

Earnings Management, Incentive Plans for Managers and Firm Performance: Evidence in the Market Capital Tehran Stock Exchange

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Abstract: The effect of executive compensation plans on earnings management with a focus on discretionary accruals to manipulate earnings as an indicator of the companies listed on the Stock Exchange of Tehran. Understanding the potential relationship, remuneration committee and the type of earnings management (predictive or opportunistically) the annual financial report, in terms of earnings management can be useful to identify the aspects to be considered. Therefore, the research for this problem is that the field of higher incentive compensation committee (lower) for companies with predictive earnings management (opportunistic) provide? To test these hypotheses by examining changes in the level of CEO and Chairman of the Board reports to the Annual General Assembly of the firms listed in the Tehran Stock Exchange in the period 2008-2013, 144 companies (of 9 different industry) through the use of regression was used to test the hypothesis. To measure earnings management was modified Jones model and hypothesis to calculate the discretionary accruals for all the selected companies for many years (for the years 2008-2013) regressions were run for each company in each industry influence executive compensation programs to determine the type of earnings management. The results showed a significant relationship between earnings management board compensation predictive and there is no significant relationship as well as the second hypothesis is based on the fact that the management of opportunistic earnings and remuneration of the board there is a significant relationship confirmed.

Key words: Earnings management, remuneration of the board, the company's performance, compensation programs, significant

INTRODUCTION

One of the accounting items in the financial statements (income statement) is prepared and submitted, it is earnings. net earnings reported in the financial statements is considered one of the most important criteria for evaluating the performance of companies that have always been used to a wide range of users of financial statements. Since, the calculation of a economic enterprisen net earnings is affected by the practices and accounting estimates and therefore lead to there earnings by management. Management incentive to manipulate earnings in order to survive and achieve other goals in the vast majority of shareholders are in conflict with the goals accomplished. Therefore, shareholders and other stakeholders in their decision making if they are less confused and in different conditions to adopt the best possible decisions it is necessary to analyze financial information and methods of manipulation and distortion of information and financial reports to know are. Accrual accounting within itself a good plat form for the managers and manipulation of accounts is. However, cash flow from operations in terms of timing and compliance with shortcomings which reduced the value of their

information. In contrast, earnings from these defects is around. The two main principles for revenue and compliance costs with income that are the basis for determining the accounting earnings. Thus, the timing of incoming and outgoing correspondence is not about earnings. It is therefore, in a better position to cash earnings from operations (net operating receipts and payments) is. Results of votes to lead this prestigious research information content and the concept of operating earnings as revenue more than your competitor's criteria. (Dechow *et al.*, 1995). Financial Accounting Standards Board (FASB) also believes that the accruals (as a result of these two principles) earnings in measuring the company' performance will be improved. For example in paragraph 44 of statement of financial accounting concepts No. states:

Information relevant to the entity' income and its components that are generally provided by accrual accounting with respect to information regarding the current cash receipts and payments, better indicator to measure the performance of offering.

However, the use of earnings as a measure of performance regarding the problems faced by the management that it believes will earnings some cause

negative publicity. This is while that management acts in the earnings reporting, may be due to their personal interests are motivated by opportunism which he called opportunistic manipulation. On the other hand regarding the management may be another reason. Managers have access to confidential information about the company and the nobility of the future developments makes them a say in the selection of accounting policies implicit attempt to transfer your personal information to other users of accounting reports the outcome. This reduces the information asymmetry between management and shareholders and other stakeholders and will increase the value of the earnings in terms of relevance. And information asymmetry condition that managers with investors has not disclosed more information about the different aspects of the company's operations in the future. This is because managers have earnings motive and opportunity management. The choice of method or commentary by management, sometimes to Mdyrytsvd (if purposeful and directed selection or judge) and sometimes outside of it (natural and neutral) falls. It should be noted that accrual accounting is inherently force a judgment in the context of the reporting process creates.

