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CORPORATE GOVERNANCE, ENVIRONMENTAL UNCERTAINTY, AND PROFIT FLUCTUATIONS

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A R T I C L E I N F O	A B S T R A C T
	In a situation where there is a difference between financial statements and an actual profit of a reported economic unit, we use a concept called earning quality. One of the time series variables is the quality of earnings profitableness. Risk management is also defined as a method for minimizing the adverse effects of risk and on the other hand maximizing the benefits of risk effects. The main objective of the research is to investigate the effect of corporate governance and environmental uncertainty index on fluctuations in earnings using Tehran Stock Exchange (TSE) information. To investigate and carry out this research and calculate risk management and a regression model was used to test the research hypothesis. The research time period was 10 consecutive years from 2007 to 2017. For this purpose, 100 firms were selected by systematic removal method. The research hypothesis is carried out using data from these years. Using the generalizing research variables to other capital market variables, a suitable model for this issue was created. The result shows that there is no significant relationship between risk management and profit fluctuation. © 2019 INT TRANS J ENG MANAG SCI TECH.

1. INTRODUCTION

Major changes in the business environment, such as globalization and the rapid pace of technological change, have increased the competitiveness and complexity of management in organizations. Under complex environments, organizations need managers who disassociate these inherent complexities when they make important decisions. Effective risk management based on valid conceptual principles. The purpose of each activity in each business unit is to achieve the highest level of efficiency and efficiency that is referred to as performance in the term. In order to achieve this goal, all efforts should be made, one of which is the risk management of the business unit (Gordon et al., 2009).

Companies are always looking for ways to deal with work uncertainties. In this regard, risk management is needed as an effective tool for managers to reinforcement and enhance the organizational effectiveness. Business risk management manages risk to provide reasonable assurance of the business unit's goals (Gordon, 2009). On the other hand, with the formation of large institutions and corporations, accounting knowledge has undergone tremendous transformations, and the establishment of major institutions has had two major consequences; 1) there is a need for a separation between ownership and management, and 2) there are uniform and uniform accounting methods for reporting more than in the past. Separation of ownership from management created a stewardship task for managers and required the owner's insights on management performance. Monitoring the management performance through various mechanisms is possible. Accounting profit is considered as the most important tool for performance evaluation as it gives information in terms of content (Bartram, 2002). Profit as an effective factor in the stock market price is the probability of a bankruptcy, and the potential risk assessment for the acquisition of stock in a unit (Kotler, 1970). However, earnings information in payout plans and management rewards and bond issuance agreements all indicate the importance of profit (Healy, 1985).

One way to improve performance is to function properly in enterprise risk management. This could increase the company's profits in the near future, through recognition of its profits and fluctuations. Considering this point and the importance of the role of profits, the users' attitude towards the balance sheet is aimed at profit and loss. Although the relationship between risk management and fluctuation in profit is not common to all, few studies have examined such the relationship. Therefore, the main issue of this research finds the relationship between corporate governance and risk management and corporate profit fluctuations, from data analysis.

2. THEORETICAL FUNDAMENTALS AND RESEARCH BACKGROUND

2.1 RISK MANAGEMENT

Essinger (1991) defines risk management as a way to minimize the adverse effects of risk and on the other hand maximizing the benefits of risk effects. Chapman (1997) also recognizes the key goal of managing process-related risks through systematic identification of project risk assessment and management. The risk is the probability of deviation from expected outcomes, which is considered in line with business objectives. Therefore, management is essential to increase the effectiveness (the amount of achievement of defined goals). If by management it is possible to identify and give the most indications of the functional behaviors of managers in the decision-making stage (which becomes apparent in practice). The relationship between effective risk management and performance level has been confirmed as a measure of functional and functional behaviors. Today, the application of risk management is seen more in companies 'use of derivatives (to cover various market risks) and the use of insurance coverage, as well as companies' compliance with comprehensive risk management, approaches. Considering the incentives for risk management in the past and the emergence of legal requirements, there has been a greater willingness to implement risk management.

