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Earnings Management with Restatement income Statement; TSE Corporation

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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

Basic financial statements aims at providing the information required for decision-making of users. They make decisions based on the information they receive through basic financial statements. The issue of restatement of financial statements to obtain management earnings, which is considered as a tool to promote financial statements reports, board of directors, and owners of capital, has recently faced investors with substantial losses. In other words, all the companies went bankrupt within recent years, have issued their financial restatements. Often, issuing financial restatements indicates that there are some problems in the internal control system, corporate governance, and misuse of the managers in the companies, which have been lost their fame and values in market, and even sometimes led them to bankruptcy

Statement of the Problem: In this study, we discuss the relationship between restatement of Income and cost with earnings management. Restatement of financial numbers provides conditions for managers to manipulate numbers of financial statements by changing time of report of items of assets and liabilities and use the gaps of the Iranian Accounting Standards in this concern in favor of their earnings. Earning Management: It includes a series of measures to reduce fluctuation of the earnings reported in accounting. Therefore, earnings smoothing tool and regular earnings should be determined. Following items are evident concerning earnings smoothing tool: • Transactions schedules • Allocation over time • Re-categorization of income items • Corporate governance. Generally, earnings management is possible in two methods: earnings management based on accounting numbers and real earnings management. In the first method, management arranges accounting numbers according to its own favorable objectives through discretionary accruals. In the second method, management appeals to real earnings management and obtains its desired earnings through taking some operational decisions, in other words, manipulating real activities. The remaining section discusses the relationship between restatement of financial numbers and earnings management, introduced by Ettredge et al. in 2010, in stock companies in Iran. Ettredge et al. (2010) state that incorrect financial statement is caused by manipulation of earnings. They also proved that incorrect financial statements are due to intentional manipulation of management, not because of misconceptions of principles and standards, but they call it 'fraud'.

Research Literature: As mentioned earlier, restatement of income numbers are committed by managers or with fraudulent purposes (earnings management) and/or due to the first misconception of the accounting principles and procedures.

Most researchers (in Iran) employ some criteria to estimate quality of earnings. For instance:

Research background: Layeghifar and Abdoli (2013) studied the rates of earnings smoothing in the companies listed in Tehran Stock Exchange. To do this, they used the negative correlation between variables in discretionary accruals and changes in the predetermined earnings. The results showed that earning smoothing raise prices in stock market. It also revealed that there is a negative relationship between earning smoothing and current ratios, interest coverage, and return on shareholders' equity.

Dastgir and Rastegar (2010) studied the relationship between quality of earnings and stock returns of accruals quality. Therefore, 95 companies among the companies listed in Tehran Stock Exchange were assessed between 2000 - 2007. Compositional data were used for assessing earnings. The results showed that there is a direct relationship between quality of earnings and accruals quality.

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Noravesh and Zakeri (2010) studied earning smoothing through selling company's assets. Operating profit was also selected for test smoothing. The results indicate confirmation of smoothing, as earnings obtained from sales of earnings smooth temporary fluctuations of earnings.

Karimi and Sadeghi (2010) studied the relationship between quality of earnings and earnings stability of the companies listed in Tehran Stock Exchange. In their study, quality of earnings was calculated based on investment in capital assets and labor. The results of their study show that there is a significant relationship between quality of earnings and earnings stability both in a retrospective approach and prospective approach.

Izadnia and Nazarzadeh (2009) studied the relationship between quality of earnings (independent variable) and stock return at three levels of high, fair, and low quality of earnings. The results show that there is a relationship between stock return and quality of earnings at the different levels of high, fair, and low.

Desai's article (2012) that follows the article of Frunkle et al. studies earnings management and non-audited fees in a sample of the Indian companies. The results showed that earnings management in family enterprises exceeds the non-family ones.

Myers et al. (2011) studied the factors effective in choosing restatement of financial numbers and its effect on stock price in that period after SOX Law. The results showed that the information leakage of the monitored enterprises exceeded other enterprises.

Ettredge et al. (2010) declared that incorrect financial statement is caused by manipulation of earnings. In addition, some incorrect financial statements are due to intentional manipulation of management, not because of misconceptions of principles and standards.

Nahar Abdullah et al. (2010) studied the effect of corporate governance in Malaysia and nature of restatements of financial numbers and its financial reports. The results showed that the preliminary objective of restatement of financial numbers is overstating earnings and concealing liabilities.