Phillippon stated that the issue of representation has resulted in many companies, executive compensation plans to do so would be to reduce conflicts of interest. He also stated that managers manage earnings to meet their own interests. He states that given that the measure is easy operating cash managers use accruals to manage earnings in order to achieve the desired benefits. Watts and Zimmerman (1986) have been expressed in the company's executive compensation programs done that managers will try to transfer profits coming period to the current period and therefore manipulate profits. The aim of this study was to investigate the impact of executive compensation plans and earnings management among Iranian companies are predictive or opportunity. Our research for this is that higher incentive compensation committee (lower) for companies with predictive earnings management (opportunistic) provide? And the impact of executive compensation programs to earnings management companies in Iran.

Background research: Chen *et al.* (2015) investigated whether legal reforms in recent decades America that most companies must be independent board members, reducing earnings management or not? Their results showed that pre-reform earnings management in the companies mentioned above, the majority of board members are not independent and then forced to reform its board of directors have on average, a significant reduction compared to other companies is not.

One study confirmed that reward management performance management with a view to earnings has a direct relationship (Adut *et al.*, 2013). They showed that manage to get more bonuses, earnings outlook based on performance and not on opportunistic approach its management.

Alfred in a study to investigate the relationship between ownership structure and reward their managers. This study on one hundred and sixty German company during the period 1987-2003 was conducted. The results show that reward managers for copper profit agency theory, decreases attention is profit. On the other hand, the lack of control of owners, managers are able to increase the reward. Managers in companies that are trying to increase their voting rights with respect to the receiving prize money, the correlation between performance and reward management is weak.

MATERIALS AND METHODS

The study, based on research of classification and the classification applied by way of the descriptive correlation and its main purpose is to determine the existence, degree and type of relationship between the variables of the test. It also uses a retrospective (through past) are.

Hypothesis:

- First hypothesis: between management and remuneration of the board there is a significant preventative earnings
- Second hypothesis: the management board there is a significant earnings opportunity and reward

Variables

Dependent variable

Rewards board: The dependent variable in this study, ranging from natural logarithm bonus reward provincial administration management in the financial statements and explanatory notes it contains is measured.

Independent variables

Predictive earnings management: If discretionary accruals (earnings management has indicated the existence of discretionary accruals) have significant positive relationship with future profitability, earnings management would be prophetic.

Management of opportunistic earnings: If the relationship between discretionary accruals and future profitability is negative or insignificant will be opportunistic earnings management. This relationship can

be positive or negative-predictive positive if earnings management and if management is opportunistic and there is no or negative earnings.

Method measure the variables: In accordance with Cho and Dee Dee Chow can be a positive relationship between the accrual of current and future cash flows predicted. This forecast implies that the Accrual Component of earnings (ACC) should in future Cash Flows (CFO) is projected as Eq. 1:

$$ACC_t = a + \beta CFO_{t+1} + \varepsilon_t \quad (1)$$

Where:

ACC = The Accrual Component of earnings
CFO = Operating Cash Flow

The slope coefficient (β) can be used as a measure of the strength of the relationship between accruals and future cash flows of a company interpreted.

As the McNichols (2000) noted, Eq. 1 focuses on the behavior of accruals and specially consider the impact of discretionary accruals. Previous studies have provided evidence that the most information are available on the accrual component. Therefore, we investigated the relationship between Discretionary Accruals (DACC) on the one hand and Operating Cash Flow (CFO) and controls (income, property, plant and equipment) to examine the other hand. This equation can be measured as Eq. 2:

$$DACC_t = \alpha + \beta_1 CFO_{t-1} + \beta_2 CFO_t + \beta_3 CFO_{t+1} + \delta Controls + \varepsilon \quad (2)$$

Where:

DACC = Discretionary Accruals
CFO = Operating Cash Flow

Companies with positive coefficient (negative) β_3 as predictive earnings management companies with PEM (Opportunistic Earnings Management OEM) have been considered.