3. CORPORATE GOVERNANCE

The International Federation of Accountants (IFAC) has defined corporate governance in 2004

as "Corporate Governance" refers to a number of responsibilities and practices used by the board of directors and managers with the aim of identifying a strategic route that ensures achievement of objectives, risk control and responsible use of resources. Limited corporate governance definitions focus on the capabilities of a country's legal system to protect the rights of minority shareholders (e.g. IFAC, 2004; Parkinson, 1994). These definitions are essentially suitable for comparisons between countries, and the laws of each country have a decisive role in corporate governance. Broader corporate governance definitions emphasize the wider response rate of shareholders and other stakeholders.

Corporate governance is important for the following reasons:

o Provides a framework for building long-term trust between companies and foreign suppliers of capital.
o By appointing managers with new experiences and ideas, they lead strategic thinking to the top of the company.
o Managing and overseeing global risk will make the company's business move logical.
o By dividing the decision-making process, the full reliance on senior executives decreases and senior executives' responsibilities are reduced.

Research shows that corporate governance can improve standards in business ,encourage foreign investment and improve corporate governance (Babaee, 2006).

3.1 CORPORATE GOVERNANCE AND RISK MANAGEMENT

Corporate governance and risk management have a special relationship with each other. The fact is now widely accepted in financial literature that risk management can lead to conflicts of interest between corporate and shareholder managers. Particularly when remunerating executives based on stock purchases, this conflict intensifies .It seems that with the formation of a risk management committee with the presence of efficient and independent managers, the potential conflict would decrease.

The issue of potential conflict between risk management objectives and policies for maximizing company value can also include corporate governance. Because the board is expected to approve the company's risk management goals and policies and to monitor the methods used to achieve those goals.

In the wake of recent scandals of large companies, serious defects in the corporate governance system were revealed. Of course, the board of directors is considered an important part of the corporate governance system, and for this reason, it is mostly blamed and slandered. So there were changes in corporate governance laws. A new law was passed in 2002 to prevent scandals similar to Enron and Worldcams under the Sarbanes Axley Act. This law takes more stringent conditions for the independent auditors, the duty of stewardship of the board of directors and the quality of disclosure of financial information.

According to the Sarbanes Axley Act and the New York Stock Exchange (NYSE) Act, members of the Audit Committee should have financial knowledge. These should improve the process of monitoring the preparation of financial statements. The NYSE Act requires the audit committee to discuss, review and evaluate the risk involved. The audit committee members must have sufficient

knowledge in various fields, such as economics, industry, laws, regulations and human resources.

The Sarbanes Oxley Act signed in 2002 to amend the Stock Exchange Law requires the Securities and Exchange Commission to comply with the amendments and publication of regulations and controls designed to protect the public and investors in accordance with the new law.   Therefore, the NYSE approved some of the criteria, including:

o   All member firms should have an audit committee consisting of exclusively independent directors and at least three members.
o   All member firms should have internal auditors.
o   Approval committees and remuneration committees should be made up of independent directors.
o   The boards of directors should be composed of independent directors.
o   All member firms should comply with minimum performance standards that are relevant to their corporate governance.
o   The audit committee should define and implement risk management policies.

To achieve effective risk management, five steps should be implemented in a desirable manner: 1) Identification of risk sources, 2) Measuring the level of risk, 3) Assessing the effect of the related risk on the company, 4) Assessment of the ability to participate in the use of risk management tools, 5) Choosing the right tools for risk management.

According to NYSE, risk management is the responsibility of the company's management. The audit committee should also examine policies that affect the process of assessing the major risks that the company faces. If the risk process succeeds in aligning with the goals and plans of the company. Therefore, individuals in the company should be responsible for risk management that are familiar with the company's goals and strategies and have sufficient experience and skills in risk management. Meanwhile, performance measurement methods must be developed to ensure resource management and equilibrium in reducing risk. In the process of risk management, the audit committee should ensure that appropriate and useful tools for risk management are selected? Are these tools sufficient? Are there different risks to the risks and insights that threaten the company? And does each part of the company play a role in coping with risk? Using and monitoring tools for risk assessment and risk management require a good mastery of mathematics and statistics. As a result, it is not clear that members of the Audit Committee without specialist training can assess and monitor all relevant issues.

