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The Impact of Psychological Dimensions of Financial Managers on Financial Reporting Quality

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Abstract

One of the primary and most important sources of information for decision-makers, especially external users, is companies' reports and financial statements. Therefore, this study aims to determine the personality traits affecting managers' and companies' financial reporting on the Tehran Stock Exchange. For this purpose, a sample consisting of companies listed on the Tehran Stock Exchange from 2014 to the end of 2018 was selected. After studying the theoretical foundations of research topics and formulating research hypotheses, collect and prepare data sets used by researchers and eventually hypotheses using structural equation modelling approach tested and analysed. The results show that personality traits significantly affect the financial reporting of managers and companies listed on the Tehran Stock Exchange. Thus, investors and the board of directors of companies are advised to consider the personality traits and components of financial intelligence of the person or persons in question at an acceptable level in selecting financial managers.

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1. Introduction

The role of appropriate and timely decisions in the current competitive market is pronounced. Companies' financial reports are among the most significant sources of information for decision-makers, mainly external users.

Thus, it can be said that companies' financial reporting method plays a significant role in the quality of decisions made by actual and potential shareholders and other users, which, in turn, affect the amount of capital, creating earning opportunities and the survival of a company (Andreou, Ehrlich and Louca, 2013).

Particularly in the present era, known as the information era, and more diverse and extensive information methods and information dissemination have increased, those companies are more successful than using new information tools and information dissemination and maintaining and improving the quality of their financial reporting.

In this regard, considering the role of financial managers and their personality traits on financial reporting quality in behavioural financial knowledge can be of significance.

Behavioural finance studies have been raised by financial scholars during recent years and have quickly attracted the attention of scholars in this field across the world, so today, such studies have led to the creation of independent studies in financial knowledge (Darabi and Zarei, 2017). Behavioural finance aims to combine the financial sciences, psychology, and sometimes sociology to evaluate individuals' decision-making processes and reactions to different financial market conditions, emphasising individuals' personalities, cultures, and judgments. Behavioural finance helps better understand the capital market by formulating behavioural models (Badri and Goodarzi, 2015).

In behavioural finance, personality type is one of the components affecting managers' decisions. Managers with different personality types apply a variety of management methods. Considering the role of personality traits among financial managers as the intrinsic dimensions of their abilities and its impact on the performance of financial managers in this study, an attempt was made to study the relationship between the personality traits of financial managers and financial reporting quality.

Personality traits are the behavioural characteristics of humans that play a critical role in their lives so that such traits can be considered in individual judgments and decisions (Amer and Gerkez, 2019).

As perception is a significant factor in decision making, personality is involved in this matter, and since personality traits are undeniable in the expressed behaviours, managers' personality traits affect their performance.

In addition, differences in personality traits lead to different performances (Heydarpour and Rajabdorri, 2017). People have different moods and spirits, and psychologists classify them based on common behavioural characteristics in personality types. Such personality types affect the individual characteristics and the type of behaviour and performance of individuals. Personality traits determine the structure and behaviour of people in society, and the differences in personality traits make people behave differently in similar situations. All personality types are equally valuable, and no personality type is better or worse than the other one. However, psychologists understand what factors affect the person the most and what behaviour occurs in different situations, depending on the personality type.

Companies often provide some justifications for confirming the information they disclose. For instance, a company that publishes some forecasted information about an unexpected increase in earnings may justify the information by explaining that the company expects an increase in sales or a decrease in administrative costs. Such additional explanations should increase the validity of earnings forecasts for different reasons (Duellman, Hurwitz and Sun, 2015). By providing specific explanations on the components of the forecasted information, managers reduce their ability to use future situations to provide personal traits for the realisation of forecast or justify the unexpected results. Such additional commitment considered by managers increases the validity of the disclosed information.

