} + \beta_7 Firm\ age_{i,t} + \beta_8 Size_{i,t} + \beta_9 Ownership_{i,t} + \beta_{10} Leverage_{i,t} + \beta_{11} Growth_{i,t} + \beta_{12} Financial\ health_{i,t} + \beta_{13} Audit\ fee_{i,t} + \beta_{14} Big4_{i,t} + \varepsilon_{i,t}$$

Since dependent variable is virtual one and covers 0 and 1 and as for above contents in third chapter, logistic regression method is used to estimate model and estimation of above model is offered in following table.

Table 1, test of first model

Probable	Z statistics	Standard error	Coefficients	Symbol	Variables
0.5074	-0.6630	0.0336	-0.0223	EDUCATION	Studying head of BD
0.0000	-12.5339	0.0050	-0.0636	EXPERIENCE	Experience of head of BD
0.0191	-2.3503	0.0107	-0.0252	CERTIFICATION	Degree of BD
0.9554	0.0559	0.3679	0.0206	NONDUALITY	Duality of BD and head of BD
0.5931	0.5344	0.5168	0.2762	INDEPENDENCE	Relatives of BD
0.1335	-1.5005	0.3009	-0.4515	MEETING	Number of sessions
0.0162	-2.4045	0.0070	-0.0168	FIRMAGE	Company age
0.0000	-5.0797	0.0744	-0.3780	SIZE	Company size
0.5594	-0.5837	0.2070	-0.1208	OWNERSHIP	Governmental ownership
0.0113	2.5343	0.4165	1.0556	LEVERAGE	Financial leverage
0.6910	-0.3975	0.0331	-0.0132	GROWTH	Growth of operational interest
0.7051	-0.3784	0.2839	-0.1074	FINANCIAL HEALTH	Report net interest
0.9744	0.0321	0.1333	0.0043	AUDITFEE	Auditing fee
0.0003	3.6275	0.2487	0.9021	BIG4	Auditing size
0.0000	4.8466	1.2794	6.2007	C	Width to destination
0.5883	Mcfadden coefficient	79.98687			LR Statistics
		0.0000			LR probable

LR Statistics: The LR test is used to accept the significance assumption of the whole model. According to the results of the model test as shown in the table above, it can be seen that the value of the significance level related to the LR statistic, which indicates the significance of the whole regression, is equal to 0.0000 and is less than the accepted error level of 0.05. It showed that the model is significant in confidence level 95% and all regression coefficients are not zero and estimation model is suitable and significant.

Mcfadden determination coefficient: Mcfadden coefficient is equal to 0.5883 and means all explanatory variables explain 58% of changes for dependent variables.

Result of Hypothesis: according to results, significant level of z statistics for members of BD., was 0.5074 and it was more than error level 0.05, thus, there is not relationship between studying level of members and weakness of internal control. Significant level of z statistics is pertinent to experience of Bd. members and equals to 0.0000 and it is lower than 0.05, also, since its coefficient is -0.0636, there is negative relationship between members of BD., and weakness of internal control in 95% and significant level of z statistics is 0.0191 and is lower than error level in 0.05, also, since coefficient is -0.0252, there is negative relationship between degree of BD., and weakness of internal control in 95%.

Hosmer-Lemeshow Good Fit Test

In the models having virtual dependent variable, R² value is not confident, in this regard, there are other scales. One of the scales is Hosmer Lemeshow test, in this scale, null hypothesis equals to observations and pertain to weak determination coefficient which is seen in below table. It is not rejected and the results are on table.

Table 2: Hosmer-Lemeshow Good Fit Test

Hosmer-Lemeshow Test	15.4776	Probable	0.505
Andrews test	14.9483	Probable	0.1340

Test of second Hypothesis

There is significant relationship between personal specifications of head of BD., and weakness of internal control

Regression pattern is used to test of hypothesis:

$$ICW_{i,t} = \beta_0 + \beta_1 \text{Education}_{i,t} + \beta_2 \text{Experience}_{i,t} + \beta_3 \text{Certification}_{i,t} + \beta_4 \text{nonduality}_{i,t} + \beta_5 \text{Independence}_{i,t} + \beta_6 \text{Meeting}_{i,t} + \beta_7 \text{Gender}_{i,t} + \beta_8 \text{Stockholdings}_{i,t} + \beta_9 \text{Firm age}_{i,t} + \beta_{10} \text{Size}_{i,t} + \beta_{11} \text{Leverage}_{i,t} + \beta_{12} \text{Growth}_{i,t} + \beta_{13} \text{Financial health}_{i,t} + \beta_{14} \text{Audit fee}_{i,t} + \beta_{15} \text{Big4}_{i,t} + \varepsilon_{i,t}$$

Since dependent variable is virtual one and covers 0 and 1 and as for above contents in third chapter, logistic regression method is used to estimate model and estimation of above model is offered in following table:

