Board Monitoring, Ownership Concentration and Internal Auditor on Conservatism

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ABSTRACT: The present research discusses earnings management of managers using restatement of income numbers to know whether managers are able to gain using restatement of income numbers. To do so, we selected 136 companies entitled in Tehran Stock Exchange through systematic elimination. We studied those using statistical methods such as regression. The results showed that restatement of income numbers accounted for earnings management up to 95 percent and managers gain through restatement of income numbers.
Keywords: Earnings Management -Financial Leverage- Restatement

INTRODUCTION

Guili and Hein studied the changes in incomes and cash trends accrual receivable and payment which the level conservatism has increase. Based on Iran's SFAC, accountants facing obscurity should observe cautiously and expose their nature and amounts. From the point of view of Iran's SFAC, conservatism means application of cautionary majors in applying judgment in assessments obscure conditions is necessary. In a way that incomes and capitals should not be exaggerated and the expenses and debts shouldn't be presented less than factual numbers.

Akinobu and Tomomi and Tresa and Pergola, defines corporate governance as the same of laws and regulations and structures and processes and also cultures which leads to achievement of transparency and in count ability for observation the rights shareholders. Some researchers have used conditional and un conditional conservatism and consider conditional conservatism as accounting standards which is necessary like application of lower of cost or market price which its good of bad results are not important. It's usually called profit and loss conservatism and on the other hand unconditional conservatism means refers to those financial attitudes that are based on accounting standards are not necessary. Net official value are presented less than factual and are called balance sheet official value. (Sharifi et al., 2013; Layeghifar et al., 2013)

Manuel and Osama (2009) in their research studied the relationship between conservatism and corporate governance. They have research the corporate governance internally and externally to study conservatism they used the market values. They found out that corporations that have stranger management team practice a higher degree of conservatism. They also found out corporations that have stronger management team use discretionary accrual to inform the investors by giving them bad news.

Banimahd and Bagebani (2009) and Midary (2006) studied the relationship between public ownership in the market and conservatism in financial reports. In their point of view one of the factors in improving the value of financial reporting is observation conservatism. In this research they study the difference between conservatism financial reports of 40 different corporations. Both before and after the names of these corporations were registered in the Tehran Stock Exchange. The result of the research showed that conservatism in financial reporting after registration of their names in the Tehran Stock Exchange was greatly reduced. Conducted a studied upon the effect of conservative accounting on the stability of profit and have concluded that in the Iranian corporations with the increase of conservatism the amount of profit will reduced. Mohamad et al. (2010) studied the predicted model of conservatism accounting with an emphasis on its relationship with the average of the cost of capital in Iranian corporations in a period of 10 years .Mehrani et al. (2009) studied the connection maker and the works of corporate governance with conservatism in the Tehran Stock Exchange. They believe that corporate management teams can act as supervisors on the actions of managers and prevent them from presenting the profits faster and delaying from presenting losses .For conservatism they used Baso's model. The result of their research was the confirmation of the meaningful and positive relationship between conservative CEOs and main investors and the negative relationship between irresponsible numbers of the conservative managers.

Fan (2010) in a research have studied that accounting conservatism and corporate governance

and the effect of political factors. They found out that effect of bad news in comparison with good news is faster. In addition to the coefficient of unity for variable of accounting committee and the number of board of directors and its independence have a strong effect on conservatism and in this corporations the level of conservatism has increased. They found out marginal affect for effective political conditions on the price changes due to good and bad news and that also the connection was negative like state ownership in this regard had a positive effect. They finally come to conclusion that there is a positive and important affect for political factors and corporate governance in regard to promotion of the profit values Matt et al. (2009) have studied the effect of the structure of corporate governance and conservative accounting numbers in China. They have used the Baso's model and its modified version BUL and Shiva Komar for measuring conservatism. They found out that corporations with stocks that circulate less have less conservatism. They discovered in confirmation of their past results the corporations that have more concentrated ownership data asymmetry and as a result there is more cost for representation and there for there is less demand for conservative earnings.