A number of business organizations, especially financial institutions, risk management committees to replace risk management committees in order to implement risk-based management. In such cases, the other audit committee is not solely responsible for assessing risk management but should also consider risk assessment and risk management methods. In other words, the risk management process in these institutions is developed by the audit committee.

There is a close relationship between corporate governance and risk management, which can be easily understood. By developing appropriate and strong standards for corporate governance, the risk management process can be improved. By consolidating risk management and internal systems, it is possible to formulate strong standards of corporate governance (Hasas, 2007). Firms face two major risks. One of these two risks is facing only Iranian companies, which is a major risk and should be given special attention. One is the financial risk that all companies in the world are facing, which in

Iran is also a risk to many companies.

4. ENVIRONMENTAL UNCERTAINTY

One of the economic environment hallmarks is environmental uncertainty, and the right and rational decisions are taken on the basis of information that describes the risks and conditions. Or at least to help identify it. In fact, what's in the real world of our day is that we lack the environment with complete confidence, and the environment around us is a climate of uncertainty.

Since the accounting system is an open information system, it also influences the environment and affects the environment. Therefore, environmental fluctuations may affect the data and information disseminated by business units. Directors use their discretion to neutralize the effects of these fluctuations and to publish reports in line with their own goals. In an interaction between the financial reporting process and the outside world, managers may choose specific accounting methods for financial reporting in order to achieve specific organizational goals or personal interests. In this way, they will report some items of financial statements in line with their goals.

5. PROFIT FLUCTUATIONS

The users of financial statements need information about the future of the company. And forecasting profit by management provides information about the company's future. One of the factors that should be taken into account in the forecast of profit is the fluctuation of profit. Sometimes to smooth out earnings by managers, sometimes to prevent large fluctuations in profits. Investors are keen to estimate future sources of their investment in order to judge future cash benefits and their stock values (Mashayekh, 2007). Profit volatility is one of the variables of the time series of profit quality. The fluctuation is associated with higher risk and the effect is caused by several factors. Profitability and profit forecasting as a qualitative feature of the time series of profit are the ability to generate current profits in predicting future earnings in the short and long term. Economic and accounting factors influence the relationship of volatility and predictability of earnings.

Edmonds (2015) studied the relationship between risk management quality and earnings fluctuations. The finding showed that companies using high-quality risk management systems are more consistent with companies with less fluctuations in their profits. The impact of the public policy initiative taken to improve risk management practices has brought significant benefits to stakeholders.

Zand (2012) studied risk management in the supply chain. The analysis were determined with the help of the DEMATEL technique, and the severity of the impact of the most important supply chain risks was identified as the priority.

Mehrani (2012) examined the fluctuations in profit and the possibility of forecasting it. In this research, first, historic profits play an important role in predicting future profits. Second, profit stability is a key factor in analyzing the relationship between volatility and its prediction. Also, regardless of the fluctuations in profits, the profits in the upper bounds, on the contrary, are more predictable. In addition, the possibility of predicting profits in the low levels of operational cash flows is more appropriate than predictive levels compared to the level of the nanosecond.

Gordon Lawrence (2009) showed that environmental uncertainty, industry competition, company size, complexity of the company, and supervisory board of directors have a significant impact on risk management. There is a positive relationship between these variables and risk management.

Petrovich et al. (2009) found a negative relationship between the volatility of profits and future earnings. The justification of this negative relationship is possible through less investment, management motivation and progressive tax.

6. RESEARCH METHODOLOGY

This research uses past information to test the hypothesis. Therefore, it is a type of post-event research. Research theoretically is a kind of provocative research and inductive type of reasoning. On the other hand, this research is a quasi-experimental research in the field of financial accounting. The statistical population of the present study is the companies listed in the Tehran Stock Exchange (TSE) for the period of 10 years from 2007 to 1396. These examples include companies that have the following features:

Table 1: Systematic Risk

Row	Description
1	Companies from the beginning of 2007 to the end of 1396 will be members of the stock exchange.
2	The end of their financial year is March 29th.
3	In the period under review, there is no stoppage or change in the financial period.
4	Their financial statements have been published by the Stock Exchange in the years ahead
5	The data they are looking for are available.
6	During the reviewed period (2007-2013) there is no change in the fiscal year.
7	It is not part of financial companies and investment companies or financial intermediation companies.