Today, one of the major concerns of managers in understanding the company's future horizon and the value creation process. Therefore, the success of large companies depends on the competence and merit of managers. As the economic unit is stronger in management, it will succeed in the unit's goals. As a result, the organisation will create the necessary conditions to implement new management systems. Meanwhile, managers' competence which refers to the characteristics and behaviours that lead to their effectiveness in the work environment, depends more on changing their behaviour, personality traits, and attitudes than on knowledge and skills and has stable effects on financial statements quality. The main objective of auditors is to protect shareholders' interests against significant distortions and errors in the financial statements. Auditors aim to increase the quality of audits to retain their professional credibility professional reputation and avoid lawsuits against them. Meanwhile, managers' incentives to apply their personal interests in the quality of earnings prevent auditors from achieving their goals. On the contrary, auditors can discover the quality of earnings management performed by managers and pressure managers to apply earnings quality by increasing audit quality (Chen, Lin and Zhou, 2005). Overall, the principle of disclosure is one of the principles of accounting which affects all aspects of financial reporting. The principle of disclosure requires that all significant facts related to the financial activities of the business unit are properly reported.

The basic financial statements should contain all related and timely information based on this principle. Such information should be presented to be understandable and complete to enable informed decisions for users.

On the other hand, the provided information should not confuse the users of financial statements in terms of quantity and quality. Full disclosure makes the financial statements prepared in such a way to give a more accurate image of the economic events which have affected the economic unit over a while and involve the information which is useful to an ordinary investor but does not mislead the reader. In other words, full disclosure means that no significant information that is of interest to an ordinary investor should be eliminated or concealed. The term disclosure means the dissemination of information, but accountants often tend to use this word in a limited way to disseminate merely financial information in the business unit in the annual reports. Determining the amount of information that can be provided depends on the financial reporting goals and the significance of the items. Financial reporting aims to provide information to potential investors, creditors, and other users, so that the information can be useful in rational decision-making of investment, accreditation, and similar decisions (Abdul Ghadir, 2016). One of the things which can affect the amount and type of information disseminated by companies is financial managers and their characteristics and personality types. Ashton, Willingham and Elliott (1987) realised that job performance is affected by managers' personality traits, and some inherent factors such as personality traits can be used to predict performance in accounting. According to Davidson and Neo, personality traits affect the performance of managers, auditors and accountants (Davidson and Neo, 1993). The five-factor model is one of the most valid and historical models of evaluating the personality of individuals, as proposed by McCrae and Costa (1996). According to many psychologists, the five-factor model involves many personality variables. Numerous studies have confirmed the validity of the five-factor model during recent years, such as Ashton and Wright (1989) and Eid and Larsen (2008). The five major personality factors are:

Neuroticism: It is an aspect based on the experience of undesirable and hypothetical emotions. Neurotic people have anxiety, anger and resentment, depression, self-awareness and vulnerability (McCrae and Costa, 1980).

This dimension refers to a person's ability in tolerating stress. The people with neuroticism have low emotional stability and may have a conscious influence in group decisions conducted by expressing the negative aspects of the decision (Andersen, 2000).

Extraversion: Being warm, sociable, expressing oneself, active, seeking excitement, and expressing positive emotions are among the characteristics of extroverts. They are happy, energetic, and optimistic. The scales of area E are strongly correlated with interest in large risks in jobs (Heidarpour and Rajebduri, 2017).

Openness to experience: The elements of flexibility such as active imagination, aesthetics, attention to inner feelings, diversity, mental curiosity, and independence in judgment have often played a role in the theories and assessments of personality.

Flexible people are curious about the inner and outer worlds, and their lives are rich inexperience. In addition, they tend to accept new ideas and unconventional values and experience positive and negative emotions more deeply than inflexible people (Heidarpour and Rajebduri, 2017).

Acceptability or adjustment: Trust, frankness, altruism, companionship, humility, and compassion are traits of people with high adjustment. An acceptable person is altruistic, sympathises with others, is eager to help others, and believes that others are helpful.

However, the readiness to fight against one's own interests is considered a privilege. Thus, being accepted on the battlefield or in court is not considered a virtue. Furthermore, critical thinking and pessimism in science help accurate scientific analysis.

Being conscientious: Being conscientious means adequacy, order, conscientiousness, efforts for success (pragmatism), and self-control (individual discipline). A conscientious person is purposeful, determined, and decided (Garossi Farshi et al., 2002).

Accordingly, this study aimed to investigate the question "Do the personality traits of financial managers affect financial reporting quality?".

Based on the research objective, the hypotheses of this study were formulated as follows:

H_1: The personality type of neuroticism in financial managers significantly affects financial reporting quality.

H_2: Financial managers' personality type of extroversion significantly affects financial reporting quality.

H_3: The personality type of openness to experience in financial managers significantly affects financial reporting quality.