Anwar et al. In their research found out certain observations that conservative accounting subsides the contradictions between the interest of shareholders and bond holders in dividend policies and it also subsides the cost of corporate debts. They have used the methods based on market value and accrual item for measuring conservatism. They discovered that corporations that face such contradictions reveal more conservatism accounting. Wang et al. (2009) studied the affective factors in conservative attitudes in corporation. For this case they researched the corporate governance factor. They believe that in corporations that conservatism is more prevalent that have problems with presentation costs. Therefore in such corporations the existence of a weak corporate governance system can lead to more conservative accounting attitude. They consider that corporations that have a weaker corporate governance structure have a bigger tendency toward conservative accounting attitudes .Hassas in their study researched the relationship between accrual   and the major of conservatism accounting based on Baso's model. They believe that the effect of accrual accounting in regard to accrual accounting is more balanced. They found out the profits of the accounting are almost 4 times more sensitive to the data profit sharing in comparison with positive data output.

Research Hypothesis: With respect to the research done in Iran and other countries the following hypothesis are created:

1-There is a positive and meaningful relationship between conservative accounting and out board ratio.

2- There is a negative and meaningful relationship between conservative accounting and in board ratio.

3-There is a positive and meaningful relationship between conservative accounting and the existence of internal auditor in corporation.

4-Thee is a positive and meaningful relationship between conservative accounting and concentration of ownership ratio.

Table1. Statistical descriptions of the sample corporations

Type of industries	Number of Selected Corporation
Mineral corporation	11
Food Corporation	12
Cement and Tile corporation	19
Metal corporation	17
Automobile corporation	25
Petrochemical corporation	17
Pharmacy corporation	14
Total	115

MATERIALS AND METHODS

For conducting the research in the beginning each variables and how they have been measured are described and in continuation model of conducting research with respect to the existing the theoretical information and result of other researches have been explained.

1. In board: Base of Iran's trading laws, trading corporations are managed by board of directors and according to relations of the charter. Some of the board members can work full time in the company as a responsible manager. These managers are more aware of what happens in the company and also share more profits. Therefore there is a kind of a contradiction of interest between them and the rest of the investors based upon corporate governance laws of Iran board of companies.

Board of directors should register descriptions and responsibilities of each one of the board members in the annual reports and announced that to all the shareholders and clients who check the internet websites.

In order to calculate the ratio of responsible board of directors, the total number of responsible and employed board members-in board- is divided to the total number of board of directors.

2- Out board: According to trading laws of Iran, business corporations can choose some of their board members from the outside of the corporation. These members over can be directors the other corporations. These members can't be the managers of state

corporations. The names of these individuals are exposed in annual reports. As these individuals don't work full time in the corporations are not aware internal conditions of the corporation. But as they have not share in the activities of the company, they enjoy more independency and are expected to have a better supervision of the board of directors. This ratio is attained by the division of the number of irresponsible board members to the total number of the board members.

3. Internal auditor: According to the laws of corporate governance of Iran and Stock Market Law, trading companies should have an internal auditing that which should be under the supervision of the board of directors. Internal auditor can audit and report in any areas of finance and activities. In Iran there is no auditing committee and this role is performed by the internal auditor in a more limited way. In order to study the research, corporations that have internal auditor segregate the corporation with no internal auditor.

4- Concentration ownership: In the Iranian corporations, major stock holders usually choose the corporate managers and miner shareholders usually have no role in the choosing managers and the CEO. Theoretically it is acceptable but it is expected that major investor would think of his own interest and would not pay attention to the miner investors.

The corporate governance laws of Iran in this regard do not present specific mechanism. To measure this variable we calculate the concentration of ownership in the company which means, how to distribute the stocks among the stockholders. In this research in order to calculate the ratio of the concentration ownership "Herfindal and Hershin's" model is used. The mentioned model is attained by the sum of the square roots percentage of the stock which belongs to the shareholders of the company. In case that entire amount of the shares belong to one individual will have the highest value and will be equal to 1000 units. In case the structure of ownership is dispersed and all shareholders have equal ratios, the HHI index still has the lowest value and calculates by N/1000.

HHI = ∑ (pi /p *100)2 : Due to problems that exist in the Baso and other's model and also in efficiency of the capital in the market in Iran(weakness of efficiency) , based up an model the company is not due to the market prices made as use" Giuli and Hil's "model in order to calculate the conservatism. In this model the conservatism is calculated as following: **TOTAL ACCURAL*(-1)/TOTAL ASSET = Conservative:** Accruals are equal to difference net income to net cash from operational activity (according to Iran's accounting standards) plus depreciation expense. Total

asset is equal to book value of assets in 2013. According to Giuli and Hil's (2000) the growth of accruals can be an index of change in the degree of conservative accounting in a long term period which means if accruals growth in that case ,the conservatism has decreased and vice versa. Therefore in order to confirm the direction of charges in conservatism accruals are multiplied by (-1). In order to homogenize information in the corporations with different size, the total accruals accounting is divided to total asset.