Accordingly, in a moderated society, 100 companies are from the statistical community. In this way, the research hypothesis and the statistical model of this research are as follows: There is a significant relationship between corporate governance and environmental uncertainty and volatility, by applying the model of Edmonds & Jennifer, 2015).

$$EV_{it} = \beta_0 + \beta_1 RMEU_{it} + \beta_2 RMEU_{it}*CG_{it} + \beta_3 CG_{it} + \beta_4 Lev_{it} + \beta_5 MTB_{it} + \beta_6 Accruals_{it} + \beta_7 EarntoPrice_{it} + \beta_8 SIZE_{it} + \varepsilon_{it} \quad (1)$$

6.1 EARNING VOLATILITY (EV)

Conceptual Definition: Earning volatility is a measure of the dispersion of returns for a particular security, such as stocks or market indicators. Volatility can also be achieved using standard deviation or price variance or market yield or market index. Usually, the greater the volatility of the bonds or the index, the greater the investment in securities will be.

Operational definition: The fluctuation of profit is equal to the standard deviation of profit before unexpected items (also scaled to the equity market value).

6.2 ENVIRONMENTAL UNCERTAINTY (RMEU)

Conceptual Definition: Environmental uncertainty, meaning that decision-makers do not have enough information about environmental factors. And face the challenge to anticipate external change. It also means a kind of inability to allocate probabilities to future incidents, the lack of information about causal relationships, or the inability to predict the probable outcome of a decision

(Daft, 2004).

Operational definition: It is an indicator of risk management measurements, which is expressed by Gordon Lawrence et al. (2009). Environmental uncertainty is defined as change or change in the internal environment of the organization. And is measured using the following three parameters:

o Market - Sales Change Coefficient: $CV(S_{it})$ .In this statement, S_{it}, is the sale of company i in year t.

o Technology - coefficient of capital cost changes. To calculate the cost of capital, the following equation is used as a rationale for the cost of capital:

To calculate capital cost, the following equation is used as the Weighted Average Cost of Capital (WACC):

$$WACC = (D/(D+E))K_d + (E/(D+E))K_e \qquad (2),$$

wherein; E: Equity Market Value, D: Market value of the borrowed debt, K_d: The cost of the cost of the owners' equity, K_e: The cost of borrowing debt. To calculate it, use the following equation:

Profit-The coefficient of net profit changes before tax $CV(I_{it})$

In which I is equal to the net profit before tax i of year t. Therefore, the uncertainty of the (EU) from the following is obtained:

$$EU = \log(\sum \sum_{k=1}^{3} CV(X_k)) \qquad (3)$$

$$CV(X_k) = \frac{\sqrt{\sum_{t=1}^{5} \frac{(Z_{k,t} - \bar{Z}_k)^2}{5}}}{|\bar{Z}_k|} \qquad (4)$$

wherein

$CV(X_k)$ Coefficient of uncertainty change k,10t = 1,2,3,4,5, ..., for the years 2007 to 2017, $\bar{Z}_k$: Average K changes over 10 years, K = 1,2,3 for uncertainty 1. Market, 2. Technology 3. Profit.

6.3 CORPORATE GOVERNANCE (CG)

Conceptual Definition: A set of rules and procedures that defines the relationship between stakeholders, management, and board members. And it affects how the company operates. Corporate governance includes a set of relationships between company management, board of directors, shareholders and other stakeholders. In addition, it provides a structure. Through which the goals of the company, the means of achieving it, the goals and monitoring of the company's performance is determined.

Operational definition: Corporate governance index is calculated using the following variables:

1) Managing Duality ($DUAL_{it}$): This means that if there is a duality in the Managing Director job, This variable is equal to 1 and otherwise equal to 0.

2) Managing Director influence ($CEOD_{it}$): If the chairman of the board of directors is obliged to have a number 1, otherwise it is equal to 0.