Before the measurement model 2, we need to calculate the discretionary accruals. The remaining amount of the adjusted model as defined Jones accruals in the Accruals (TA) inverse regression of total assets at the beginning of the period, the difference between changes in income and changes in receivables (accounts and notes receivable) (DRev-DRec), Property, Plant and Equipment (PPE), Return on Assets (ROA) (Eq. 3):

$$TA = \lambda_0 + \lambda_1 \left(\frac{1}{Assetst-1} \right) + \lambda_2 (\Delta Rev - \Delta Rec) + \lambda_3 PPE + \lambda_4 ROA + \varepsilon \quad (3)$$

Where:

Assets-1 = Total assets of the previous period
 $\lambda_0 - \lambda_4$ = Company-specific parameters
TA = Total Accruals
 ΔRev = Changes in income during the current period
 ΔRec = Changes in receivables items in the current period
PPE = Property, Plant and Equipment
ROA = Return on Assets

Research models

First hypothesis test: First question asks if we study the predictive earnings and reward management board there is a significant relationship?

To answer these questions, we encourage variable regression on variables predictive and Opportunistic Earnings Management (PEM and OEM) measure. As shown below:

$$INCENT = \alpha + \beta_1 PEM + \beta_2 OEM + \delta CONTROLS + \varepsilon$$

Depending on the model, INCENT, equal to salaries, bonuses or compensation of capital and other general (as salaries, bonuses, capital and other items and was TCOMP) requirements. Because we are part of the basic studies is a continuity test, we use a contemporary character. The dependent and independent variables that can be measured in the same time period.

Second hypothesis test: The second question asks if we study the opportunistic earnings management and remuneration of the board there is a significant relationship? Therefore, we modify our equation as follows:

$$INCENT = \alpha + \beta_1 PEM + \beta_2 OEM + \delta CONTROLS + \varepsilon$$

RESULTS AND DISCUSSION

Test hypotheses: So for first score of the study (first and second hypothesis) integration method in accordance with the four default regression (independence of explanatory variables, homogeneity of variance components independent, normal errors and other errors) used the results in Table 1 is presented.

According to the results shown in Table 1, it can be concluded the following be considered. F Fisher is <1% significance level then we can say that this model is a significant probability of 99%. In other words, this model of high validity. Moreover, determination coefficient of this model is 27%, this implies that 27% of the value of the dependent variable by explanatory variables, explained. The risk of earnings management variables predictive

Table 1: The result of the first research model

$INCEN_{it} = \alpha_0 + \alpha_1 PEM_{it} + \alpha_2 OEM_{it} + \alpha_3 SIZE_{it} + \alpha_4 BTM_{it} + \alpha_5 LEV_{it} + \alpha_6 FCF_{it} + \alpha_7 ROA_{it} + \alpha_8 BETA_{it} + \epsilon_{it}$					
Variables\Statistical indicators	Variable symbol	Coefficient	Standard error	Statistic t	Sign
C	α_0	0.0100	0.0012	8.06	0.000
Predictive earnings management	PEM_{it}	0.0008	0.0015	0.58	0.562
Opportunistic earnings management	OEM_{it}	-0.0035	0.0014	-2.42	0.016
Size	$SIZE_{it}$	0.0004	0.0009	4.99	0.000
Book value to market value	BTM_{it}	-0.0004	0.0002	-1.84	0.066
Leverage	LEV_{it}	-0.0047	0.0007	-6.59	0.000
Operating cash flow	FCF_{it}	0.0016	0.0014	1.13	0.259
Return on assets	ROA_{it}	0.0033	0.0011	3.00	0.003
Systematic risk	$BETA_{it}$	-0.0001	0.0001	-0.88	0.379

F: (0.000) 11.52; R²: 0.27

values of 0.56 that the amount of the error is 5% suggesting that this variable with the dependent variable, the remuneration of the board ($INCEN_{it}$) is not a significant relationship. So, that it can be predictive of earnings management and board of directors remuneration in the Tehran Stock Exchange, there is no significant relationship. Thus, the first hypothesis is based on the fact that the management board there is a significant earnings predictive and reward are not approved. Amounts likely to be opportunistic earnings management variables 0.016 that the amount was lower than the 5% level and suggests that the dependent variable (compensation board) statistically significant relationship. According to the sign variable coefficients (-0.0035) also may be argued that this variable has a negative relationship with the variable remuneration of the board. So that a unit increase in the variable and fixed qualified opportunistic earnings management, remuneration of the board of directors to reduce the amount of 0.0035. As theoretically expected earnings management the variable remuneration of the board of opportunistic and there is a significant relationship this relationship is empirically confirmed. Therefore, the second hypothesis is based on the fact that the management of opportunistic earnings and remuneration of the board there is a significant relationship is approved.