H_4: Financial managers' personality type of adjustment significantly affects financial reporting quality.

H_5: Financial managers' personality type of conscientiousness has a significant effect on financial reporting quality.

2. Research Methodology

This study is a descriptive – correlational study that applied to the target sample based on the following criteria:

- The end of the year for the studied companies is the same as the end of March.
- The companies have not changed their fiscal year during the studied period.
- The companies have not changed their type of activity during the studied period.
- The companies should not be an investment and financial intermediation, banking, insurance, and leasing.

Requires data were collected in two parts:

1. The first part of required data was collected using "Rahavard Novin[1]" software and provided data in www.rdis.ir
2. The second part of the required data was collected using an electronic questionnaire

Data were analysed in two sections: 1-Descriptive statistics and 2- Inferential statistics.

A simple random sampling method was used for collecting data, and Cochran's formula was used for determining the sample size based on the following equation:

$$n = \frac{NZ_{\frac{\alpha}{2}}^{2}p(1-p)}{(N-1)d^{2} + Z_{\frac{\alpha}{2}}^{2}p(1-p)}$$

3. Findings

According to the answers in the questionnaires, which included 104 respondents, the descriptive demographic statistics were extracted based on Table 1.

Table 1. Descriptive demographic statistics

Gender	Percentage	Number	Education	Percentage	Number
Female	5.8	6	Bachelor	5.8	6
			Master	46.2	48
Male	94.2	98	PhD	48.1	50
Age	**Percentage**	**Number**	**Work experience**	**Percentage**	**Number**
Less than 40 years	10.6	11	Less than 10 years	12.5	13
40-50 years	52.9	55	10-20 years	48.1	50
More than 50 years	36.5	38	Over 20 years	39.4	41

In order to evaluate the normality of the distribution of variables, the Kolmogorov-Smirnov test was used in SPSS software with the following sub-hypotheses.

The results of this test are shown in Table 2.

Table 2. Kolmogorov-Smirnov test output for research variables

Variable	Mean	Std. D	Z	Sig	Result
Neuroticisim	2.500	0.719	0.934	0.347	Normal
Extraversion	2.475	0.847	1.801	0.103	Normal
Openness to experience	2.702	0.694	0.972	0.301	Normal
Acceptability	2.506	0.811	1.310	0.064	Normal
Conscientiousness	3.386	0.545	0.889	0.408	Normal
financial reporting quality	-0.079	0.023	1.098	0.113	Normal

Suppose the significance level value obtained for the Kolmogorov-Smirnov test in each variable is higher than 0.05. In that case, the null hypothesis will be accepted, and the opposite hypothesis will be rejected, meaning that the distribution of the variable is normal.

Based on the output of the Kolmogorov-Smirnov test for variables (data in the table mentioned above), it can be observed that the significance levels obtained for all variables are more than 0.05. It can be concluded that the hypothesis of the normal hypothesis is confirmed. Thus, the distribution of all research variables is normal. This study used the Fornell and Larcker attitude to interpreting factor loading values (1981). The factor analysis results indicated that the factor loading related to a number of items is less than 0.3, and thus other items have good validity.

[1] An Iranian data base which listed companies in Tehran Stock Exchange data are provided in it.

On the other hand, factor analysis data indicate that the composite reliability obtained for all variables is more than 0.5, and Cronbach's alpha obtained for all variables is higher than 0.7, indicating a high degree of convergence validity. Give. In the final model, inappropriate items were eliminated, and the hypotheses were analysed based on the correction model.

In the partial least squares (PLS), the quality and fit of the model are measured through two indicators of CV-Redundancy and CV-Communality. Positive numbers represent the appropriate quality of the model. The values obtained for the indicators mentioned above are displayed in Table 3.

Table 3. CV-Red and CV-Com index values for research model variables

Variable	CV-Red	CV-Com
Neuroticisim	0.942	0.942
Extraversion	0.753	0.753
Openness to experience	0.222	0.222
Acceptability	0.325	0.325
Conscientiousness	0.167	0.167
Financial reporting quality	0.883	0.883

Based on the information in the above table, the values obtained for the CV-Red and CV-Com are all positive, indicating the appropriate quality of the tested model. Convergent validity is the second criterion used to fit the measurement models in the pls method. The AVE criterion shows the average variance shared between each structure and its indices. The AVE of more than 0.5 shows acceptable convergent validity. The results of calculating the AVE criterion are shown in Table 4.