3) Board size ($BRDSIZE_{it}$): Number of members of the board of directors

4) Independence of the Board ($BRDIND_{it}$): The proportion of non-executive directors to

the entire board of directors.

5) Ownership Focus (OWNCON$_{it}$): Total percentage of ownership of shareholders holding at least 5% of the shares of the company.

For variables that are either proportions or percentages.

After calculating these variables for each company, After calculating these variables for each company, a mean for each variable is obtained from all the relevant samples during the study period.

If any of the variables calculated for each company in each period exceeds the average calculated for all samples related to that variable in all courses. That variable is equal to 1, otherwise, it will be 0. After determining the variables, the ability of corporate governance is calculated as

$$CG = (\sum d_i)/(\sum H_j) \tag{5}.$$

In this regard, di denotes all items that have been rated 1. And Hj represents all items that have zero or one values for them. In this way, for each corporate index, the ability to measure corporate governance is measured at 0 to 1. This approach has been used in the many researches. The control variables of the research are as follows:

SIZE: represents the size of a company that is obtained by logarithm of the book value of the total assets.

Lev: The financial leverage defined as the total carrying amount of debt divided by total assets at the end of year t.

MTB: Equals the market value to book value

Earn to price: The proportion of the price to the profit of each share.

Accruals: Indicates optional commitment items that are used by the modified Jones method. In the modified Jones model, the total of accruals is first calculated as

$$NDA_{it} = \alpha_1 \frac{1}{A_{it-1}} + \alpha_2 \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} + \alpha_3 \frac{PPE_{it}}{A_{it-1}} \tag{6},$$

wherein: NDA: Non-controlling liabilities of Company i in year t, ΔREC: Change in receivables from *i* between *t* and *t*-1.

Table 2: Descriptive statistics of the variables of the research model

The statistics	SIZE	Earn to Price	ACC	MTB	LEV	CG	EU	EV
Average	13.9	0.54	-2.06	2.7	0.61	0.24	0.01	0.42
Middle	13.7	0.02	0.00	1.98	0.62	0.16	0.02	0.5
Maximum	18.4	155.9	76.4	5.5	1.31	0.5	0.16	2.2
Minimum	10.9	9.6	17.489	0.6	0.09	0.16	0.005	0.09
SD	1.4	7.4	33.17	7.12	0.19	0.09	0.28	0.88
Skidding	0.7	19.07	12.7	12.4	-0.1	0.8	-20.1	-0.04
Elongation	3.6	390.16	187.7	196.3	3.06	2.65	431.2	2.84
observations	1000	1000	1000	1000	1000	1000	1000	1000
Number of companies	100	100	100	100	100	100	100	100

Table 3: Estimates of the hypothesis

Variable	Coefficient	SD	Statistics T	Prob
EU	-0.61	1.21	-0.5	0.61
CG EU	-6.11	7.05	-0.88	0.38
CG	-0.9	0.47	-1.9	0.04
LEV	-0.53	0.19	-2.7	0.00
MTB	0.01	0.01	1.6	0.1
ACC	9.07	0.001	0.07	0.93
EP	-0.005	0.005	-1.16	0.2
SIZE	-0.09	0.03	-2.7	<0.001
C	2.23	0.46	4.7	<0.001
F-statistic = 5.12			Prob (F-statistic) = <0.001	
Durdin Watson =1.72			R-squared = 0.79	

The coefficients of the regression model are not shown, that there is a negative correlation between corporate governance and environmental uncertainty and the fluctuation of earnings of companies that are accepted in the TSE. In other words, the coefficient for the uncertainty variable that represents the number -0.61. With the increase in a unit of environmental uncertainty, we can expect a decrease of -0.61 in the fluctuation of corporate profits. The coefficient is related to the industrial competitiveness variable, which is -13.28. States that with an increase in one industry competition, the corporate profit fluctuation rate could be down by -13.28 percent. On the other hand, according to the results of the study of the interaction of corporate governance with environmental uncertainty (CG EU), it indicates a lack of meaningful relationship between these variables. According to the results of the review of the corporate governance variable, it can be also stated that the corporate governance variable does not have a significant relationship with research variables. This is true of the variables of the financial leverage, relative to the price of each share, the size of the company, and indicates the lack of relation between these variables. The only controlling variable of accruals and the market-to-book ratio remains in the equation.