5- The research control of variable: Base on other research done in Iran and other countries variable control include size of corporations, type of ownership (government or private) and ratio of leverage. The size of corporations is calculated with logs total asset of corporation's values at the end of the financial period in 2010. The type ownership of corporation's done by General Business law of Iran. Thus total of corporation segregated to two divisions. According to Iran's General Business law, corporations that directly or indirectly their shares are owned by the government or state organizations and corporations are considered government and otherwise are private .The ratio of leverage is calculated by dividing the total debts to total asset of each company. Research model, Base on above discussion, relation of variables is: CONSERVATISM=α0-α1*IN–BOARD+α2*OUT–BOARD+α3*INTAUD+α4*OWNCONC+α5*VARIABLE CONTROL.

In the above model conservatism as a dependent variable and inboard to, out board, INT AUD and OWN CONC are independent variables of research. Variable controls are includes the size of the companies, the type of the ownership and the ratio of leverage. In this section we look at the result of description statistics of the corporations under study and also the results of pre formulated of the regression test and in them the result of research test theories will be presented.

Society and statistical samples: In order to study the research model and also test the hypothesis, the acceptable corporations in the Tehran Stock Exchange are considered. The end of financial year of those corporations must be at the mid of March and must not be include investing corporations and financial dealers. And in the period 2009-2013 their information should be available. The number of corporations with respect to conditions described was 355 companies which 115 of them from different industries have been chosen randomly.

RESULTS

The results of the statistical descriptions of each variable have been given in the table below. The study of corporations in this research has shown that 63% are private and 37% are government. Also 67 companies

have internal auditor .mean wall 45 companies are private and rest are government. The results of solidarity between variables are shown in the following chart. For this purpose we use the Pierson correlations.

Table 2. Descriptive statistics

Variable	Minimum	Maximum	Statistic Mean	SD
Corporation Index	-.85	0.15	-0.1671	0.18296
In board Ratio	0	0.67	0.3431	0.15224
Out board Ratio	0.33	1.00	0.6570	0.15224
Ratio of Consecration	4	11325	3082.97	2321.724
Internal Auditor	.00	1.00	0.5465	0.50075
Size of Corporation	10.38	13.90	11.8344	0.60870
Leverage Ratio	0	2.14	0.6741	0.3170
Type of Ownership	0	1.00	0.4070	0.49415

Table3. Correlations of variables

Correlations of variables	Cons index	Size	Lev .index	Type corpo	In board	Out board	Int.Auditor	Conc.index
Pearson Correlation	1	0.166	0.093	-0.176	0.265*	-0.130	0.050	-0.085
Sig. (2-tailed)		0.126	0.395	0.105	0.014	0.234	0.645	0.435
Parsone Correlation		1	-0.108	0.086	-0.203	0.233*	0.280**	-0.085
Sig. (2-tailed)			0.324	0.431	0.060	0.031	0.009	0.438
Pearson Correlation			1	-0.333**	0.209	-0.017	-0.017	0.111
Sig. (2-tailed)				0.002	0.053	0.878	.875	0.308
Pearson Correlation				1	-.225*	-0.103	-.018	0.061
Sig. (2-tailed)					0.038	0.346	0.871	0.580

The test of pre formulated use of regression model for the research model.