Table 4. AVE values for research model variables

Variable	AVE
Neuroticisim	1.000
Extraversion	0.819
Openness to experience	0.745
Acceptability	0.773
Conscientiousness	0.711
Financial reporting quality	0.952

The results of the AVE indicated that all research variables have good convergent validity.

The results of testing the model in the form of path coefficients with t-statistics of the hypotheses related to the model paths are indicated in Table 5.

Table 5. Path coefficient values and t-statistic of hypotheses related to research model paths

Path	Relationship			Path coefficient	T statistics	Result
1	Neuroticisim	→	Financial reporting quality	0.851	6.714	Confirmed
2	Extraversion	→	Financial reporting quality	0.056	2.168	Confirmed
3	Openness to experience	→	Financial reporting quality	0.037	2.322	Confirmed
4	Acceptability	→	Financial reporting quality	0.022	2.333	Confirmed
5	Conscientiousness	→	Financial reporting quality	0.127	2.068	Confirmed

Based on the interpretive model in structural equation modelling, if the value of t-statistic related to a path is more than 1.96, it can be stated that the related path is significant at the 95% level, and the hypothesis related to that path is confirmed. Based on the information obtained from the model test (Table 5), each of the research hypotheses is evaluated separately.

First hypothesis: The t-statistic value related to the first path of the model is 6.714, which is more than 1.96; thus, the relevant path is significant at the 95% confidence level. In other words, the hypothesis related to this path (the first hypothesis) is confirmed. Regarding the path coefficient obtained for this path, it can be stated that the effect of neuroticism in financial managers on financial reporting quality is 0.851.

Second hypothesis: The t-statistic value for the second path of the model is 2.168, which is more than 1.96; thus, the relevant path is significant at the 95% confidence level. In other words, the hypothesis related to this path (the second hypothesis) is confirmed. Based on the path coefficient obtained for this path, it can be stated that the effect of extroversion in financial managers on financial reporting quality is 0.056.

Third hypothesis: The t-statistic value for the third path of the model is 2.322, which is more than 1.96; thus, the corresponding path is significant at the 95% confidence level. In other words, the hypothesis related to this path (the third hypothesis) is confirmed. According to the path coefficient obtained for this path, it can be stated that the effect of openness to experience in financial managers on financial reporting quality is 0.037.

Fourth hypothesis: The t-statistic value for the fourth path of the model is 2.333, which is more than 1.96; thus, the corresponding path is significant at the 95% confidence level. In other words, the hypothesis related to this path (the fourth hypothesis) is confirmed. Based on the path coefficient obtained for this path, it can be stated the effect of financial managers' adjustment on financial reporting quality is 0.022.

Fifth hypothesis: The t-statistic value for the fifth path of the model is 2.068, which is more than 1.96; thus, the relevant path is significant at the 95% confidence level. In other words, the hypothesis related to this path (the fifth hypothesis) is confirmed. Considering the path coefficient obtained for this path, it can be stated that the effect of conscientiousness in financial managers on financial reporting quality is 0.127.

4. Discussion

In the present study, based on the presented theoretical foundations, the effect of personality traits of financial managers on the quality of financial reporting has been investigated. To measure managers' personality traits, the Neo questionnaire was used based on the five-factor personality model, one of the most comprehensive tools for assessing personality based on factor analysis. These five factors are neuroticism, extroversion, receptivity, adaptability, and conscientiousness. Also, The Tanchi self-control questionnaire was used to measure the level of religious commitment. The accuracy of financial information has also been considered a measure of its quality. The remnants of the cash flow forecasting regression model were used to measure the accuracy of financial information using the components of operating profit accounting for a previous period.

The results showed that managers' personality traits, in general, have a significant effect on the quality of financial reporting of listed companies on the Tehran Stock Exchange. The present study is innovative, and due to the lack of previous similar research, it is not directly comparable with previous research; however, conceptually, the findings of this study with the results of Ashton, Willingham and Elliott (1987); Davidson and Neo (1993); De Bortoli et al. (2019) and Tambingon, Yadiati and Kewo (2018) are compatible.

The results of this study would be useful to Investors on the board of Managers of the Tehran Stock Exchange.

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