Plumlee and Yohn (2009) stated that the considerable increase of restatements of financial numbers during recent years is due to the above items 1- Complexity of accounting standards 2- Internal control 3- Conservatism 4- Earnings management

Collins et al. (2009) studied earnings obtained from restatement of financial numbers for management. They intended to know whether the earnings are regulated after The Sarbanes-Oxley Act (SOX) ratification. The results showed that the earnings of the companies disclosed information exceeded the other companies.

Cheng and Farber (2008) studied to discover whether the earnings obtained from restatement of financial numbers have been useful to compensate shareholders' equity. The results showed that the correct restatements of financial numbers improved company's condition and in some cases followed by investment risk reduction; however, in some cases, it fluctuated stock price.

Ahmed and Goodwin (2007) studied earnings of restatement of financial numbers for 500 companies. Generally, their research showed that restatement of financial numbers has negative impact on value of stock market and corporation.

Hypothesis

H1- There is a significant relationship between earnings management and restatement of income and expenses. H2- There is a significant relationship between earnings management and restatement of income and expenses.

MATERIALS AND METHODS

Financial size and leverage, type of audit's opinion, type of ownership, growth rate of benefits of a corporation + restatement of financial numbers = Earnings management

$DA_{it}=\alpha_0+\beta_1$ RESTATMENT+ β_2 GROWTH+ β_3 AUDITING +β_4 LEVE+β_5 OWNE+з

Relationship between the above items and dependent variable is written with respect to the theoretical basics and the results of other studies.

Statistical Population, Sampling Method, Sample Volume

The statistical population of the research includes all the companies listed in Tehran Stock Exchange with the following qualifications: 1- Their fiscal year would be mid of March .
2-They should not be investment companies or financial intermediation companies. Their data would be available and they would be listed within the time period.

Statistical Sample: The statistical sample will be selected as systematic elimination. **Test to Determine Significance of Coefficients**

Restatement of income numbers of companies has no effect on earnings management of companies H_0: $\beta=0$

Restatement of income numbers of companies affects earnings management of companies H_1: $\beta \neq 0$

As the following table shows, the standardized regression coefficient for the variable of restatement of income numbers of companies (-0.209) is significant at the error level of 0.05 (sig=0.02). Therefore, H_0 is rejected and H1 is confirmed. The results show that variable of restatement of income number of companies may have a significant effect on earnings management of the companies.

Hypothesis 2: There is a significant relationship between earnings management and restatement of cumulative income numbers.

Table1. Relationship between earnings management and restatement of income and expenses

Model	Non-standardized Coefficients		Standardized Coefficients	T	Level of Significance	Alignment	
	B	Standard Error	Beta			Tolerance	variance inflation factor (VIF)
	-0.091	0.056		- 1.633	0.105		
Expense-Income X3	0.0008	0.00033	0.209	2.365	0.020	1.000	1.000

Table 2. Relationship between earnings management and restatement of cumulative income numbers

Model	Non-standardized Coefficients		Standardized Coefficients	T	Level of Significance	Alignment	
	B	Standard Error	Beta			Tolerance	variance inflation factor (VIF)
	-0.096	0.049		- 1.975	.051		
Cumulative Income	0.0003264	0.00007	0.400	4.844	0.000	1.000	1.000

S F value (F=23.463) is significant at the error level of 5 percent (sig=0.000), it is possible to reject H_0 and confirm H_1 with a confidence level higher than 95%. In this case, we can reject H_0 and confirm H_1 with a confidence level higher than 95%. Therefore, linearity assumption of the regression model of research hypothesis is confirmed. This indicates that the independent variables have high description ability. It is capable of describing changes and variance of independent variables.

DISCUSSION

The results of testing the above hypothesis in this model show that there is a significant relationship between restatements of income and expense numbers and earnings management. That is, as income and expense and following that earning are calculated based on accruals and identification of income and expense are not necessarily based on receiving and paying, the author believes that foresees and estimations are used for calculating earnings. By changing timing of income and expense identification, management would be able to smooth earnings. Therefore, hypothesis 3 is confirmed. The results of testing the above hypothesis show that there is a significant relationship between restatement of cumulative income numbers and earnings management. The author believes that the annual income account in which the remaining of accumulated income balance of the beginning of term is registered and or other real accounts in which errors of identification of income and expense and/or changes of procedure (principle) occur the year before pave the way for a manager to smooth earnings. Therefore, hypothesis 4 is confirmed. This research showed that cumulative income has maximum effects on earnings management in these hypotheses.

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