CONCLUSION

In order to continue the study and further research in relation to earnings management and corporate performance bonus plan and proposals for future research are presented. It is hoped that results in such a way as to improve the process of optimizing the capital structure and desired salary rates and valuation of companies in the Tehran Stock Exchange will help. As a result of first hypothesis specified amount of earnings management variables predictive probability of 56/0 that the amount of error of 5% level and suggests that this variable with the dependent variable, the remuneration of the board ($INCEN_{it}$) is no significant relationship. So

that, it can be predictive of earnings management and board of directors remuneration in the Tehran Stock Exchange, there is no significant relationship. Thus, the first hypothesis is based on the fact that the management board there is a significant earnings predictive and reward are not approved. Identify the type of earnings management due to the quality of the company's profits for financial analysts and other users is important. It is expected that companies with high earnings quality level of earnings management have performance but the findings are not as expected. Research evidence of opportunistic earnings management in both companies with high earnings quality and low earnings quality protection. Therefore, it can be concluded opportunistic earnings management, earnings quality decreases and dummy data does not lead to an appropriate decision. The research is due to the difference with similar studies can not accurately compare their findings together. However, in general, be results with the results by Li *et al.* (2011) in a match because of evidence of opportunistic and efficient management of the company's earnings for the three helpless, bankrupt and well presented.

SUGGESTIONS

The results are comparable with findings Baharmoghaddam and Koochi, Sajjadinia and Ahmadpur and Montazeri have confirmed the efficiency earnings management not consistency. One reason for the lack of consistent findings with similar studies is that internal survey firm characteristics such as corporate governance which affect the tendency of managers to choose the type of earnings management.

Bahar Moghadam and Koochi suggest that for companies with high growth, market commentary discretionary accruals and earnings management is efficient but it is more likely for companies with relatively high debt, discretionary accruals in the market, earnings management opportunities self-defeating. Given these characteristics could explain the inconsistency of results.

The second hypothesis was determined based on the result, the values of variable risk of opportunistic earnings management of 0.016 that the amount was lower than the 5% level and suggests that the dependent variable (compensation board) terms there is a statistically significant relationship. According to the sign variable coefficients (-0.00035) also may be argued that this variable has a negative relationship with the variable remuneration of the board. So, that a unit increase in the variable and fixed qualified opportunistic earnings management, remuneration of the board of directors to reduce the amount of 0.00035. As theoretically expected, opportunistic earnings management and remuneration of the board of a significant relationship between the variables exist this relationship is empirically confirmed. Therefore, the second hypothesis is based on the fact that the management of opportunistic earnings and remuneration of the board there is a significant relationship is approved. The results of this study, a research trust and cooperation corresponded. They are evidence of earnings management have been opportunistic in Tehran Stock Exchange. Confirmed opportunistic earnings management of high-level and low quality of earnings, shows that financial performance reported by the company and may not represent the actual economic performance management arrangements to increase the personal interests of its authority to use financial reports is. The top and bottom surfaces quality of earnings on earnings management chosen by the company director has no effect. These findings may be the focus of financial analysts and investors, especially retail investors is in the sense that in your investment portfolio to select companies that have reported earnings quality, fundamental factors to consider companies put. Identify the type of earnings management in companies, taking into account the effect of errors in the qualitative

characteristics earnings accruals based on market data on the type of earnings management, it is possible subject for future research. Evidence, rejects the view of opportunistic earnings management. In spite of possible misuse of the phenomenon of earnings management, academic studies argues that freedom of managers they will be able to adjusted earnings in the private and confidential information that it allows administrators to move users. The results of this study evidence consistent with the view that earnings management is the least harmful and indicates that in firms listed in the Tehran Stock Exchange not opportunistic earnings management tends to performance.

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