Table 3, test of second model

Probable	Z statistics	Standard error	Coefficient	Symbol	Variables
0.0181	-2.3639	0.1129	-0.2668	EDUCATION	Studying head of BD
0.0499	-1.9606	0.6612	-1.2963	EXPERIENCE	Experience of head of BD
0.3625	0.9107	0.6778	0.6173	CERTIFICATION	Degree of BD
0.9202	-0.1001	0.3740	-0.0374	NONDUALITY	Duality of BD and head of BD
0.4263	0.7955	0.4930	0.3922	INDEPENDENCE	Attribution of members
0.0294	-2.1783	0.2995	-0.6524	MEETING	Number of sessions
0.0929	1.6801	0.1823	0.3063	STOCKHOLDINGS	Shareholders of head of BD
0.0457	-1.9983	0.0069	-0.0139	FIRMAGE	Company age
0.0015	-3.1804	0.0664	-0.2112	SIZE	Company size
0.8957	-0.1311	0.2119	-0.0278	OWNERSHIP	Governmental ownership
0.0185	2.3562	0.4185	0.9860	LEVERAGE	Financial leverage
0.7587	-0.3071	0.0339	-0.0104	GROWTH	Growth of operational interest
0.7580	-0.3081	0.2874	-0.0886	FINANCIALHEALTH	Report net interest
0.5842	-0.5473	0.1310	-0.0717	AUDITFEE	Auditing fee
0.0019	3.1121	0.2542	0.7911	BIG4	Auditor size
0.0000	4.2955	1.2703	5.4566	C	Width to destination
0.5937	Mcfadden coefficient	84.8338		LR statistics	
		0.000		LR Probable statistics	

LR Statistics: The LR test is used to accept the significance assumption of the whole model. According to the results of the model test as shown in the table above, it can be seen that the value of the significance level related to the LR statistic, which indicates the significance of the whole regression, is equal to 0.0000 and is less than the accepted error level of 0.05. It showed that the model is significant in confidence level 95% and all regression coefficients are not zero and estimation model is suitable and significant.

Mcfadden determination coefficient: Mcfadden coefficient is equal to 0.5883 and means all explanatory variables explain 58% of changes for dependent variables.

Result of Hypothesis: according to the results, significant level of z statistics is pertinent to studying of head of BD and equals to 0.0181 and it is lower than 0.05, also, since the value of coefficient is -0.2668, there is negative relationship between experience of head of BD., equals to 0.499 and lower than 0.05. Also, there is negative relationship between two factors, its value is lower than it and confirmed the relation, and its value is equals to 0.3652 and higher than 0.05, there is not significant relationship between head of BD., and weakness of internal control.

Hosmer-Lemeshow Good Fit Test

In the models having virtual dependent variable, R^2 value is not confident, in this regard, there are other scales. One of the scales is Hosmer Lemeshow test, in this scale, null hypothesis equals to observations and pertain to weak determination coefficient which is seen in below table. It is not rejected and the results are on table:

Table 4: Hosmer-Lemeshow Good Fit Test

Hosmer-Lemeshow test	15.133	Probable	0.0566
Andrews test	17.6591	Probable	0.0610

Conclusion and Discussion

First Hypothesis

- 1,1 there is significant relationship between members of BD., and weakness of internal control
- 1,2 there is significant relationship between members of BD., and weakness of internal control
- 1,3 there is significant relationship between accounting degree of BD., and weakness of internal control

Conclusion of First Hypothesis

According to results, significant level of z statistics for members of BD., was 0.5074 and it was more than error level 0.05, thus, there is not relationship between studying level of members and weakness of internal control. Significant level of z statistics is pertinent to experience of Bd. members and equals to 0.0000 and it is lower than 0.05, also, since its coefficient is -0.0636, there is negative relationship between members of BD., and weakness of internal control in 95% and significant level of z statistics is 0.0191 and is lower than error level in 0.05, also, since coefficient is -0.0252, there is negative relationship between degree of BD., and weakness of internal control in 95%.

It seems that studying levels (diploma, post diploma, bachelor and master and PhD.) of BD., members has not effect on weakness of internal control and experience of members can reduce weakness of internal control. The managers who have financial experience and expertise, can supervise on operations pertain to accounting and financial and play vital role in organizations, at same time, they play role to make decisions and respond to shareholders. Since managers are familiar with financial different techniques and quality, thus, they have ability to supervise the manner of control.

Similar to results, there are many researchers on financial expertise. For example, Johnston and et al (2011) discussed that can financial expertise improve weakness of internal control. The results showed that accounting expertise can improve weakness, also, if the members have certificates like official accountant, the quality is improved. Also, the results of Kovolo (2020) showed that personal specifications of BD., members including education, experience, degree and integration are pertinent to weakness of internal control. The general results showed that quality of internal control and reduce internal weakness is increased in companies where members are powerful than others.

Conclusion of Second Hypothesis

There is significant relationship between personal specification of head of BD., and weakness of internal control. according to the results, significant level of z statistics is pertinent to studying of head of BD and equals to 0.0181 and it is lower than 0.05, also, since the value of coefficient is -0.2668, there is negative relationship between experience of head of BD., equals to 0.499 and lower than 0.05. Also, there is negative relationship between two factors, its value is lower than it and confirmed the relation, and its value is equals to 0.3652 and higher than 0.05, there is not significant relationship between head of BD., and weakness of internal control. It seems that studying levels (diploma, post diploma, bachelor, master and PhD.) of head of BD., can reduce weakness of internal control, generally, population specifications of head can be effective on their behavior and mechanisms of internal control, thus, their specifications are necessary to obtain internal control aims. According to Sandberg and Hoffer (1988), specifications of head of BD., are pertinent to success in business, Chen and Wang (2014) believed that the older managers aware from important role of internal control and when head of BD., knows internal control who have high ability and concentrates his own ability on internal control. Comparison of first and second hypothesis shows that experience pertain to financial and accounting affairs is so important whereas, graduation pertains to accounting is proved. The average of experience shows that 61% of BD., members are accounting and 60% are accounting and 15% have others. In other word, less percent of head of BD., has its position and the results conform to results of Kovolo (2020).

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