1-The study of standardized residual: in order to study the plot of the standardized of residual we can use Kolmogorov–Smirnov test further more histogram diagrams Q-Q and P-P diagrams are also used to study the normality of inputs. If all the points shown on the diagram are on bisector of the first quarter then the inputs are completely distributed normally. The below chart shows the residuals are distributed normally. 2-K-S test. Another test for the normality of data is Kolmogorov - Smirnoff test which is a non-parametric test. In case the amount is sig. %5, the speculation of statistical zero based on normality of distribution variable under study with the confidence interval of 95% is accepted.
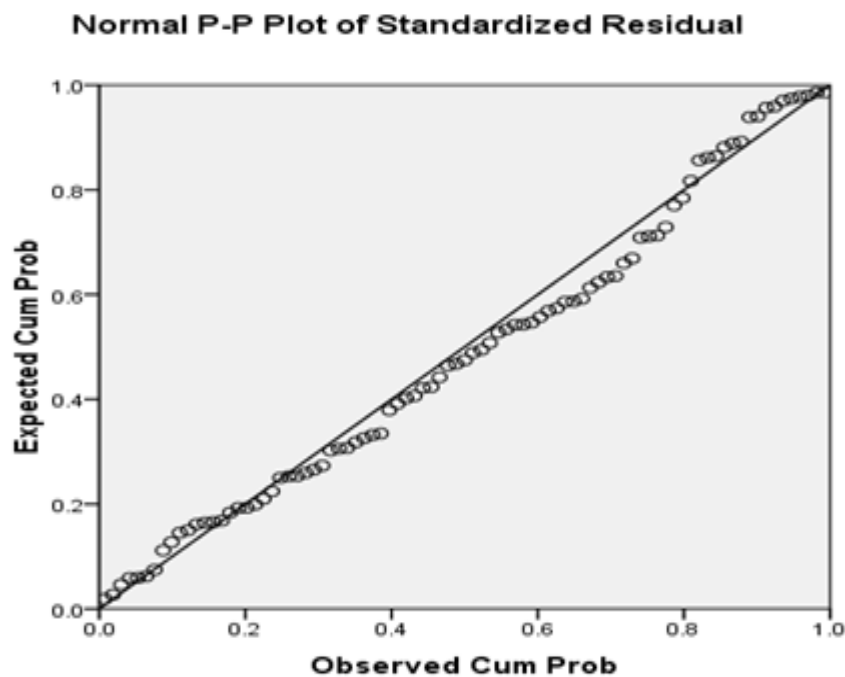

Fig1. Residuals status

Table4. Kolmogorov - Smirnoff result

Index	Standardized Residual
Mean	0.1328491
Std. Deviation	0.26980506
Absolute	0.077
Positive	0.077
Negative	-0.054
Kolmogorov-Smirnov Z	0.720
Asymp. Sig. (2-tailed)	0.677

Table5. Durbin-Watson results

Model	R	R Square[b]	Adjusted R Square	Durbin-Watson
1	0.770[a]	0.593	0.552	1.532

In case the statistic of this test is between 1.5 to 2.5 it is proper. It is observed that statistic of Durbin-Watson is proper and be concluded that the errors are independent and we can use regression model in order to test hypothesis research

In continuation we will statistically study each researched hypothesis result

Hypothesis 1: There is a meaningful and positive relationship between the ratio of our board and conservatism. The related statistic to determine the meaningfulness of the coefficients is the statistic of T instead of which sign is used. The ratio of our board has no effect on conservatism. H0: β=0The ratio of our board has effect on conservatism.   H1: β#0.

Table 6. Results of Hypothesis 1

Model		Unstandardized		Standard	f	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.477	0.047		2.834	0.001
	Out board Ratio	0.619	0.126	0.565	2.523	0.014

In the column β in the table above amount and independent variable coefficient is presented orderly in regression equation. Therefore the model equation is Y=0.477+0.619X

It is clear from the column sign in the chart above, amount of statistics sign for the variable of inboard is equal to 0.014 .With respect to the considered   alpha for this study is equal to 5% , therefore this valuable is meaningful(. 565 percent) and the mentioned hypothesis is acceptable .

Hypothesis 2: There is a meaningful and negative relationship between conservative accounting and ratio of in board. It is expected that the presence of the responsible members in the board of directors which are employed in the company and part of their benefits and rewards come from reported profits in the financial forms. We'll have less conservative attitudes try to exaggerate the incomes and present the profits earlier. The study of this attitude is presented in the table below.

Table 7. Results of Hypothesis 2

Model		Unstandardized		Standard	f	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.302	0.065		2.157	0.001
	In board Ratio	-0.421	0.973	-0.365	2.789	0.036

As the result of statistical test shows in the level of 5% because the amount of sign is less than the level of alpha thus research hypothesis is accepted. The coefficient of correlation between these two variables is about 36%; furthermore the relationship between them is negative.

Hypothesis 3: There is a positive and meaningful relationship between conservative accounting and internal auditor. In this hypothesis we expected to have more conservatism in the companies which has internal auditor.

Table 8. Results of Hypothesis 3

Model		Unstandardized		Standard	f	Sig.
		B	Std. Error	Beta		
1	(Constant)	.378	0.029		3.020	0.001
	Internal Auditor	0.622	0.040	0.510	2.463	0.037

As it is shown in the table above, the amount of sign is less than alpha 5%. Therefore the research hypothesis is accepted which means there is a meaningful relationship between internal auditor in the company with level of the conservatism. The amount of coefficient of beta confirms the intensity of this relationship.