Therefore, considering that the significance level is greater than 5%, this relationship is reliable and meaningful and the assumption of the research cannot be confirmed. In fact, corporate governance and environmental uncertainty have no significant effect on the fluctuation of earnings of companies that are accepted in TSE.

7. CONCLUSION

From the research equations and test results, we have found that in the capital market of Iran, environmental uncertainty as one of the main indicators of risk management does not affect the control of corporate net profit fluctuations, but it is effective in predicting cash flow fluctuations and control. Also, the corporate and legal ownership of equity holders is one of the effective factors in controlling and forecasting net profit fluctuations, which emphasize shareholders' perception of risk control in the company. In other words, companies that are growing and developing, their fluctuations in net profits are decreasing, and their rate of cash flow fluctuates. This can be due to accruals from the profit and loss account, which can prevent the risk of loss of profit or loss. But cash flows consist of a set of real events that can show the severity of the risk associated with growth and development.

The results of this study coincide with the results of the Zhang studies (2006). In his article, Zang

considers the corporate profit fluctuations due to the ineffectiveness of risk management approaches. The results are also consistent with Bartom's research (2009). Bartom concluded that there was no meaningful relationship between risk management and net corporate income fluctuations. Bartom concluded in his research that financial instruments would reduce systemic risk and reduce company risk management. This will positively affect the company's corporate profit fluctuations. Also, the results are consistent with Edmonds research results (2015). They also concluded that there was no meaningful relationship between risk management and profit fluctuations. Regarding this compatibility, it can be stated that in the capital market of Iran, the conditions of protection and risk management do not affect the control of profit fluctuations.

Growing and expanding companies have fluctuated their fluctuations, and there is a growing upward trend in their cash flow fluctuations. This could be due to accruals from the profit and loss account, which can avoid the severity of the risk management effect in the event of a loss. According to the equation, we can say this. Companies increase risk management systems to achieve a lower-income profits fluctuation and reduce risk management to achieve higher returns.

These results can be seen in the company's profits and losses. Although the economic impact of risk management for companies is more pronounced than their effect on profit fluctuations. Also, considering the interaction between corporate risk variables and risk management with the fluctuation of profits in companies, this can be stated. The gap between ownership and control in companies creates problems of information asymmetry between shareholders and corporate executives. Which gives the attention of stakeholders to risk. It also creates information asymmetry. This information asymmetry occurs when investors can not correctly and accurately measure the fluctuations in profit and economic value. And that this information asymmetry is due to ambiguity in the quality and profitability of the profits. And also because of the gap that exists between shareholders and managers of the company. And this leads to a lack of positive and meaningful relationship between risk management, corporate governance, and corporate profit fluctuations. Therefore, the overall conclusion of the relationship between corporate governance and risk management concluded that there was no significant relationship between these two variables and profit fluctuations.

8. CONCLUSION

Considering the importance of risk management and volatility for investors, and given that risk management can lead to conflicts of interest between corporate and shareholder managers, particularly when remuneration of executives is increased based on the purchase of shares of this conflict, this conflict intensifies. It seems that by creating a risk management committee with the presence of efficient and independent managers, the conflict is reduced. It is suggested that analytical and cultural technical concepts be operationally analyzed from the management perspective.

It is also suggested that investors and creditors consider investment decisions and provide facilities for fluctuations in profits as well as forecast future profits. Especially at the time of the purchase of corporate shares, which is a corporate risk management and corporate governance that results in a more severe conflict. Particularly in the case of insurance companies and banks that have a risk management committee, this issue has been carefully considered. And that the risk

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management index in this study is measured by the environmental uncertainty factor. It is suggested that these indicators be measured by submitting questionnaires to companies and through other risk management factors such as industry competition.

9. AVAILABILITY OF DATA AND MATERIAL

Data used or generated from this study can be requested to the corresponding author.

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