Hypothesis 4: There is a meaningful and positive relationship between accounting conservatism and the rank of the concentration of ownership in the company. Based upon theoretical principals it is expected that companies in which the rank of the concentration of ownership is higher and closer to the number 1 the measure of conservatism due to more supervision by measure stockholders will be higher. The result of the studies is presented in the table below.

Table 9. Results of Hypothesis 4

Model		Unstandardized		Standard	f	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.146	0.033		2.437	0.001
	Rankof Concentration	0.513	0.064	0.432	3.784	0.015

With regard to the result of the above chart the amount of sign is less than the level of %5, therefore the researched hypothesis is accepted. Intensity of relation is 43 percent. In order to study the control variables the forward method is used. The 7 variables which are studied as specific features among many of feature corporate governance in order to predict conservatism. It is possible that some of the variables of this feature among chosen corporate managers might not be good perditions. These cases are very natural; therefore when unrelated variable entered the model without improving the predictions the flaws of the added values will be increased entering each of the 3 control variables which include the size of the companies. The ratio of financial leverage and the type of ownership of companies separately in each of the research hypothesis the following results are attained.

As above chart shows with entering each of the control variables to the hypothesis model 1 the measure of their correlations is changed and is increased. And this level with respect to the amount of alpha is meaningful.

The study of attained results from the rest of the research hypothesis indicates that with entering the variable of the size of the company and the ratio of financial leverage and the type of ownership of the corporations in the second researched hypothesis are consequently coefficients R2 for the size of the company 3% and for the ratio of leverage 3% and for the type of the ownership of the company has increased 2%.

The study of the results of research hypothesis indicates that with entering the variable of the size of the company and the ratio of financial leverage and the type of the ownership of companies in the model of third research hypothesis are consequently coefficient of R2 for the size of the company 5% and for the ratio of the leverage 3% and for the type of the ownership of the company has increased 4%.

The study of the attained result from the rest research hypothesis indicates that with entering variables of the size of company and the ratio of financial leverage and the type of ownership of corporation in the model of 4th research hypothesis are consequently coefficient for the size of the company is 4 % and for the ratio of leverage 6 % and for the type of the ownership companies have increased 4%.

The separation companies in statistical society to governmental ownership and private ownership and the comparison of their average index conservatism are cleared with the test of T with 5% alpha have a meaningful difference with each that company the trend of this financial ratio for 5 years to the end 2010. The growth of this ratio for government corporations 6% and the private corporations have been found to be 2.5%.

DISCUSSION

Based upon theoretical principles and also the results of research about conservatism, it is expected that the ratio of inboard of directors and the presence of internal auditor and the higher concentration of ownership lead to more conservative attitude from executive managers and on the contrary the presence of the higher ratio of our board of directors leads to less conservatism in those companies. Furthermore with respect to hypothesis , the effect of political attitudes and the agency theory it is expected that the managers of the bigger companies are under pressure from outside and delay presenting their profits and with recognition of all costs and all kinds of reserve less than actual numbers. This issue is also true about the corporations that have higher ratio of leverage.

The results of research showed that the presence of in board of directors usually in IRAN which is chosen by majority of stockholders and introduced to the company will result in more conservatism index and recognition of accruals including are kinds of reserve and the companies will announce their profits with delay.

In addition the presence of major stockholders in the companies that consider themselves the main owners of the company and do not necessarily cover the interest of the minority of stockholders and have no say in choosing of executive board members such behavior will emphasize on conservatism and support it and the presence of internal accounting in the company will also lead to more conservatism and they will also reiterate on presenting profits with procrastination. The relation between responsible board members with the amount of conservatism are confirmed but negative which means with the increase of the presence of in board in companies, the level of conservatism is reduced. In other words the profits are recognized early and this type of attitude might be because profit sharing and the rewards on the parts of these boards and CEO from these benefits and also increase of job security for them in the company. in this study just like the results of other studies the effect of the size of corporations and their ratio of financial leverage and the type of private ownership in the company on conservatism has been positive that indicates these factors cause more conservatism on the part on executive board members in the companies. The reason for this increase seems to be the protection of benefits in the company and less exposure of such benefits to others like financial sponsors and government and politicians.

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